Economic Outlook

October 2021

CENTRALE BANK VAN ARUBA

Abstract

In 2021, the Aruban economy is expected to continue its recovery path set forth in the second half of 2020. Specifically, real GDP is projected to grow by 12.7 percent under the baseline scenario, 15.5 percent in the optimistic scenario, and by 8.2 percent in the pessimistic scenario. The anticipated economic recovery in 2021 follows the speed of tourism recovery after the international travel restrictions were lifted, as well as the continued availability of the GOA's wage subsidy and FASE programs, which aid in maintaining private consumption.

Tourism credits are assumed to nominally grow by 54.4 percent in 2021, compared to a year earlier. The additional tourists, as well as the associated extra cumulative income for domestic employees, push up the demand for goods and, by extension, the import of goods by 28.6 percent. Despite the stronger upswing in tourism credits relative to the import of goods, the expected level of tourism exports is too low to compensate for the outflows of mainly import payments for goods and services. Therefore, the current account is anticipated to register a deficit of Afl. 108.5 million. As for the financial account, large inflows arising from foreign borrowings by the GoA to cover its deficit are assumed, estimated at Afl. 782.8 million, to the extent that they more than cover the current account deficit. As such, the balance of payments is forecasted to record a surplus of Afl. 700.6 million.

As a result, international reserves (excluding revaluation differences) are foreseen to reach Afl. 2,756.5 million in 2021, thereby comfortably exceeding the required current account coverage ratio, and comply with the IMF ARA (Assessing Reserve Adequacy) benchmark.

Centrale Bank van Aruba

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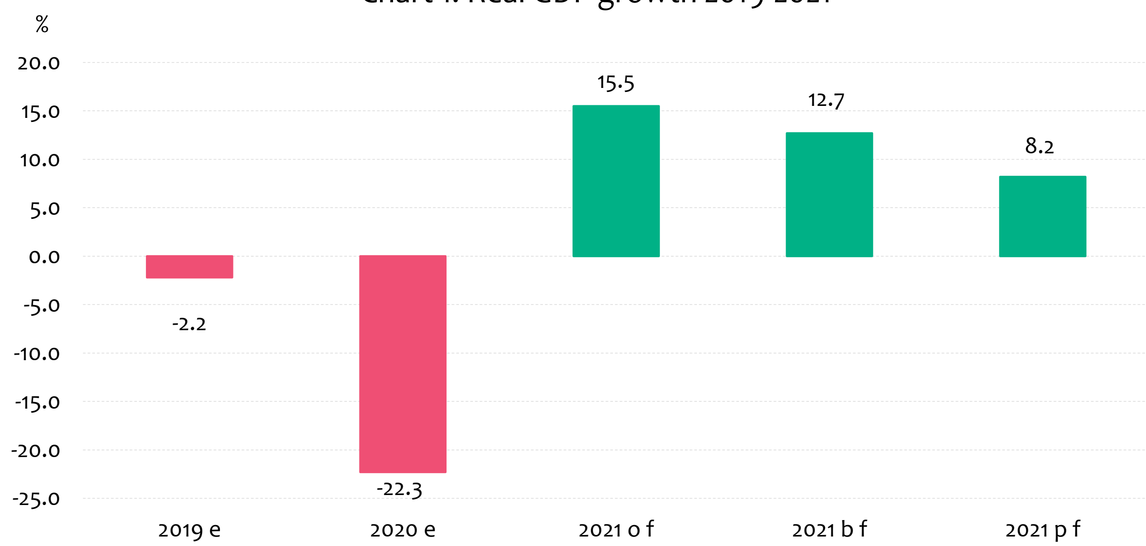
1. Introduction

The Research Department (RD) of the Centrale Bank van Aruba (CBA) updated its economic forecast for 2021 based upon *economic developments and available data up to and including April 2021.* This update follows new information on private consumption and the expectations regarding the recovery of the tourism sector. Particularly, the continuation of the Government of Aruba's (GOA) wage subsidy and FASE programs for the whole of 2021, as well as a stronger performance of the tourism sector are taken into account. The persistence of significant uncertainty in 2021 with regard to how the COVID-19 pandemic will evolve, is cause for the presentation of several scenarios. The baseline scenario is based on assumptions of the most likely developments regarding various important economic aggregates. In addition to the baseline scenario, both a pessimistic and optimistic scenario are included. The pessimistic and optimistic scenarios deviate from the baseline in terms of the speed of the tourism recovery. The latter impacts consumption, investment (affected through increased confidence), as well as import and export levels.

In 2021, the Aruban economy is expected to continue its recovery path set forth in the second half of 2020. Specifically, real GDP is projected to grow by 12.7 percent under the baseline scenario, 15.5 percent in the optimistic scenario, and by 8.2 percent in the pessimistic scenario (Chart 1). The anticipated economic recovery in 2021 follows the speed of tourism recovery after the international travel restrictions were lifted, as well as the continued availability of the GOA's wage subsidy and FASE programs, which aid in maintaining private consumption.

Chart 1: Real GDP growth 2019-2021



Source: CBA
e = estimate, f= forecast, o = optimistic, b = baseline, p = pessimistic

2. Economic forecast

2.1 Gross domestic product and its components

Due to the significant uncertainty related to the duration of the COVID-19 pandemic and the strength of economic recovery thereafter, several scenarios were produced for the year 2021:

1. **Baseline Scenario: The main driver for the envisaged rebound in economic activities is the tourism sector, as it continues its path to a relatively strong recovery. The expected number of stay-over visitors is projected to reach 55.0 percent of the 2019 level, resulting in a 55.4 percent growth in tourism credits compared to 2020.** In addition, it is considered that the GoA will maintain FASE and the wage subsidy program throughout 2021. As a result of the above-mentioned developments, the baseline scenario for 2021 foresees a 2.5 percent growth in private consumption, even though the absolute level remains below the pre-pandemic level. Based on the recovery in tourism in 2021 and the availability of the government's assistance programs, the unemployment rate is forecasted to be 10.3 percent. Increased activity in the tourism sector will not necessarily lead to job creation, but rather a reduction in the amount of wage subsidy paid by the GoA. Inflation is anticipated to amount to 0.0 percent in 2021, resulting mainly from a continued decrease in prices of CPI components excluding food and energy, offsetting the increases in gasoline prices, housing, transport, and communication. With respect to private investment, the baseline scenario assumes a further contraction in investment, mostly resulting from the finalization of numerous (large) construction projects in 2020, coupled with the start of relatively few new construction projects in 2021. Imports, on the other hand, are projected to pick up following the recovery within the tourism sector. The former is partially mitigated by the expected decline in investments.
2. **Pessimistic Scenario: The pessimistic scenario in 2021 is based on a level of stay-over visitors that is equal to 49.0 percent of the 2019 level.** In this scenario, the FASE and wage subsidy programs provided by the GoA are also available for the full year, leading to a projected unemployment rate of 10.7 percent. Consequently, disposable income and, thus, private consumption are relatively stable compared to the baseline scenario. With regard to private investment, the pessimistic scenario takes into account a larger extent of delays in construction, resulting in a lower investment amount in comparison to the baseline scenario. Nonetheless, the speed of recovery in tourism activities is enough to anticipate a positive growth in imports, despite the foreseen contractions in investment.

3. **Optimistic Scenario: For the optimistic scenario in 2021, the number of stay-over visitors is expected to reach 58.0 percent of the 2019 level.** While the recovery in the tourism sector is relatively stronger, disposable income and private consumption are relatively stable compared to the baseline scenario. This is due to the expected substitution of FASE or wage subsidy income for wages, while not much new job creation is expected. Regarding investment, fewer delays are expected compared to the baseline, leading to a higher amount for investment.

2021 Baseline Scenario

For the 2021 baseline scenario, a real GDP growth of 12.7 percent is projected, mainly driven by an upturn in real tourism exports (+59.8 percent). The expansion in tourism sector activities is expected to support real private consumption growth (+2.5 percent), leading to a 1.0 percent increase in real total consumption. Real investment, on the other hand, is expected to record negative growth in 2021, contracting by 19.2 percent, as lower outlays for both private and public investment are foreseen. Imports are expected to increase by 7.8 percent, given the expected recovery in tourism activity and resulting uptick in private consumption.

2021 Pessimistic Scenario

While the pessimistic scenario for 2021 results from a slower recovery of tourism, the FASE and the wage subsidy program provided by the GoA remain in place for the whole year. In this scenario, real GDP is also expected to grow, i.e., by 8.2 percent, supported by a relatively stable real consumption level, due to the prolongation of the FASE and wage subsidy programs. Real private investment is projected to contract further, resulting in a 22.6 percent downturn in overall investment. Furthermore, the growth in real total exports is lower compared to the baseline scenario, due to the above-mentioned slower rate of recovery in real tourism exports. Even so, the pessimistic scenario foresees a positive growth of 2.3 percent in imports, which is attributed to tourism and domestic demand for imports.

2021 Optimistic Scenario

The optimistic scenario results in a real GDP growth of 15.5 percent for 2021. This result follows the significant recovery in tourism sector activities as well as an increase in private consumption. The performance of the tourism sector is for the most part related to a steep expected increase in tourism arrivals and spending (respectively, +76.2 percent and +64.4 percent). The total amount of real investment is also expected to be at a higher level (+4.3 percent) relative to the baseline. Finally, following the changes in the other GDP components, imports are projected to grow by 11.3 percent.

Table 1: Growth of real GDP and its components 2019-2021 (in percent).

Indicator	2019 e	2020 e	2021 o f	2021 b f	2021 p f
Current Outlook (April 2021)					
GDP	-2.2	-22.3	15.5	12.7	8.2
Consumption	-1.6	-7.7	1.0	1.0	0.8
Private consumption	1.3	-11.9	2.6	2.5	2.2
Public consumption	-8.3	3.4	-2.4	-2.4	-2.4
Investment	-0.2	-20.9	-15.7	-19.2	-22.6
Private investment	1.5	-21.4	-14.3	-17.9	-21.5
Public investment	-37.2	-0.7	-54.8	-54.8	-54.8
Exports	0.6	-44.4	50.6	42.0	27.6
Tourism exports	-0.6	-51.9	70.2	59.8	41.0
Imports	1.9	-27.1	11.3	7.8	2.3

Source: CBA e = estimate, f= forecast, o = optimistic, b = baseline, p = pessimistic

Nominal growth rates

For 2021, the nominal GDP growth range varies between an expansion of 14.8 percent and 6.6 percent (Table 2). The outcome will depend largely on which scenario plays out.

Table 2: Growth of nominal GDP and its components 2019-2021 (in percent)					
Indicator	2019 e	2020 e	2021 o f	2021 b f	2021 p f
Current Outlook (April 2021)					
GDP	3.4	-24.6	14.8	10.8	6.6
Consumption	2.5	-10.1	0.4	0.3	0.1
Private consumption	5.2	-13.1	2.6	2.5	2.2
Public consumption	-3.8	-2.3	-4.8	-4.8	-4.8
Investment	2.8	-21.0	-15.0	-18.5	-22.0
Private investment	4.5	-21.5	-13.6	-17.2	-20.8
Public investment	-35.3	-0.9	-54.4	-54.4	-54.4
Exports	4.5	-42.8	48.5	39.9	25.5
Tourism exports	3.6	-49.2	64.4	54.4	36.2
Imports	3.4	-26.5	13.3	10.9	4.1

Source: CBA e = estimate, f= forecast, o = optimistic, b = baseline, p = pessimistic

Box A: GDP and its components

This box serves as an explanatory note to the components of GDP. The components are explained below:

Private consumption: the monetary value of all goods and services purchased by consumers.
Public consumption: government spending, in monetary value, on goods and services.
Private investment: monetary value of investment made by the private sector.
Public investment: monetary value of investment made by the public sector (government).
Tourism exports: Expenditures, in monetary value, made by inbound visitors.
Imports: Purchases made from abroad, in monetary value.

2.2 Balance of payments and net foreign assets

In view of the uncertainty surrounding the economic recovery path, the balance of payments for 2021 is forecasted under three scenarios, i.e., a baseline scenario, as well as an optimistic and a pessimistic scenario.

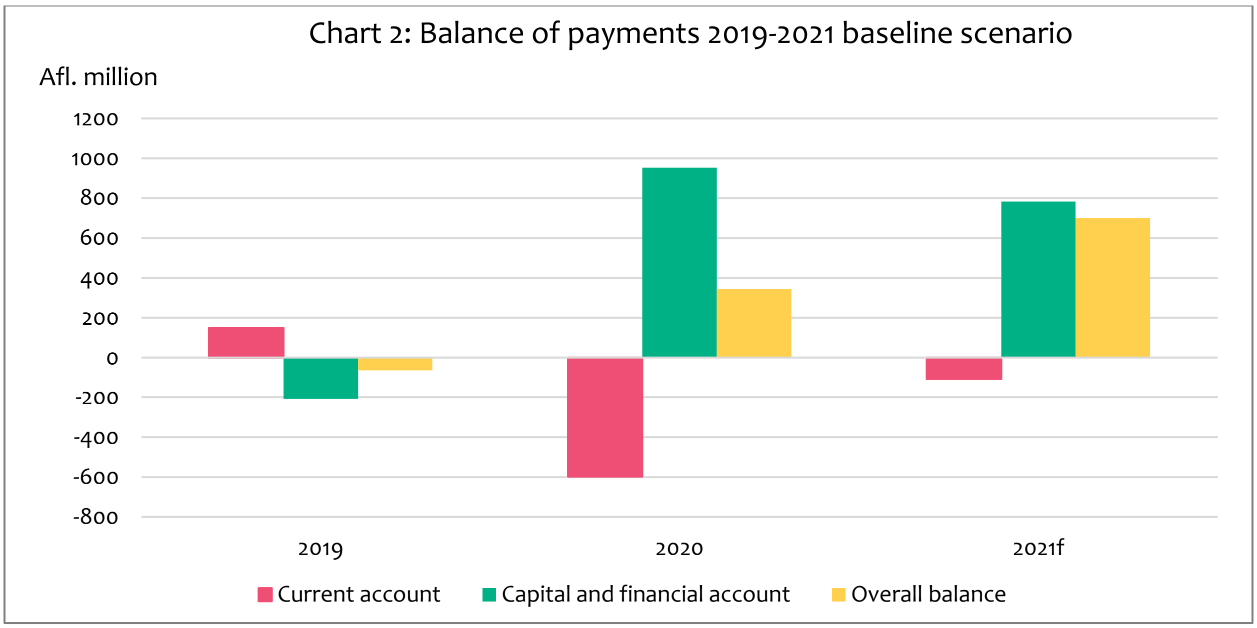
1. ***Baseline scenario*: Tourism credits are assumed to nominally grow by 54.4 percent in 2021, compared to a year earlier.** The additional tourists, as well as the associated additional cumulative income for domestic employees, push up the demand for goods and by extension, the import of goods by 28.6 percent. Despite the stronger upswing in tourism credits relative to the import of goods, the level of tourism exports is too low to compensate for the outflows of mainly import payments for goods and services. Therefore, the current account registers a deficit of Afl. 108.5 million. As for the financial account, large inflows arising from foreign borrowings by the GoA to cover its deficit are assumed, estimated at Afl. 782.8 million, to the extent that they more than cover the current account deficit. As such, the balance of payments is forecasted to record a surplus of Afl. 700.6 million.

2. ***Pessimistic scenario*: Tourism credits are projected to rise in 2021, although by 18.2 percentage points less compared to the baseline scenario.** Against this background, the import of goods is slightly lower compared to the baseline, while the lower tourism credits are insufficient to compensate for the total current account payments. Therefore, a deficit in the current account is anticipated (Afl. 331.0 million). With regard to the financial account, investment inflows are expected to be smaller vis-à-vis the baseline scenario, in stark contrast to government inflows. Overall, the relatively large government inflows lead to a financial account surplus (Afl. 773.0 million) in excess of the current account deficit, resulting in a surplus in the balance of payments (Afl. 468.3 million), although much smaller compared to the baseline scenario.

3. ***Optimistic scenario:* The expectation is that tourism credits expand in 2021 by an additional 10.0 percentage points compared to the baseline scenario.** The import of goods is then anticipated to be also higher. While tourism credits are projected to reach a level higher than the import of goods, it will not be enough to realize a current account surplus (Afl. 10.8 million deficit). In terms of the financial account, investment inflows are expected to be larger vis-à-vis the baseline scenario. However, in the optimistic scenario, government inflows are relatively more subdued, due to a fiscal balance improvement and, thus, a lesser need for foreign borrowing. Despite being more muted, government inflows are still sufficiently large to result in a financial account surplus (Afl. 807.8 million) and compensate for the current account deficit. Thus, a surplus on the balance of payments of an estimated Afl. 904.0 million is foreseen.

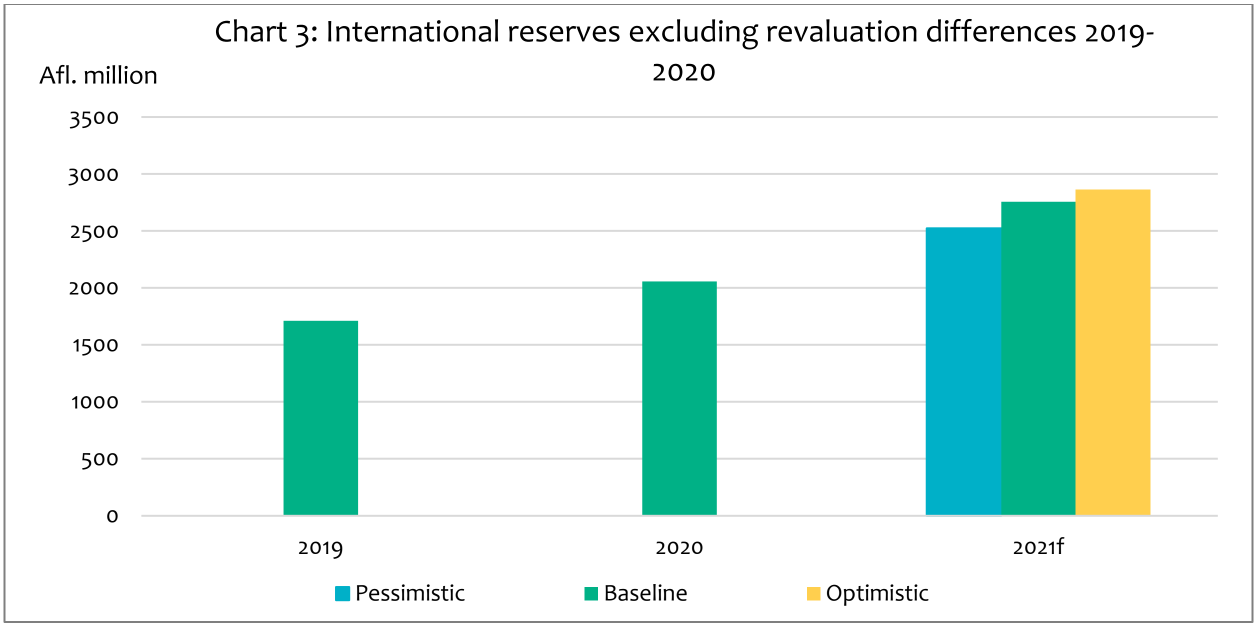
2021 Baseline Scenario

The current account is anticipated to record a deficit of Afl. 108.5 million in 2021 (Chart 2). This will likely result from the import of goods, which are up by 28.6 percent and consistent with the buoyant economic recovery seen thus far. The economic recovery brings about higher outgoing payments related to other services, while outgoing payments related to investment income are expected to remain subdued reflecting the absence of significant profits during 2020. Meanwhile, incoming tourism credits are anticipated to reach 78.9 percent of the 2019 level, representing a 54.4 percent expansion vis-à-vis 2020. Notwithstanding the strong recovery projected in tourism, 2021 tourism credit levels are insufficient to completely offset outgoing payments related to the import of goods, investment income, and other services.



The capital and financial account balances are expected to record an Afl. 782.8 million surplus in 2021. This is primarily linked to continued Dutch financial support to GoA to finance its deficit, leading to a projected net inflow of Afl. 734.8 million on the other investment account. Nevertheless, foreign debt repayments (Afl. 165.2 million) are anticipated to be a partially offsetting factor, bringing the portfolio account to a net outflow of Afl. 81.2 million.

Against this backdrop, the projected overall balance surplus stands at Afl. 700.6 million (Chart 3). As a result, international reserves (excluding revaluation differences) will reach Afl. 2,756.5 million in 2021, thereby comfortably exceeding the required current account coverage ratio, and remain within the optimal bandwidth of the IMF ARA (Assessing Reserve Adequacy) metric.

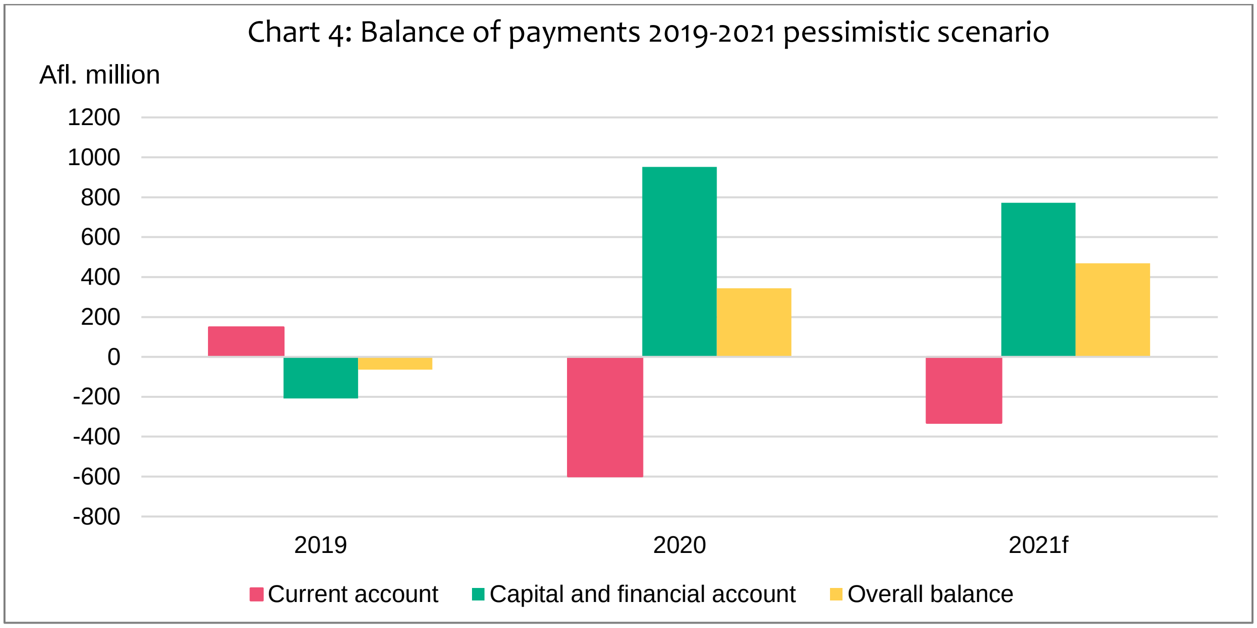


2021 Pessimistic Scenario

The current account is forecasted to register a deficit of Afl. 331.0 million in 2021 (Chart 4). This deficit can be largely linked to the import of goods, valued slightly below the baseline scenario. Similarly, outgoing payments related to other services and tourism are expected to further widen the current account deficit. These outflows are still lower than the baseline scenario, in connection with the assumption of unfavorable economic conditions. Amid forecasted tourism credits remaining 18.2 percentage points below the baseline scenario, there will be insufficient momentum in tourism activity to reverse the current account deficit.

The capital and financial account balances are expected to attain an Afl. 773.0 million surplus in 2021. This will be primarily associated with a greater government foreign borrowing need compared to the baseline scenario, which in turn emerges from the fiscal balance deterioration. This entails a net inflow to the other investment account of Afl. 732.3 million.

All in all, the overall balance is anticipated to record a surplus of Afl. 468.3 million. Consequently, the international reserves (excluding revaluation differences) are expected to reach Afl. 2,524.2 million in 2021 and remain well above the required current account coverage ratio and within the optimal bandwidth of the ARA metric.



2021 Optimistic Scenario

A current account deficit of Afl. 10.8 million is projected in 2021 (Chart 5). This deficit is chiefly related to the import of goods. Furthermore, outgoing payments related to other services and tourism services contribute to the current account deficit. These outflows are comparatively higher than the baseline scenario, owing to the presumption of improved economic conditions. Despite tourism credits being forecasted 10.0 percentage points above the baseline scenario, a current account deficit still results, albeit a smaller one than in the baseline. This results from the assumed faster recovery in tourism credits than import of goods in comparison to the baseline.

The capital and financial account balances are expected to attain an Afl. 792.2 million surplus in 2021. This will be primarily associated with a smaller government foreign borrowing need compared to the baseline scenario, which in turn emerges from a less negative fiscal balance. This entails a net inflow to the other investment account of Afl. 737.3 million.

All in all, the overall balance is anticipated to record a surplus of Afl. 807.8 million. Consequently, the international reserves (excluding revaluation differences) are foreseen to reach Afl. 2,863.7 million in 2021 and remain far higher than the required current account coverage ratio and comfortably within the optimal range of the ARA metric.

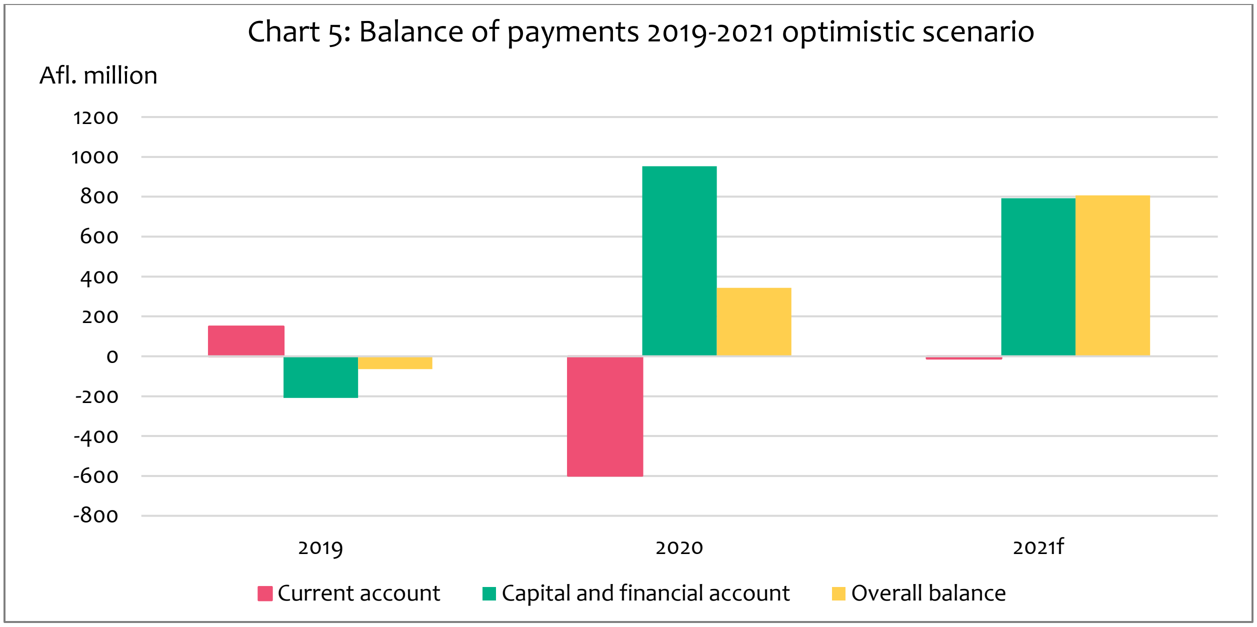


Chart 5: Balance of payments 2019-2021 optimistic scenario
Afl. million
1200
1000
800
600
400
200
0
-200
-400
-600
-800
2019
2020
2021f
Current account
Capital and financial account
Overall balance

2.3 Outlook assumptions and risks

Given the uncertainties related to the evolution of the COVID-19 pandemic, its effects on the Aruban economy, as well as on the pace of the subsequent economic recovery, a number of assumptions were made to arrive at the various scenarios. The main assumptions and risks to this outlook scenarios are:

- **Duration and depth of the pandemic.** In all scenarios, the duration and depth of the pandemic are important factors underlying the outcomes. The impact of new variants of COVID-19, subsequent waves of contagion, as well as vaccination rates, may have significant downside effects on output.

- **Speed of recovery.** The specific assumptions regarding the recovery of hotel occupancy rates are instrumental for the outcomes in each scenario. If tourists turn out to be more reluctant to travel and/or spend less during their stay-over than in these assumptions, this could mean lower receipts from tourism activities, stagnation in consumption recovery, and in turn a weaker rebound in economic output. Conversely, if the propensity to travel and/or visitor spend is larger than assumed in the scenarios, GDP growth could be higher.

- **Employment restoration.** The assumption in the estimations is that as tourism activities recover and economic activity picks up, persons who are dependent on the FASE and wage subsidy program will receive their pre-pandemic wages paid by their employers. This assumption implies that the businesses that employed these persons before the pandemic, will remain in business for the whole year. Moreover, the planned flexibilization of the labor laws is not taken into account. However, employees who manage to keep their jobs may experience increased job insecurity and lower wages, which would likely lead to a much more cautious spending pattern, thereby negatively impacting private consumption.

- **Investment projects.** The timely execution of relatively large investment projects is always a source of downside risk for GDP projections. In these scenarios, this risk is amplified due to a significant dampening of profits, a lower investment appetite, and the ability to obtain financing. Moreover, setbacks in these investments projects also could reduce FDI inflows and, thus, international reserves.

- **Additional government measures.** The government may introduce additional measures to reduce its deficit, such as further lowering personnel expenses and/or introducing tax and other income generating measures for the general public. Such measures could have a dampening effect on private consumption. This effect would be even larger if the government is unable to obtain full financing of its deficit or short-term liquidity support. In that case, more stringent measures could be necessary, and the government would not be able to provide ample social assistance to vulnerable groups and to those who lose their jobs. Furthermore, the expected government financial position and associated government foreign borrowing have a significant impact on the net foreign assets. Thus, deviations in the expected fiscal outcome and external financing would affect the net foreign assets position.

- **World oil prices.** Oil prices have been quite volatile over time and have been following a decreasing trend since the beginning of 2020 and the onset of the COVID-19 pandemic. Due to the inherent volatility of oil prices, exacerbated by the uncertainty of the duration of the pandemic and the strength of the subsequent economic recovery, current oil price projections seem even more uncertain than usual. Oil prices at low levels for a prolonged period potentially could influence local utility and gasoline prices, as well as import prices for goods and thus the inflation rate.

- **Tourism resurgence.** An important risk to economic growth and the level of the NFA is tourism performance. In the past years, Aruba experienced stronger than expected tourism growth. However, the COVID-19 pandemic and the subsequent measures taken by the government to contain its impact on public health, have led to the restriction of mobility, particularly that of international travel. Ultimately, the actual number of tourist arrivals is dependent on a variety of factors, such as the softening of travel restrictions in different markets, the appetite of tourists for international travel, the appearance of new variants of the virus, and the household financial situation of potential visitors, particularly from the U.S.A, which is Aruba's main market.

3. Concluding remarks

Due to the open nature of the Aruban economy and its huge tourism dependency, international developments, especially in the United States, play a significant role in its economic output. Recovery from the COVID-19 pandemic is, thus, dependent on the softening of travel restrictions in other countries, their economic recovery, potential new travel rules in place, the successful roll-out of the vaccine, the outbreak of new variants, and the willingness of people to travel once travel restrictions are lifted. This willingness relates to potential safety concerns, but also to the adverse impact that the crisis may have had on their disposable income.

Based upon available data, the Aruban economy is forecasted to continue its recovery path during 2021. While uncertainties related to new variants of COVID-19 and waves of contagion are expected to persist, the positive performance of the tourism sector, as well as the availability of the GOA's FASE and wage subsidy programs are pushing economic growth, albeit subject to (downside) risks. As outlined in the three scenarios used by the CBA, the real GDP is projected to grow by 12.7 percent in 2021, but could range between 8.2 percent and 15.5 percent. In nominal terms, this reflects a range between 6.6 percent and 14.8 percent, with a baseline expectation of 10.8 percent.

The resurgence of the tourism sector is the main driver in all scenarios, with the scenarios differing from one another in terms of the speed of the recovery. The improved performance of the tourism sector is expected to support the recovery of real private consumption, leading to an increase in real total consumption. However, real investment is projected to record a negative growth in 2021. The latter is due to the relatively low level of both private and public investment foreseen for 2021. Given the gradual recovery in the tourism sector and the subsequent uptick in private consumption, mitigated by the expected further abatement in investments, imports are expected to rise.

The current account deficit is expected to vary between Afl. 331.0 million and Afl. 10.8 million in 2021 across three scenarios. The main takeaway from these scenarios is that the recovery in tourism is not strong enough vis-à-vis goods and services payments to bring about a current account surplus. Moreover, as a result of the varying foreign borrowing needs, the capital and financial account are projected to record a surplus between Afl. 773.0 million and Afl. 792.2 million in 2021. Ergo, the balance of payments fluctuates between a surplus of Afl. 468.3 million and Afl. 807.8 million in 2021. A higher (lower) balance of payments surplus directly corresponds to a larger (smaller) NFA increase, hence the forecasted 2021 NFA stands at Afl. 2,524.2 million and Afl. 2,863.7 million for respectively, the pessimistic and optimistic scenario. Consequently, international reserves in 2021 are projected to remain well above the adequacy benchmarks monitored by the CBA.