

CENTRALE BANK VAN ARUBA



**REPORT 2010**  
**ECONOMIC AND FINANCIAL DEVELOPMENTS**





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# REPORT 2010

## ECONOMIC AND FINANCIAL DEVELOPMENTS

Aruba's economy is characterized by a high level of openness, with a significant portion of its GDP derived from tourism and related services. The financial sector remains a key component of the economy, contributing to the country's status as a financial center. The report details the economic and financial developments in 2010, highlighting the challenges and opportunities faced by the country. The Central Bank of Aruba continues to monitor the economic and financial situation closely, ensuring the stability and soundness of the financial system. The report provides a comprehensive overview of the economic and financial developments in 2010, including the performance of the economy, the financial system, and the central bank's activities. The report is a key document for stakeholders, providing valuable insights into the economic and financial landscape of Aruba. The report is available in both Dutch and English, ensuring accessibility for a wide range of readers. The report is a key document for stakeholders, providing valuable insights into the economic and financial landscape of Aruba. The report is available in both Dutch and English, ensuring accessibility for a wide range of readers.

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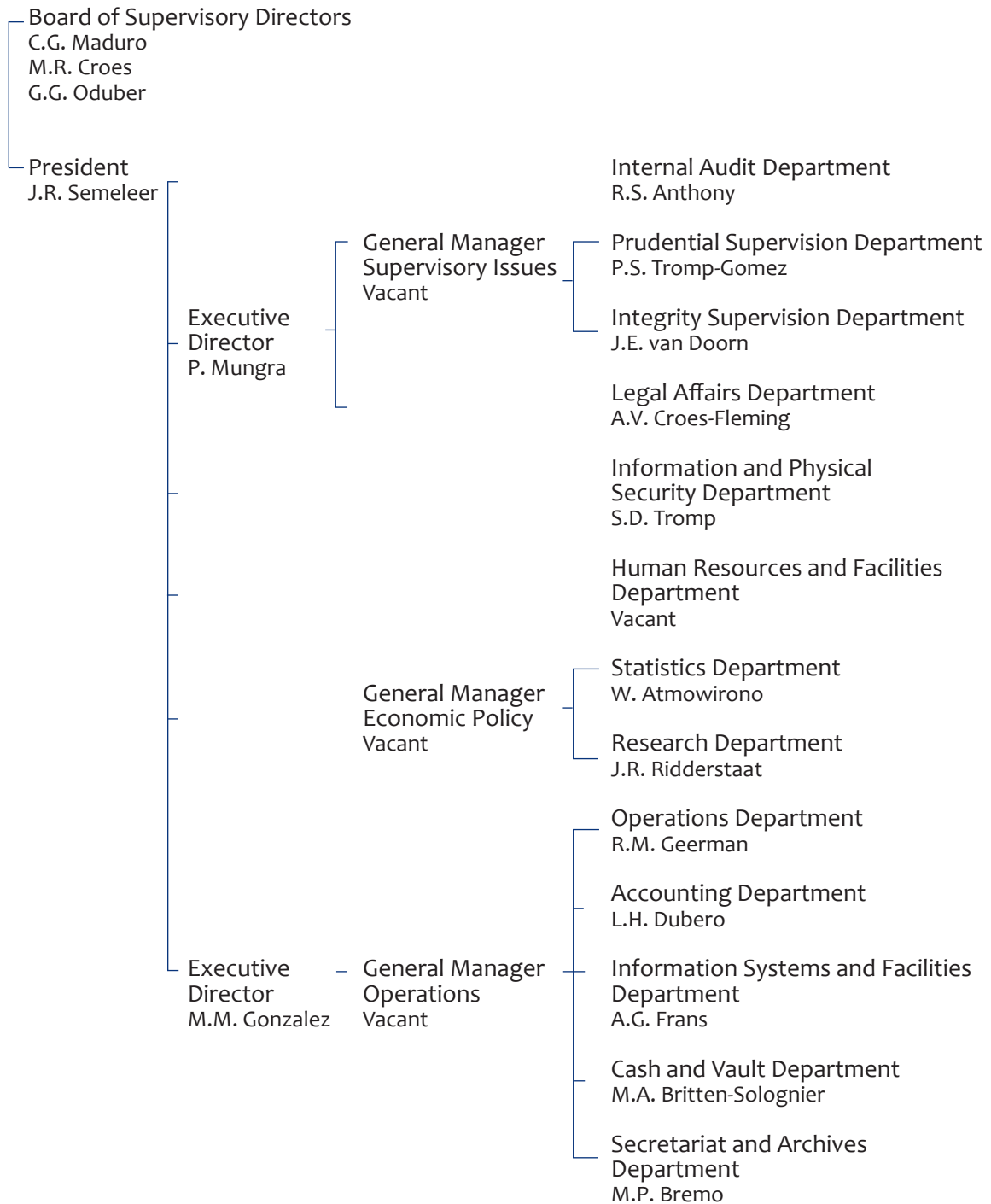
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## Organization Chart (As of January 1, 2011)





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## List of abbreviations

AAA	Aruba Airport Authority N.V.
ADR	Average daily rate
Afl.	Aruban florin
AIB	AIB Bank N.V., formerly known as the Aruban Investment Bank N.V.
ALLP	Allocated loan loss provision
AML/CFT	Anti-money laundering and combating financing of terrorism
AOV	Algemene Ouderdoms verzekering (the general old age pension system)
APFA	Stichting Algemeen Pensioenfonds Aruba (the civil servants pension fund)
ASBA	Association of Supervisors of Banks of the Americas
ATA	Aruba Tourism Authority
AWW	Algemene Weduwen- en Wezenwet (the general widowers and orphans insurance)
AZV	Algemene Ziektekostenverzekering (the general health insurance)
BBO	Belasting op Bedrijfsomzetten (a turnover tax)
BEA	U.S. Bureau of Economic Analysis
BGD	Bedrijfsgezondheidsdienst (the occupational health services)
BLS	U.S. Bureau of Labor Statistics
CAPA	Cooperativa di Ahorro y Prestamo Aruba
CBA	Centrale Bank van Aruba (Central Bank of Aruba)
CBCS	Centrale Bank van Curaçao en Sint Maarten (Central Bank of Curaçao and St. Maarten)
CBS	Centraal Bureau voor de Statistiek (the central bureau of statistics)
CGBS	Caribbean Group of Banking Supervisors
CD	Certificate of Deposit
CDD	Customer Due Diligence
CPI	Consumer Price Index
CTA	Cruise Tourism Authority
CTO	Caribbean Tourism Organization
DEZHI	Directie Economische Zaken Handel en Industrie (the department of economic affairs, commerce and industry)
DF	Department of Finance
DNB	De Nederlandsche Bank N.V. (the Central Bank of the Netherlands)
DOW	Dienst Openbare Werken (the department of public works)
DTI	Dienst Technische Inspectie (the department of technical inspections)
ELMAR	Naamloze Vennootschap Electriciteitsmaatschappij Aruba (the publicly owned electricity provider)
EU	European Union
FAO	Food and Agriculture Organization of the United Nations
FATF	Financial Action Task Force
FCCA	Fundacion Cas pa Comunidad Arubano
FDA	Stichting Fondo Desaroyo Aruba (the development fund foundation of Aruba)
FOMC	Federal Open Market Committee
FIU	Financial Intelligence Unit
GDP	Gross Domestic Product
GOA	Government of Aruba

IAS	International Accounting Standards
ICRG	International Cooperation and Review Group
IMF	International Monetary Fund
MC	Monitoring Committee
MER	Mutual Evaluation Report
MMoU	Multilateral Memorandum of Understanding
MOT	Meldpunt Ongebruikelijke Transacties (the agency where unusual transactions are to be reported)
MoU	Memorandum of Understanding
MPC	Monetary Policy Committee
MR	Ministerial Regulation
NCPF	National Commission on Public Finance
OECD	Organization for Economic Cooperation and Development
OGBS	Offshore Group of Banking Supervisors
OGIS	Offshore Group of Insurance Supervisors
OV	Ongevallen verzekering (the accident insurance)
PLR	Prudential liquidity ratio
PVL	Pensioenverordening Landsdienaren (the pension scheme for civil servants)
RevPar	Revenue per Available Room
RR	Reserve Requirement
SETAR	Servicio di Telecomunicacion di Aruba (Setar) N.V. (a publicly owned telecommunications company)
SDQHI	State Decree Qualifying Holding Insurance Companies
SOCPF	State Ordinance on Company Pension Funds
SOFEC	State Ordinance Foreign Exchange Commission
SOFET	State Ordinance Foreign Exchange Transactions
SOGM	State Ordinance Governing the Monetary System
SOIPS	State Ordinance on the Identification when Providing Services
SORUT	State Ordinance on the Obligation to Report Unusual Transactions
SOSCS	State Ordinance on the Supervision of the Credit System
SOSIB	State Ordinance on the Supervision of the Insurance Business
SOSMT	State Ordinance on the Supervision of Money Transfer Companies
SOSTSP	State Ordinance on the Supervision of Trust Service Providers
SVB	Sociale Verzekeringsbank (the social security bank)
TCO	Tax Collector's Office
UN	United Nations
VAT	Value Added Tax
VEC	Valero Energy Corporation
WEB	Water en Energie Bedrijf Aruba N.V. (the publicly owned water and power company)
ZV	Ziekteverzekering (the sickness insurance)



The Executive Committee and Members of the Board of Supervisory Directors (as of January 1, 2011);  
Seated l.-r.: J.R. Semeleer (President), C.G. Maduro (Chairman);  
Standing l.-r.: G.G. Oduber, M.R. Croes, M.M. Gonzalez, P. Mungra



# 1 STATEMENT OF THE PRESIDENT

Kenya is a country of great diversity and rich cultural heritage. We are a nation of many tribes, languages, and religions. It is our duty as leaders to ensure that we all live together in peace, harmony, and unity. We must work together to build a strong, prosperous, and democratic Kenya for all our people. We must ensure that the rule of law is upheld and that the rights and freedoms of every citizen are protected. We must also ensure that we are good stewards of the environment and that we take care of our natural resources for the benefit of future generations. We must work together to address the challenges of poverty, unemployment, and inequality. We must ensure that every citizen has access to quality education and healthcare. We must also ensure that we are good neighbors and that we work together to promote peace and stability in the region and the world. We must ensure that we are good citizens and that we all contribute to the development and progress of our country. We must ensure that we are good leaders and that we all serve the interests of our people. We must ensure that we are good role models and that we all live by the highest standards of integrity and honesty. We must ensure that we are good citizens and that we all contribute to the development and progress of our country. We must ensure that we are good leaders and that we all serve the interests of our people. We must ensure that we are good role models and that we all live by the highest standards of integrity and honesty.



## 1 Statement of the President

In 2010 much of the Aruban economy continued to encounter challenges and uncertainties. Relying largely on external sources of income, Aruba's economy historically has been vulnerable to changes in world economic conditions. Consequently, the global economic and financial crisis of 2008-2010, combined with the temporary shutdown of the refinery, the slowdown in the tourism sector and a significant drop in foreign direct investment had a severe impact on the Aruban economy, as nominal gross domestic product (GDP) fell by 3.8 percent to Afl. 4,306.1 million in 2010.

On the other hand, the world economy appears on the mend following the global crisis and the further bouts of financial turbulence and contagion risks associated with the Greece and Ireland sovereign debt crises. While the return to broad price stability remains an important policy achievement, macroeconomic instability has persisted in much of the world economy, continuing to pose challenges for and in many ways make new demands on economic policies. In this context, the world economy stays a complex mosaic of contrasting developments in countries and regions where trends in aggregate output do not converge.

The island's economy was characterized by a decline in business activities in many sectors, a situation reminiscent of but less grave than the period 1985-1986. Almost 25 years ago the culprit was the sudden closure of the Lago refinery. This time that same refinery, now operated by the Valero Energy Corporation (VEC), was the main reason for the contraction of Aruba's economy. Coinciding with the most severe economic and financial crisis since the Great Depression, the VEC announced its intention in June 2009 to temporarily shut down the Valero refinery as the narrow heavy sour crude oil margins did not make it economically feasible to operate the refinery. Moreover, the enacted 1 percent turnover tax on export sales on January 1, 2007 was a significant source of dispute because it negatively impacted the refinery's operations and threatened continuity over time. In the words of the VEC, "various tax disputes with the Government of Aruba (GOA) created uncertainties with respect to the future economics of the refinery."<sup>1</sup>

The operational shutdown of the refinery, which took place in July 2009, was more detrimental to the Aruban economy than the then on-going global crisis itself. It caused a decline in the number of contracted personnel at the refinery (estimated at about 1,200), a loss of foreign exchange income, and substantial uncertainty within other sectors of the economy. Moreover, the ensuing economic recession led to a decline in government revenue.

In late February 2010, the GOA and the VEC reached a settlement agreement, which ended the tax dispute between the two parties. The settlement stated that the Valero refinery would enter into a new tax covenant, thereby relinquishing its tax holiday status, and be subject to a flat profit tax rate of 7 percent and a dividend withholding tax rate of zero percent. Moreover, all imports and exports would be exempt from the turnover tax and throughput fees of any kind. After two years, more specifically on June 1, 2012, the refinery would start to make a minimum annual tax payment of US\$ 10 million, in equal quarterly installments. It also has been granted the entitlement to carry forward, as a tax credit, any excess of its tax prepayments versus its future tax liabilities. At the end of May 2010, the Aruban Parliament adopted a number of laws that permitted the implementation of the provisions of the tax settlement.

Shortly after the Parliamentary approval of the settlement, the VEC paid US\$ 118 million to the GOA as part of the deal. In the third quarter of 2010, the refinery initiated a company-wide maintenance program, announcing an investment of about Afl. 161 million. Due to the improved sour crude oil price differentials and refining margins in the first six months of 2010, the VEC's investment program was designed to prepare its production units for a possible restart by the end of September 2010. Aside from being an impetus to economic activity, the investment program was only partial good news because of uncertainty as to whether the refinery was going to fully restart its operations. It was not until the beginning of 2011 that almost all of the associated uncertainty was eliminated and the start of production became a reality. The importance of the restart of the refining activities is highlighted by estimations by the

<sup>1</sup> Valero Energy Corporation, 10-Q Quarterly report pursuant to sections 13 or 15(d), Second Quarter 2010, p. 12.



Centrale Bank van Aruba (CBA) that indicate that the inactivity of the refinery during 2010 had a negative direct impact (not accounting for the indirect effects of the shutdown of the refinery) of about 3.4 percentage points on the estimated decrease of 2.8 percent in the real GDP.

The negative performance in Aruba's aggregate output in 2010 coincided with the moderate growth of tourist arrivals, particularly in the second half of the year, and the distressed construction activities. Overall, the economic performance of Aruba's other industries was not enough to prevent the negative outcome in the real GDP.

Growth in tourist arrivals reached 2.5 percent in the first half of the year, but weakened to 0.6 percent in the second half, as the U.S. market showed debilitated progress in the latter part of the year. For the year as a whole, tourist arrivals grew by 1.6 percent of which 0.9 percentage point was related to the U.S. market. The performance of tourist arrivals from the United States was associated with growing concern about the sustainability of the U.S. economic recovery. Nominal tourism receipts increased by 2.2 percent or Afl. 47.7 million in 2010. In the first eight months of 2010, the hotel occupancy rate grew by 1.9 percentage points to 78.1 percent, in contrast to average daily rates which fell by 0.8 percent to Afl. 321. Meanwhile, revenue per available room (RevPar) went up by 4.5 percent to Afl. 147 in the first eight months of 2010. At the same time, in line with expectations, cruise tourism did not perform well. This result is in part related to volatile oil prices and a decline in advanced bookings, many of which originated up to six months earlier when the economic and financial crisis was still on-going.

The retail sector recorded a modestly improved performance in 2010 compared to 2009. Nonetheless, the level of activities in this sector remained subdued when compared to 2008 and prior years. Apart from the difficult economic situation in 2010 and the reluctance of consumers to spend, the retail sector faced a problem of over-capacity, built-up in the years leading up to the recession.

The construction sector also had been severely affected by the recession and remained

depressed in 2010. This result is evidenced by information obtained by the CBA through both quantitative indicators (number of construction permits granted, imported cement and electrical installations approved), and qualitative indicators (business perception surveys and regular business visits). Besides the negative impact of the temporary shutdown of the Valero refinery during 2010, this fallout had its roots along with lower overall investment activities on the island, estimated at -9.9 percent in real terms. This situation was, among others, brought about by the delay in the implementation of announced public-private partnership projects and the delay of some large investment projects (e.g. Ritz Carlton Hotel).

Workers suffer with the decline in wages and employment that tends to occur during a recession. In this context, the distress in the construction sector had its repercussions on the labor market, as it caused a surge in the unemployment rate. Coupled with meager performances in other sectors such as wholesale and retail trade, hotels and restaurants, real estate, renting and business activities, the number of persons without a job appears to have remained on a relatively high level in 2010. Preliminary estimates by the CBA indicate an unemployment rate of 9.0 percent at the end of 2010, equivalent to around 4,800 persons.

Fewer individuals with a job mean less income available for private consumption, one of the backbones of Aruba's economy. In real terms, private consumption is estimated to have declined by 0.3 percent in 2010. Lagging consumptive spending also was reflected in the performance of selected economic indicators: a 2.7 percent reduction in turnover tax receipts (BBO) in real terms<sup>2</sup>, a 3.8 percent decline in container transport, and a 2.9 percent decrease in consumer credit extended by the banking sector.

The banking sector in Aruba was also affected by weaker business activities in 2010. The weak outcome in consumer credit occurred in an environment where the commercial banks, within the boundaries of prudential parameters and requirements, are no longer restricted in the amount of credit they are allowed to grant. The CBA did away with the credit-ceiling instrument as of January 1, 2010, and introduced a new monetary

<sup>2</sup> Corrected for the tariff reduction of the BBO as of January 1, 2010 and the incidental receipt of Afl. 211.6 million related to the Settlement Agreement with the VEC.

policy framework. The very modest developments in credit should be attributed essentially to both restrained demand for consumer credit and loans to businesses. Moreover, the tightening of lending conditions may have contributed to the depressed outcome in both categories of credit. On the other hand, housing mortgages increased by 5.8 percent. The refinancing of existing debt may have played a major role in this increase, considering the meager performance in housing construction.

The removal of the limitation in credit growth marked the end of the direct system of monetary policy, and the introduction of an indirect arrangement mainly comprising the Reserve Requirement (RR). This instrument, through which commercial banks are obligated to hold 11 percent of their short-term liabilities (less than 2 years and excluding domestic interbank deposits) as unremunerated deposits at the CBA, is currently used by the CBA to mop up part of the excess liquidity within the banking system, and signals the CBA's monetary intentions.<sup>3</sup> Under the CBA's new monetary policy framework, the main monetary policy objective remains the same, i.e., the preservation of the stability of the value of the Aruban florin, as mandated by the Central Bank Ordinance. Within this context, the operationalization of the monetary policy of the CBA became more flexible, meaning that it is subject to periodic revision, depending on the expected developments in, among others, the net foreign assets.

In light of the new, more flexible, monetary policy framework the CBA established the so-called Monetary Policy Committee (MPC) in May 2010. The committee consists of the President and both Executive Directors of the CBA, with the main responsibility of periodically reviewing CBA's monetary policy stance, based on a selected number of economic indicators, among others, gross domestic product, net foreign assets, inflation, credit, and liquidity. In 2010, the MPC held seven meetings. The MPC concluded in its meetings that the rate of the main instrument of monetary policy, the Reserve Requirement (RR), could remain unchanged. Because the decision-making process within the monetary policy framework is dynamic, the

CBA has flexibility to add other instruments as needed to its arsenal of monetary policy instruments.

Lower demand for credit and the removal of credit restrictions, however, were not enough to influence the relatively high spreads in interest rates (8.2 percent in 2010) adopted by the commercial banks. The spread between the weighted average interest rates on new loans and new deposits widened further in 2010, as the average rates on new deposits showed a steeper decrease than the average rates on new loans, a disquieting pattern that has been going on for some time. This phenomenon, and particularly the level of the interest rates on loans and deposits has been a topic of debate for years, not only in Aruba, but in many of the neighboring Caribbean islands as well.

The challenge of high interest rate margins is endemic to small island economies, such as Aruba, where diseconomies of scale are more the rule than the exception. The introduction of interest rate ceilings (for loans) or floors (for deposits) does not seem to be the solution and many countries tend to move away from these instruments. It would be more fruitful to take measures that promote competition between the commercial banks, thereby mitigating the negative effects of the existing oligopolistic market structure on pricing. Already at the beginning of 2010, the CBA moved toward more market-oriented monetary policy instruments in an effort to stimulate competition. However, unlike other sectors of the economy, the push for more competition in the banking sector also bares risks for maintaining financial stability. The costs and benefits of increased competition must be well-balanced in the pursuit of lower interest rates on loans, without further depressing the interest rates on savings and deposits, while a sound and safe financial system for a stable socio-economic development remains a top priority. The recent global financial and economic turmoil is a case in point.

Besides low demand for credit, the economic contraction led to a substantial increase in loan defaults, as measured by past-due loan status of more than 90 days on the payment of interest or principal by businesses and individuals. Non-

<sup>3</sup> For more information, please refer to Box 2.2, p.21 of the CBA Report 2009: *Economic and Financial Developments*, published in July 2010.



performing loans recorded a steep increase in the second half of 2010, particularly with respect to commercial mortgages. Although the commercial banks have adequate provisions in place to cover possible loan losses, this trend requires careful monitoring.

Price stability was not a pertinent issue in 2010, as the 12-month average inflationary pressures remained restrained with a 2.1 percent increase in prices. This outcome had to do essentially with the development in energy prices. If the food and energy components are eliminated, however, the so-called core inflation stood at -0.3 percent, indicating a light decrease in prices of the remaining components of the consumer price index. The latter prices have been showing a steady decreasing trend over the last year and conveyed a stable development in the inflation differential of 0.4 percentage point with the United States, Aruba's main commercial and tourism partner.

The fixed exchange rate between the Aruban florin and the U.S. dollar is sustained in the long term by maintaining a comfortable level of foreign exchange reserves. In contrast to the last three years, the international reserves dropped 11.3 percent or Afl. 167.0 million to Afl. 1,308.1 million in 2010. This result was attributed mainly to incidental transactions related to, among other things, the oil sector in the last month of 2010. The level of international reserves remained adequate despite the mentioned decline, as the average import coverage ratio in months of current account payments actually increased from 5.9 months in 2009 to 6.3 months.

After four consecutive years of surplus, the balance of payments recorded a deficit of Afl. 167.0 million in 2010. Transactions of the oil sector and to a lesser extent the non-oil sector contributed to this outcome. The current account deficit of the oil sector was Afl. 825.4 million, as imports of crude oil and other goods were higher than exports of refined oil. The financing of this deficit was done mostly from trade credits received and withdrawals from the oil sector's foreign bank accounts for the total amount of Afl. 698.6 million, and the purchase of Afl. 127.7 million in foreign exchange from the commercial banks. The non-oil sector bought, on balance, Afl. 39.3 million in foreign exchange from the commercial banks. This money was used together with its current account surplus, to cover the

deficit on the capital and financial accounts related essentially to advances on imports of goods and services and increased balances on foreign bank accounts.

Public finances entered another stage of adversity in 2010, when the financial deficit (including the change in payment arrears) reached a new high of Afl. 190.4 million, equivalent to 4.4 percent of the GDP. This outcome is still below what it would have been, were it not for the incidental government revenue of Afl. 211.6 million stemming from the Valero tax settlement agreement. As the public sector revenue picture changed during the period 2008-2010, the outlook of the government finances for the coming three years is challenging, given the government's substantial financing needs to cover both the deficit and the repayment of several large loans.

With the aim to structurally reform some costly programs such as the health care and the pension system, the government introduced a series of so-called Social Dialogues, based on the "Dutch Polder Model" of consensus in economic policy. The CBA contributed to the Social Dialogues by presenting medium and long-term projections of government finances under different scenarios.

The results of the first round of this Social Dialogue are encouraging. The involved parties reached an agreement in June 2010 on three main fiscal challenges: the civil servants pension fund (APFA), the old age pension insurance (AOV), and the general health insurance (AZV). Measures to address the significant weaknesses in all three schemes were implemented in January 2011. The agreement reached within the first round of the Social Dialogue is commendable and has been welcomed by international institutions, such as the International Monetary Fund (IMF) and Standard & Poor's. However, the IMF also expressed the view expressed the view that these measures will yield limited fiscal savings in the short-term, more specifically a reduction in the underlying fiscal deficit by 2 to 2.5 percent of GDP. The latter estimation excludes some expansionary measures resulting from the Social Dialogue Agreement.

Along this line of fiscal policy, the IMF concluded that to reach a balanced budget, more adjustments are needed on both the expenditure side and the revenue side of the budget. Its calculations show that expenditure corrections would fall short about 2.5 percentage

points of the estimated required adjustment, necessitating additional revenue-generating measures that should promote economic growth, be fair and transparent, and prompt high taxpayer compliance with low administrative costs. More specifically, the IMF recommended investigating the possibilities of introducing a value-added tax (VAT) to replace the current turnover tax (BBO).

The GOA reduced the BBO tariff by half at the beginning of 2010, using the rationale of improving the purchasing power of consumers. The argument was that this reduction would not only benefit consumers but also would have extended positive effects for businesses, tourists, and even the informal sector. Aside from the anticipated positive effect on purchasing power, the tariff reduction of the BBO also has a downside, i.e., a loss in government revenue. Since the BBO applies to tourists as well as domestic consumers, the tariff reduction led to a loss in government revenue (excluding the government revenue received from the settlement agreement with the VEC) from tourists as is illustrated by the estimation by the CBA that tourists contributed by about 42 percent to the BBO revenues of the government in the period 2007-2009.

The loss in revenue further increased the pressure on the GOA's already weak financial position. As part of its advisory role, the CBA cautioned the GOA of the potential ensuing fiscal risks. While it agreed with the government on the objective of improving the purchasing power of consumers, the CBA expressed concern about the impact a reduction in the BBO rate would have on the financial position of the government.

Besides economic monitoring, CBA's supervisory activities were enhanced in 2010, particularly in the area of anti-money laundering and the combating of terrorism financing (AML/CFT). The deficient Aruban AML/CFT framework required swift actions, after the unfavorable outcome of the October 2009 Mutual Evaluation Report of the Financial Action Task Force (FATF). The report cited an incomplete and incoherent AML/CFT framework. With this in mind, the GOA installed an AML/CFT strategy group, presided over by Aruba's Prime Minister. With the assistance of an external consultant, a plan of action to remedy the identified deficiencies in the AML/CFT framework was drafted.

The FATF placed Aruba under the enhanced follow-up procedure, which implies that Aruba

has to report back to the FATF during each of the three FATF Plenary Meetings held each year. After the second Plenary Meeting of 2010 the FATF was of the opinion that Aruba still had to demonstrate substantial progress in the implementation of its action plan. However, at the third Plenary Meeting the FATF decided that Aruba had made significant advances and should report back to the Plenary Meeting of June 2011 instead of February 2011. Still, the FATF decided to leave Aruba in the enhanced follow-up procedures, and to review in June 2011 whether Aruba could be moved to the regular follow-up procedures.

Aside from the FATF issue, the CBA continued to monitor the effects of the aftermath of the global economic and financial crisis on the supervised financial institutions in Aruba. All supervised financial institutions were able to continue to operate within the prudential parameters set by the CBA in the area of solvency and liquidity. The three company pension funds, whose coverage ratio had declined below the minimum requirement of 100 percent since 2008, succeeded in bringing their coverage ratio above the required minimum by the end of December 2010.

The incorporation of the civil servants pension fund (APFA) under the supervision of the CBA as of January 1, 2011, forms a new challenge to the CBA's supervisory activities. Previously, the APFA was under the oversight of the Minister of Finance. In connection with its underfunded position, the APFA has to submit, in the short term, a recovery plan to the CBA for its approval. The GOA has committed itself to offer ample financial support to the APFA if and when needed, thereby providing a basis for the APFA's supervision by the CBA. However, the underfunding of the APFA remains substantial and may require additional corrective measures.


The Aruban economy is anticipated to grow by 8.9 percent in real terms in 2011, derived mostly from a further pick-up in the tourism sector and the restart of the Valero refinery activities. Overall consumption is expected to strengthen by 0.9 percent, with the private sector as the main catalyst, given that government consumption is predicted to decline in real terms. Investments are forecast to show a strong rebound in both the public and private sectors, while the CBA foresees a net growth in the external sector as tourism is expected to continue to increase, although still



below the average rates of growth recorded in the previous decade.

The assumptions underlying the CBA's projections for the short to medium term take into account future policy measures likely to be implemented. Both projections and policy assumptions are generally based on information available to the staff of the CBA at the time of analysis. One of the main downside risks to the baseline scenario is that the world economy will not meet the expected real GDP growth of nearly 4.2 percent for 2011. The current turmoil in the Middle East and Northern Africa, which has significantly driven up oil prices on the international market, increases this risk. An additional risk is related to significantly weaker than expected economic growth in the United

States. Because of these possible risks, there is reason for concern about the depth of the tourism recovery underway in Aruba since its economy would be vulnerable under these scenarios. On the other hand, an upside risk is the realization of the investment plans of the GOA and the VEC regarding a liquefied gas project to replace oil as the main energy source on the island.

The year 2010 was difficult and challenging for Aruba. Some significant obstacles were dealt with, while others still await suitable solutions in 2011 and beyond. Effective results, which are not always based on win-win situations, require determination and willingness of all involved parties to bring outcomes that in the end will benefit the people of Aruba. 



The Executive Committee, l.-r.: M.M. Gonzalez, J.R. Semeleer (President), P. Mungra



Efficiency is important in settling domestic payments. The CBA operates an automated clearing system between the commercial banks and a number of government-related institutions.



## 2 ECONOMIC AND FINANCIAL DEVELOPMENTS

... ..



## 2 Economic and financial developments

### 2.1 International environment

In 2010, nearly two years after the financial meltdown of 2008, the economic slowdown continued to reverberate throughout the world. Indications were that a currency war might have begun, with the United States (U.S.) and China the key participants. Several European Union countries (E.U.) faced possible bankruptcy. U.S. citizens learned that the cost of keeping the international financial system afloat was nearly US\$ 3.5 trillion in support loans and other forms of credit from the U.S. Federal Reserve to a number of large domestic and foreign banks.

How global was the financial crisis? Generally, the crisis hit most sharply in developed economies that were closely connected to the global economy. More precisely, the recession's sting was most acute in countries whose financial systems and trade patterns depended on ties with the U.S. economy. Thus, during the period 2008-2010, most members of the Organization for Economic Cooperation and Development (OECD) suffered recessions of varying degrees of severity. However, most of Asia, except Japan, escaped the shock of the financial crisis.

According to the IMF estimates, China's economic growth slowed almost imperceptibly to 10.4 percent as a result of the recession in the United States and other major developed economies, while India's economic growth regressed gradually to 6.8 percent in 2009 before rebounding to 10.4 percent in 2010. On the other hand, Canada and Mexico suffered a decrease in exports to their U.S. neighbor as the United States combatted recession. Concurrently, economic growth increased a bit in Argentina and decreased slightly in Brazil.

After bouncing back to positive economic growth in the second and third quarters of 2009, the global economic recovery, led in particular by the developing Asian economies<sup>1</sup>, stabilized in 2010, becoming increasingly self-sustained. In addition, the first signs were visible that overall

unemployment had stabilized. Manufacturing, energy producers, and to a lesser extent, renewed strength in the service sector were the main sources of global economic growth at the beginning of 2010.

The available data further suggest that growth in world output was more moderate in the second part of the year than in the first. This outcome was due to a slowdown in the build-up of global inventories and the winding down of fiscal policy stimuli in emerging and developing economies<sup>2</sup>. Overall, global economic production ended 4.7 percent higher in 2010, compared to the 0.6 percent contraction in 2009. Rates of growth differed, however, across regions and economies.

As a result, the world economy is experiencing a dual-speed recovery. On the one hand, economic growth in advanced economies<sup>3</sup> remained subdued due to the fragile financial position of private households, tight credit, weak labor market conditions, and low levels of consumer confidence. It became evident that private consumption, which fell sharply during the crisis, had started to gain a foothold in advanced economies during the second half of 2010. On the other hand, growth in many emerging and developing economies remained strong, despite moderation in the latter part of the year.

Amid lingering vulnerability, global financial conditions generally improved during the second half of the year. Equity markets rallied, risk spreads narrowed, and bank lending conditions in advanced economies relaxed somewhat. Nonetheless, some weak spots remained: depressed real estate markets and household income in some advanced economies (Table 2.1), as well as the sovereign debt crisis in the euro area. The latter originated in May 2010 when Greece and subsequently Ireland (in November 2010), on the brink of bankruptcy, accepted massive bailouts from the E.U., bilateral European lenders, and the IMF.

The massive liquidity and credit support for Greece (May 2010) and Ireland (November 2010)

<sup>1</sup> Consistent with the definition of the IMF, developing Asia consists of China, India, Philippines, Indonesia, Malaysia, Singapore, and Thailand.

<sup>2</sup> According to the definition of the IMF, the emerging and developing economies include: the economies of Central and Eastern Europe, the Commonwealth of Independent States, Developing Asia, Latin America and the Caribbean, the Middle East and North Africa, and Sub-Saharan Africa.

<sup>3</sup> In line with the definition of the IMF, the advanced economies include the economies of the United States, the euro area, Japan, the United Kingdom, Canada, and other advanced economies.



**Table 2.1: Selected international and financial indicators**  
(percentage change)

	2008	2009	2010
Equity Markets			
MSCI World Index	-43.5	-43.5	10.4
Dow Jones Industrial Index	-33.8	18.8	11.0
S&P 500	-38.5	23.5	12.8
Commodities			
FAO Food Price Index	18.0	-18.0	17.2
Oil	37.8	-38.1	28.8
U.S. Housing Starts	-32.9	-38.4	5.6
U.S. Real Disposable Income	0.8	0.6	1.4

**Source:** MSCI Inc.; Federal Reserve Bank of St. Louis; Food and Agriculture Organization of the United Nations; Bank of Montreal; IMF.

contained their crises, generated confidence in the financial markets, and mitigated their sovereign risk. Both countries implemented strong fiscal reforms and painful austerity measures. In this context, pension reforms were long overdue and badly needed to counter the impacts of the increasing proportion of elderly dependent on the contributions of shrinking work forces.

Global price developments tended to reflect the uneven price accelerations across countries and regions. In advanced economies, inflationary pressures remained subdued because of substantial unused capacity, while inflation rates increased in the rapidly growing emerging and developing economies. The upsurge in inflation in these economies reflected in part higher food prices (as per United Nations' Food and Agricultural Organization (FAO) Food Price Index), resulting from weather-related crop losses and increased demand. In the second half of 2010, input prices started to pick up on the back of higher food and other commodity prices, but this effect was more the case in the emerging and developing economies that experienced stronger economic activity than in the advanced economies.

In the end, inflation in advanced economies accelerated to an average of 1.6 percent in 2010. On the other hand, in the emerging and developing economies the pace of price increases accelerated by 1.0 percentage point to 6.2 percent on average (Table in Box 2.1).

The year 2010 was one of recalibration and uncertainty for the United States. However, its economy failed to emerge robustly from a major recession, which prompted unprecedented government actions to keep a fragile recovery on track. As a result, the economic recovery endured in 2010, with the fourth-quarter GDP level exceeding, for the first time, the pre-recession peak achieved in the fourth quarter of 2007 as financial and economic indicators improved. For the year as a whole, economic activity expanded by 2.9 percent (Table in Box 2.1).

Household consumption in the United States rebounded to a positive growth rate of nearly 1.8 percent after strong advances in the last quarter of 2010. The expanded consumer spending was associated with increased real disposable income. Moreover, business investments, predominantly in equipment and software, showed a 3.2 percent rise, as the Federal Open Market Committee (FOMC) kept the upper target of the Fed Funds rate at 0.25 percent while engaging in two rounds of strong stimulus monetary policy. This approach, named "quantitative easing", seemed to create a positive effect in late 2010. Business confidence also received a boost, because of signs that the recovery was becoming more and more self-sustained.

On the other hand, net exports made a negative contribution to the GDP growth in the United States because the development in imports

outpaced that of exports. Despite the economic expansion and the creation of 1.1 million jobs since the bottoming of employment in December 2009, unemployment at 10.0 percent remained historically high in December 2010. Inflation stood at 1.7 percent for the year 2010, credited mostly to higher energy and food prices.

In Japan, the economy came back from the worst recession since World War II, registering a GDP growth of 3.9 percent in 2010. This rebound was traced to robust domestic demand prompted

by stimulus measures and growth in exports. However, export growth abated dramatically toward the end of the year because of a strong yen. The CPI decreased on average by 0.7 percent during 2010, notwithstanding the economic growth and gains in commodity prices.

Emerging economies, such as Brazil, China, India, and the other developing Asian economies led the continued recovery of the world economy in 2010, backed by stimulus packages, investment, and strong demand for exports. Economic

### Box 2.1: Global economic outlook for 2011 and 2012

Global economic conditions improved modestly after the turbulence in the period 2008-2010. Emerging and developing countries are taking the lead in the recovery, buoyed by solid public coffers and strong currencies. The U.S. economy lagged well behind, burdened by extraordinary debt and high unemployment. Its resilience and long-term dominance is suddenly being questioned. According to the latest forecasts, the IMF expects the global recovery to continue in 2011, anticipating different speeds of growth in the various regions of the world. The world economy is estimated to grow, on average, by 4.2 percent in 2011 and 4.5 percent in 2012 (Table below).

**Table: Economic indicators and respective forecasts for selected countries/regions**

	Real GDP <sup>1)</sup>			Inflation <sup>2)</sup>		
	2010	2011	2012	2010	2011	2012
World	4.7	4.2	4.4	3.6	4.1	3.5
Advanced economies <sup>3)</sup>	3.0	2.4	2.6	1.5	2.2	1.7
United States	2.9	3.0	3.2	1.7	2.3	1.8
Euro area	1.7	1.8	1.8	1.6	2.2	1.8
Japan	3.9	1.0	2.1	-0.7	0.1	0.3
United Kingdom	1.4	1.7	2.2	3.3	3.8	2.0
Emerging and developing economies <sup>3)</sup>	7.1	6.5	6.5	6.3	6.9	5.3
China	10.4	9.2	9.0	3.3	4.4	3.6
India	8.1	8.2	8.3	12.1	7.0	5.9
Russia	4.0	4.3	6.9	8.6	7.2	7.2
Brazil	7.4	4.5	4.8	5.0	5.7	4.9
Venezuela	-2.4	1.6	1.9	28.8	30.5	29.1
Caribbean region	2.5	3.3	3.8	6.9	6.1	5.2

#### Notes:

<sup>1)</sup> Percentage change. The figures for 2010 are either actual outcomes, or estimates published by national agencies or in the IMF's World Economic Outlook. The projections for 2011 and 2012 are calculated by the CBA from different sources, unless otherwise stated.

<sup>2)</sup> In percent.

<sup>3)</sup> From IMF-World Economic Outlook.

Continues 



In an environment of slow recovery, real GDP in the advanced economies is expected to expand by 2.5 percent in both 2011 and 2012. The U.S. economy is projected to advance by 3.1 percent in 2011 and 3.2 percent in 2012, whereby the 2011 growth most likely will profit from the new fiscal package passed in late 2010. Spending by households will gain momentum as disposable income edges up, while the unemployment rate is on a descending path, albeit unhurried.

The pace of recovery of the euro area will be slower in 2011 and 2012 than in the United States, given the unfading concerns about European sovereign debt and the required fiscal consolidation in many European countries. Growth in emerging and developing economies is expected to remain robust at 6.5 percent in the next two years, with developing Asia on the front row of rapid growth. Nevertheless, other emerging and developing regions are also projected to post strong performances. China's growth rate is likely to remain robust, downshifting somewhat from the fast pace set in the previous years.

Inflationary pressures will remain subdued in most advanced economies during 2011 because of the low levels of capacity utilization. In emerging and developing economies, prices already are flaring up because of the strong increase in food and commodity prices. While runaway inflation is not likely, further acceleration in prices could cause central banks in these countries to tighten their monetary policies, thereby increasing the risk of renewed deterioration in their economies. In 2011, inflation is forecast to reach 6.0 percent in the emerging and developing economies, and 1.6 percent in the advanced economies.

This outlook has important downside risks, the key one being the sovereign debt crisis that remains latent in the euro area because of which a deepening of this crisis cannot be ruled out entirely. Another risk involves the exceptional increases in food and other commodity prices, which may constrain the recovery in the world economy. This risk has become even bigger recently because of the political turmoil in some North African and Middle Eastern countries.

growth in these economies, however, moderated somewhat with the withdrawal of stimulus actions toward the latter part of the year. The economic performance of these countries is showing signs that their economies remained resilient. China was once again the leader in the recovery, posting a 10.4 percent GDP growth. On the other hand, that country recorded 3.3 percent inflation, owing to abundant domestic liquidity, a sharp jump in food prices, and an upward movement in nonfood prices.

The euro area also showed signs of recovery, when it experienced a 1.7 percent economic expansion in 2010. The recovery, which started in the export sector, subsequently contributed to strengthening domestic demand. However, the recovery has been uneven among the member countries of this region with the German economy leading the way with strong growth in capital goods exports, and economic activity in Ireland and Greece remaining fragile. Inflation in the euro area stretched to 1.6 percent, where higher energy prices played a significant role (Table in Box 2.1).

Overall, unemployment jumped to 10.0 percent, reflecting limited employment opportunities in an environment of generally frail recovery.

The economies of Latin America and the Caribbean consolidated on the recovery process that started in the second half of 2009 in most countries. For the region as a whole, real GDP showed 6.1 percent growth in 2010. The South American region recorded the lion's share of this economic growth, expanding by 6.5 percent. Underpinning the robust economic growth has been the counter-cyclical policies implemented in various countries as well as a more attractive international environment (recovered trade and a rebound in commodity prices). Moreover, increased employment, expanded credit, and improved consumer confidence stimulated private consumption, which, together with investment in machinery and equipment, were the principal factors driving demand.

In the Caribbean, with its heavy reliance on income from tourism and output growth in the

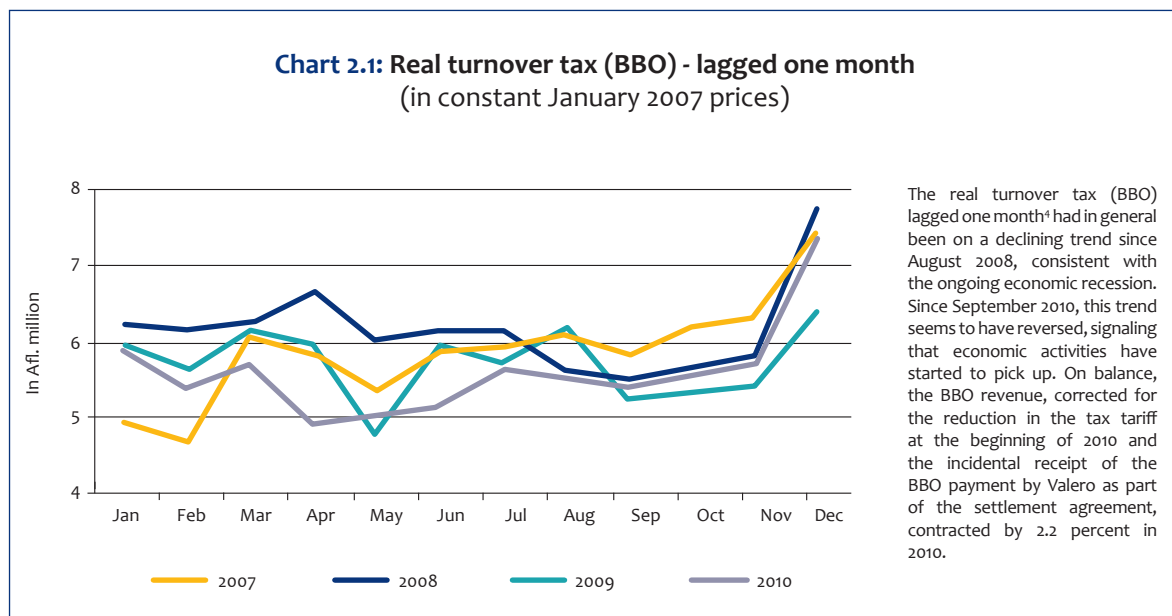
United States, the economic recovery remained stuck in first gear, with an average growth rate of 2.5 percent. This challenging economic situation persisted, despite improvements in workers' remittances and tourist spending. Unlike some of the South American countries, most countries in the Caribbean were unable to respond to the crisis with sustained fiscal and monetary stimuli as they battled the chronic problems of twin deficits and a high public debt level. In addition, the Caribbean region was impacted by several major natural disasters in 2010, with Haiti among the hardest hit.

### 2.2 Domestic real sector

When the world economy appeared set in 2010 for the first significant expansion in three years and the crisis was making room for economic recovery on a global scale, Aruba's economy remained in rough waters. The storm that had been hammering the Aruban economy since 2008 did not cease in 2010, although it was downgraded to some extent. This time, the main factor in preventing economic recovery was on the domestic front, where the temporary shutdown of the Valero refinery was heavily felt throughout the economy. The overall decline in economic activity resonated to its full

extent because refinery operations remained dormant for the whole year. Moreover, the economic recovery in the United States (Aruba's main tourism origin market) was insufficient to trigger a significant rebound in either tourist arrivals or tourism receipts in real terms. Business investment experienced a steep decline due to the increased uncertainty among businesses and consumers, the moderate tourism performance, and the challenging international economic environment. More worrisome has been the lack of major investment projects under execution to jumpstart the economy; several planned projects, both private and public, encountered significant delays. Under these weak economic circumstances, unemployment remained relatively high, especially in the construction sector. As a result, reduced disposable income contributed to stagnant consumer demand, triggering a slowdown in business sales as evidenced by a contraction in the real turnover tax (BBO) revenue in 2010 (Chart 2.1).

At the beginning of 2010, the government reached an agreement with the Valero Energy Corporation (VEC) resolving a lengthy and complicated tax dispute. As part of this agreement, the government enacted a new tax regime applicable to the refinery. Under the new system,



<sup>4</sup> The real turnover tax (BBO) receipts in a given month reflect the transactions in the previous month. Therefore, the receipts are lagged one month to reflect these transactions.



the refinery will be subject to a flat profit tax of 7 percent and a dividend withholding tax rate of zero percent. Additionally, all imports and exports of the refinery are exempt from the turnover tax and throughput fees of any kind. Under this agreement, as of June 2012, the refinery will make a minimal annual tax payment of US\$ 10 million with the ability to carry forward as a tax credit, any excess tax payments to be applied to future tax liabilities. Pursuant to the terms of the agreement, the refinery relinquished the provisions of the previous tax holiday regime.

Moreover, the agreement also provided for the refinery to pay the previously disputed amounts with respect to the turnover tax, dividend tax, and wage tax against a full exoneration from all tax claims prior to June 1, 2010. This agreement, ratified by Parliament in May 2010, together with improved margins on heavy sour crude oil, induced the VEC to announce in June 2010 the intention to restart the operations of the refinery within 90 days. This news was well received and constituted a much needed bright spot in the domestic economic environment. It also meant that the refinery had to embark on a program of investment, a so-called turn-around, to prepare for the intended restart. Aside from its positive

effect on employment in the construction sector, the announcement also brought forward renewed confidence in other sectors of the economy in the last half of 2010.

Given the dramatic direct, indirect, and induced impacts that the shutdown of the refinery had on economic performance in both 2009 and the first half of 2010, it appeared that the worst was over, and the economy could finally build up some momentum. In retrospect, however, the restart of the refinery took longer than previously anticipated, delaying the expected economic impact on the economy. On balance, the estimated real GDP contracted 2.8 percent in 2010 (Table 2.2).

The deteriorated labor market conditions, lower real disposable income, and the uncertainties surrounding the future of the Valero refinery led to decreased private consumption, down by as much as 0.3 percent on a 12-month basis. Private consumption contributed 0.2 percentage point of the decrease in real GDP (Chart 2.2).

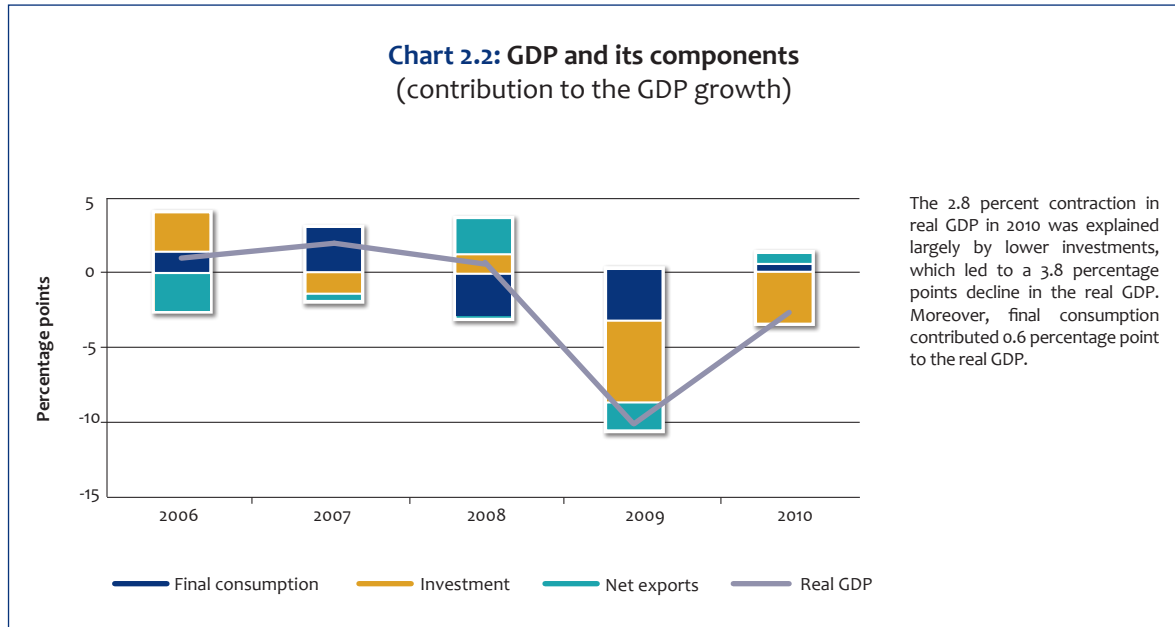
Private investment continued on a steep decline, although at a lower pace than the year before. Private investment was 9.9 percent lower in 2010. Investment was constrained, to a large extent, by reduced business investment. The higher capital expenditure of the oil refinery for

**Table 2.2: Gross domestic product**  
(percentage change)

	2006	2007	2008	2009	2010
<b>1. Aruba: Real GDP and its components</b>					
Real gross domestic product	1.1	2.0	0.2	-11.0	-2.8
Final consumption	1.7	4.7	-4.2	-3.7	0.7
Gross capital formation	6.5	-3.6	-16.6	-16.6	-9.9
Exports	-2.1	3.8	1.7	-12.5	-10.0
Imports	1.4	3.1	-1.7	-8.4	-8.1
<b>2. Selected Caribbean countries: Real GDP</b>					
Bahamas	3.5	1.9	-1.7	-4.3	0.5
Barbados	3.6	3.8	-0.2	-5.5	-0.5
Eastern Caribbean Currency Union <sup>1)</sup>	3.6	4.6	2.0	-4.7	-0.3
Jamaica	5.1	1.4	-0.9	-3.0	-0.1
Former Netherlands Antilles	3.0	3.2	2.4	-0.5	0.2
Trinidad & Tobago	2.1	4.8	2.4	-3.5	1.2

Source: CBA; DEZHI; CBS Aruba; CBS Curaçao; CBCS; Eastern Caribbean Central Bank; IMF.

<sup>1)</sup> Comprising Antigua and Barbuda, Dominica, Grenada, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines.



the restart was unable to ameliorate the decline. Public investment lessened by 10.1 percent due to delays in several projects funded by the Fondo Desaroyo Aruba (FDA). Overall, private plus public investment declined by 9.9 percent in 2010.

The subdued performance in the tourism sector and the temporary shutdown of the refinery were paralleled by a decline in exports of goods and services. Specifically, the rate of growth of exports of goods and services dropped by 10.0 percent in 2010. The temporary shutdown of the refinery implied that it did not process any oil in 2010 (Table 2.3), resulting in a negligible volume of both refined oil exports and crude oil imports. This explains the substantial reductions, on a transaction basis, in the value of exports of refined oil of 95.4 percent and crude oil imports of 77.7 percent. Consequently, the refinery presented an overall net loss of Afl. 288.2 million (US\$ 161 million) in 2010, comparable to the Afl. 298.9 million (US\$ 167 million) loss in 2009.<sup>5</sup>

The investments related to the preparation of the restart of the refinery boosted imports in the product categories “base metals and derivated works” and “machinery and electrotechnical equipment” by Afl. 26.3 million in the fourth quarter of 2010. Nevertheless, the Central Bureau

of Statistics (CBS) reported that total merchandise imports on a transaction basis decreased by 17.8 percent to Afl. 1,605.6 million in 2010.

For many years, the tourism sector has been the island’s leading economic sector. Its role is only partly reflected in the estimated direct contribution to GDP, which in 2010 amounted to 51.4 percent (Table 2.4). A more accurate measure of the importance of tourism receipts is the sector’s contribution to Aruba’s foreign exchange earnings, as recorded in the balance of payments (BOP). In 2010, these earnings amounted to Afl. 2,212.0 million.

The year 2010 started off strongly, but then witnessed a deceleration in the growth rate of tourist arrivals in the latter part of the year. The 2010 figures show an increase of nearly 1.6 percent in tourist arrivals, a rise of 5.2 percent<sup>6</sup> in visitor nights, and a modest growth of nearly 2.2 percent in tourism receipts (Table 2.4). In terms of the ratio of tourism’s contributions to the current account receipts of the rest of the economy (excluding the oil sector), tourism receipts gained 0.5 percentage point to 70.4 percent. On the other hand, cruise tourism was colorless, as fewer ships called in, bringing 6.2 percent fewer passengers to Aruba.

<sup>5</sup> Source: Valero Energy Corporation Form 10-K for the fiscal year ended December 31, 2010.

<sup>6</sup> For the period January-October 2010.



The hotel industry benefitted from the increase in tourism arrivals. Estimates using the available data for the first eight months of 2010 indicate

that the average daily rate (ADR) was nearly 0.8 percent lower than in the corresponding months of 2009, while the revenue per available room

**Table 2.3: Main indicators of the real sector**

	2006	2007	2008	2009	2010
<b>1. Merchandise trade statistics<sup>1)</sup></b>					
Exports of goods (in Afl. million)	46.4	55.7	54.7	52.0	41.6
Imports of goods (in Afl. million)	1,736.7	1,874.9	1,891.2	1,777.6	1,605.6
Trade balance (in Afl. million)	-1,690.3	-1,819.2	-1,836.5	-1,725.6	-1,564.0
<b>2. Utilities</b>					
Water consumption (in thousand m <sup>3</sup> )	11,473.6	11,749.5	11,444.9	11,383.1	11,046.8
Electricity consumption (in thousand kWh)	761,361.6	781,072.6	764,291.0	773,908.7	789,581.1
Gas consumption (in thousand pounds)	19,275.4	19,979.0	20,485.6	20,510.6	20,399.3
Utilities index (1996=100)	139.4	142.9	140.1	141.1	142.6
<b>3. Airport activities</b>					
Number of airport passengers	1,638,126	1,837,413	1,973,561	1,923,623	1,984,173
Number of aircraft landings	33,088	35,774	36,818	38,355	38,404
<b>4. Oil refining</b>					
Exports of refined oil (in Afl. million)	8,100.8	8,500.0	9,215.6	3,194.1	145.8
Imports of crude oil (in Afl. million)	6,533.8	7,233.9	8,513.2	2,503.7	558.3
Quantity of oil refined (in thousand barrels)	61,486	65,525	58,259	35,767	0
Number of employees <sup>2)</sup>	709	695	673	649	615
<b>5. Construction</b>					
Number of construction permits granted	1,303	1,151	962	857	899
Value of construction permits granted (in Afl. million)	525.7	447.6	670.5	343.2	488.8
Cement imported (in thousand kg)	78,412.6	77,832.2	67,040.5	49,746.0	35,649.3
Electrical installations approved	2,463	2,138	2,272	2,021	1,506
<b>6. Gross value added by sector of economic activity (in Afl. million)</b>					
Electricity, gas and water supply <sup>3)</sup>	144.6	146.3	147.9	143.3	151.8
Manufacture of refined petroleum products <sup>3)</sup>	248.0	257.4	294.8	211.7	13.5
Construction	319.4	346.2	303.8	228.0	185.8
Wholesale and retail trade, repair of motor vehicles and household goods	409.6	445.2	464.0	367.5	381.1
Hotels	289.9	306.5	319.8	255.1	271.3

**Source:** CBA; CBS Aruba; WEB; ELMAR; Arugas; AAA; Valero.

<sup>1)</sup> Excluding mineral fuels and free-zone goods; on a transaction basis.

<sup>2)</sup> Employees directly employed by the refinery at the end of the year. Thus, this figure excludes personnel employed through contractors.

<sup>3)</sup> The figures for 2006-2009 are estimates by the CBA. The figures for 2010 are forecasts by the CBA.

**Table 2.4: Main indicators of tourism activity**

	2006	2007	2008	2009	2010
Tourism receipts (in Afl. million)	1,895.5	2,162.7	2,400.5	2,164.3	2,212.0
Tourism receipts (as a percentage of nominal GDP)	43.7	46.2	48.8	48.3	51.4
Tourism receipts per capita (in Afl.)	18,433	20,794	22,800	20,304	20,582
Stay-over visitors (in thousands)	694.4	772.1	826.8	812.6	825.5
Stay-over visitors per capita	6.8	7.4	7.9	7.6	7.7
Visitor nights (in thousands)	5,470.5	5,879.9	6,264.7	6,172.9	n.a.
Average occupancy rate of resorts (in percent) <sup>1)2)</sup>	76.8	77.3	76.6	74.7	78.1
Average daily rate of resorts (in Afl.) <sup>1)2)</sup>	316.7	322.2	327.0	313.3	321.3
Revenue per available room (in Afl.) <sup>1)2)</sup>	146.6	150.8	144.8	133.3	146.6
Cruise visitors (in thousands)	591.5	481.8	556.1	606.8	569.4
Aruba's market share in the Caribbean (in percent)					
- Stay-over visitors	3.5	3.8	4.0	4.1	3.9
- Cruise tourism	3.1	2.5	2.9	3.1	2.7

Source: CBA; ATA; CBS Aruba; CTA; CTO.

<sup>1)</sup> Contains both hotels and timeshares. Due to the business structure of timeshare properties in Aruba, the theoretical link between the average occupancy rate, the average daily rate, and the revenue per available room is not valid for timeshares and, thus, cannot be calculated from the aggregated figures presented in this table.

<sup>2)</sup> Preliminary figures for 2010 are for the period January – August 2010.

(RevPar) went up by 4.5 percent in the same period. Moreover, the average occupancy rate was estimated at nearly 78.1 percent, equivalent to 1.9 percentage points above the corresponding level of a year earlier.

In 2010, tourist arrivals in the Caribbean region benefitted from the global economic recovery, with Cancun & Cozumel and the Bahamas having the best performances (Chart 2.3). On balance, tourist arrivals in the Caribbean region increased by 6.3 percent, 4.7 percentage points larger than the 1.6 percent expansion in Aruba. This growth differential was due in part to a tourist arrivals base effect, that is, in 2009 the number of tourist arrivals contracted more strongly in the Caribbean region as a whole than it did in Aruba. Consequently, Aruba's share in Caribbean stay-over tourism deteriorated to 3.9 percent. Compared to its Caribbean peers, cruise tourism in Aruba was lackluster, causing its market share in the Caribbean to diminish by 0.4 percentage point to 2.7 percent.

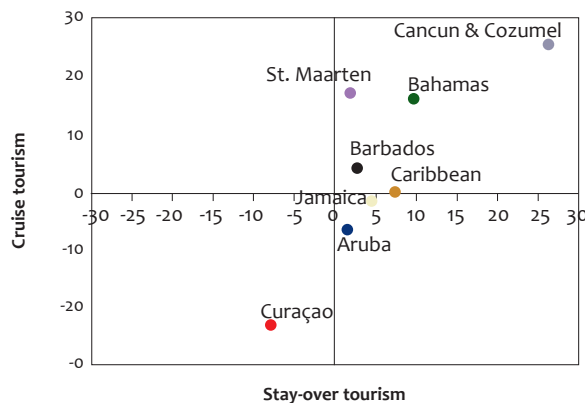
Retail trade, including motor vehicles, recorded a modest improvement in 2010, bringing the nominal output of the retail trade sector somewhat above the depressed level of 2009, but still a long way from the level recorded in 2008. The advance in 2010 was attributed to the nominal growth in private consumption and tourism receipts as well as increased demand from tourism related companies such as hotels and restaurants.

The output of the construction sector continued to be negatively affected by the further contraction in business activities, as indicated by a decline in the volume of imported cement in 2010. This sector contracted by 18.5 percent in nominal terms, attributed primarily to the extended weakness in private investment as well as the inactivity at the oil refinery.

The nominal output of the utilities sector moved upward in 2010, as utility tariffs were on average higher than in 2009. The impact of the increased tariffs outweighed the effect of the



**Chart 2.3: Growth in stay-over and cruise tourism in 2010 in selected Caribbean destinations and the Caribbean as a whole (percentage change)**



In 2010, both the stay-over tourism of Aruba and Jamaica performed well. Yet their respective cruise markets experienced a contraction, with Aruba suffering the largest setback. Cancun and Cozumel, and to a lesser extent the Bahamas, St. Martin and Barbados, posted positive results in both stay-over and cruise tourism, a picture in line with the average for the Caribbean. Curaçao saw decreases in both the cruise industry and their stay-over business.

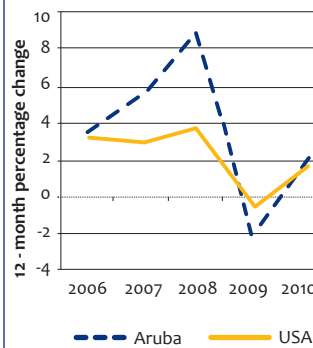
deterioration in consumption and, subsequently, production of water and gas. In contrast, the consumption of electricity, by both households and businesses, continued to increase, despite the higher tariffs. On balance, the volume of utility consumption, as measured by the utilities index, increased by 1.1 percent, in essence because of the greater demand for electricity.

Spurred by the higher oil prices on the international markets and the related upward adjustments of the utilities tariffs and gasoline prices, the 12-month average growth in the CPI of Aruba logged an inflation of 2.1 percent, after recording a deflation of 2.1 percent in 2009. When adjusted for the energy-related components (water, electricity and gasoline), Aruba's CPI showed a deflation of 0.6 percent in 2010, compared to an inflation of 2.3 percent a year earlier (Table 2.5).

The inflation rate in Aruba was 0.4 percentage point higher than that in the United States, resulting in an increase in the real exchange rate index of the Aruban florin vis-à-vis the U.S. dollar, and a deterioration in Aruba's competitiveness in foreign trade (Chart 2.4).

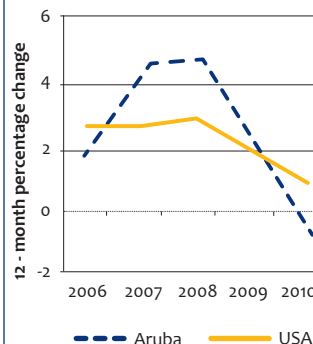
A different picture emerges when the inflation is adjusted for the energy-related component. In that case, the CPI in the United States was 1.5 percentage points larger than that in Aruba (Chart 2.5).

**Chart 2.4: Inflation Aruba versus the USA**



The inflation differential with the United States widened in recent years, because changes in the prices of the energy-related components have a greater impact on Aruba's CPI than that of the United States. The differential reached a peak in 2008 when oil prices reached their highest level and subsequently receded in 2009. In 2010, oil prices were on the rise again, lifting Aruba's inflation higher than that of the United States.

**Chart 2.5: Inflation excluding energy Aruba versus the USA**



When correcting for the energy-related components (water, electricity, and gasoline), there was a differential building up between 2007–2008, most likely reflecting the effects of higher food prices as well as the introduction of the BBO. In 2010, the energy adjusted CPI in Aruba again moved below the U.S. figure.

**Table 2.5: Consumer price index**

	2006	2007	2008	2009	2010
1. Aruba: inflation indicators					
12-month average (in percent)	3.6	5.4	9.0	-2.1	2.1
12-month average excluding energy (in percent)	1.9	4.2	4.7	2.3	-0.6
12-month average excluding food & energy (in percent)	1.4	3.0	3.3	1.8	-0.3
End of period (in percent)	2.5	9.9	-1.9	6.8	-0.7
Real effective exchange rate index (1995 = 100) <sup>1)</sup>	105.4	108.0	113.4	111.3	111.8
2. Selected Caribbean countries: 12-month average inflation (in percent)					
Bahamas	1.8	2.5	4.5	2.1	1.7
Barbados	7.3	4.0	8.1	3.7	5.0
Eastern Caribbean Currency Union <sup>2)</sup>	4.0	3.6	7.1	0.4	2.2
Netherlands Antilles	2.9	2.8	6.3	1.6	2.9
Trinidad & Tobago	8.3	7.9	12.0	7.0	9.4

**Source:** CBA; CBS Aruba; CBS Curaçao; CBCS; Central Bank of the Bahamas; Central Bank of Barbados; Eastern Caribbean Central Bank; Statistical Institute of Jamaica; Central Bank of Trinidad & Tobago; IMF.

<sup>1)</sup> Against the U.S. dollar.

<sup>2)</sup> Comprising Antigua and Barbuda, Dominica, Grenada, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines.

### 2.3 Financial sector

On the financial front, the CBA noted a net outflow of foreign funds of nearly Afl. 167.0 million during 2010. Notwithstanding an expansion in net domestic assets, which countered much of the outflow in foreign funds, the result was a nearly 0.3 percent contraction in the money supply, equivalent to Afl. 8.8 million (Table 2.6). The money supply at end-2010 amounted to Afl. 3,154.8 million. The origin of the net outflow in foreign reserves was related, above all, to the external transactions of the oil sector.

The consequence was a reduction in the net foreign assets of the monetary system (excluding revaluation differences of gold and official foreign exchange holdings) to Afl. 1,308.1 million, much less than the level of Afl. 1,475.1 million at the end of 2009 (Chart 2.6).

After two consecutive years of decrease, net domestic assets were on the rise again by Afl. 158.3 million in 2010. The upward move in this indicator reflected the increase in net claims on the public sector as domestic commercial banks invested in

government bonds. The banking sector's credit to the private sector continued to be fragile, with the exception of housing mortgages, a clear sign that the economy remained lackluster. Consumer credit and loans to enterprises were, respectively, Afl. 16.6 million (-2.9 percent) and Afl. 5.6 million (-0.5 percent) lower. The latter reflected to a large extent declines in loans to the construction and manufacturing sectors.

On the other hand, housing mortgages expanded by Afl. 47.5 million (+5.8 percent), believed to be largely associated with refinancing activities, as housing construction stayed weak. In the end, the aggregated commercial bank lending grew by 6.1 percent during 2010, but excluding the purchase of government bonds by the commercial banks, lending edged up by a modest 1.4 percent.

Despite the downturn in the money supply, its ratio to nominal GDP grew by 1.2 percentage points to 71.8 percent in 2010 as the contraction in nominal GDP outpaced that of the money supply. Money, in narrow terms, declined by 10.9 percent, largely the result of a 19.2 percent decrease in demand deposits of private enterprises. Quasi-

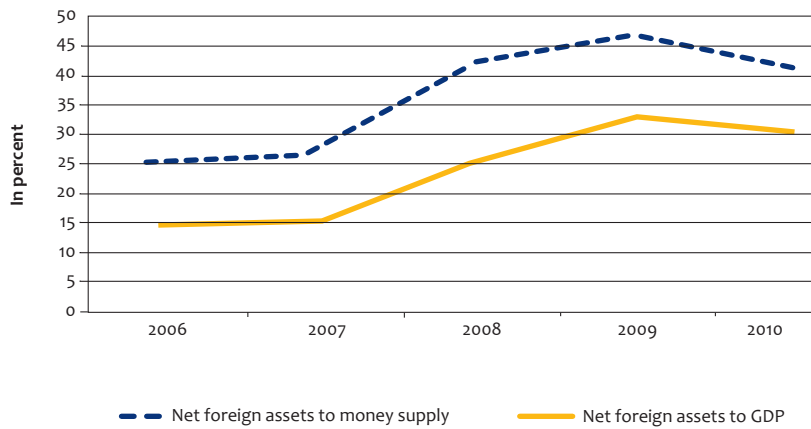


money extended by 9.8 percent, given a significant rise in savings and time deposits of development funds, private enterprises, and other financial institutions.

Total assets of the nonmonetary financial institutions expanded by Afl. 75.2 million, (+2.8

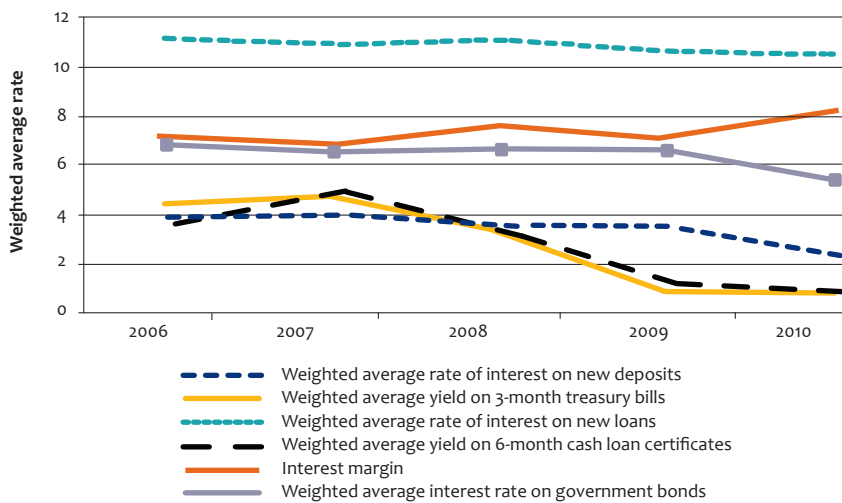
percent), mirroring first and foremost higher prices of securities on international markets in an environment of improved financial market conditions. The increased assets of these businesses depicted a general rise in net foreign assets, which to some extent was mitigated by a

**Chart 2.6: Net foreign assets**



The ratios of net foreign assets (excluding revaluation differences of gold and official foreign exchange holdings) to money supply and to GDP are generally used as indicators of reserve adequacy. Their patterns are similar: after being on a rising trend since 2007, the ratios retreated in 2010 due to the decline in net foreign assets but remained adequate, when compared to historical averages<sup>7</sup> and to the ratios for both small tourism-dependent economies<sup>8</sup> and selected Caribbean countries<sup>9</sup>.

**Chart 2.7: Interest rates of commercial banks and average yield on government papers**



The interest rate margin between commercial bank loans and deposits was 1.1 percentage points higher in 2010 and reflected a steeper cut in the weighted average interest rate on new deposits than on new loans (the latter comprising loans to enterprises, housing mortgages and consumer credit). The weighted average yield on short-term government papers (consisting of 3-month treasury bills and 6-month cash loan certificates) continued on a downward slope for the third year in a row, reflecting in part the increased liquidity in the capital market.

<sup>7</sup> The average ratio of net foreign assets to money supply during the period 1986-2009 was 33.6 percent.

<sup>8</sup> Including Croatia, Cyprus, Fiji, The Gambia, Jordan, Lebanon, Maldives, Malta, (former) Netherlands Antilles, Samoa, São Tomé, Seychelles, Vanuatu, and Togo.

<sup>9</sup> Including Bahamas, Barbados, Belize, Guyana, Haiti, and Jamaica.

**Table 2.6: Causes of changes in the money supply**  
(in Afl. million)

	2006	2007	2008	2009	2010
1. Net domestic money creation	1.8	19.1	-128.4	-33.0	158.3
Net domestic credit	53.8	90.0	-47.4	16.6	162.9
- Public sector	-48.1	3.3	-146.1	39.7	134.4
- Private sector	101.8	86.7	98.6	-23.2	28.5
Other domestic factors	-52.0	-70.9	-81.0	-49.6	-4.6
2. Inflow of foreign funds <sup>1)</sup>	55.8	63.0	552.3	206.2	-167.0
Oil sector	229.9	95.5	141.8	70.6	-127.7
Non-oil sector	-174.2	-32.5	410.5	135.7	-39.4
Current account (net)	-45.0	-157.9	-295.2	234.5	-734.3
Capital and financial account (net) <sup>2)</sup>	100.7	220.8	847.5	-28.3	567.3
3. Broad money creation	57.5	82.0	423.9	173.2	-8.8
Money	82.4	99.7	249.6	144.6	-168.2
Quasi-money	-24.9	-17.7	174.3	28.6	159.4
4. Key indicators (in percent)					
12-month change in money supply	2.4	3.3	16.5	5.8	-0.3
Broad money coverage <sup>3)</sup>	26.3	27.9	42.4	46.6	41.5
Money supply to GDP	57.2	54.8	60.9	70.6	73.3
Reserve to monetary base <sup>4)</sup>	150	155	153	144	135
Liquidity banking sector (in Afl. million) <sup>5)</sup>	986.4	1,080.1	1,429.1	1,579.9	1,612.1
Credit growth (in Afl. million)	95.9	91.2	62.8	-1.7	161.7

Source: CBA.

<sup>1)</sup> Revaluation differences of gold and official foreign exchange holdings are excluded to approximate the net import of foreign funds by the nonmonetary sectors.

<sup>2)</sup> Including items not yet classified and errors and omissions.

<sup>3)</sup> Ratio (in percentages) of net foreign assets of the monetary system to broad money.

<sup>4)</sup> Ratio (in percentages) of official reserves to the monetary base (i.e., total bank notes issued and outstanding liabilities to the banking system).

<sup>5)</sup> Total available liquid assets. Liquid assets comprise assets with a remaining maturity of less than one year, and consist here of cash, demand and time deposits at the CBA and commercial banks, short-term securities, government bonds, and other marketable securities.

decline in domestic claims on enterprises (Table 2.7). In 2010, the share of the nonmonetary financial institutions in total housing mortgages diminished to 38.8 percent, or 1.0 percentage point less than in 2009. This decrease occurred despite the increase in the total amount of housing mortgages granted by the nonmonetary financial institutions for the fifth consecutive year.

On the liability side, it is important to note that the pension fund provisions and the insurance reserve fund were, respectively, 7.2 percent and 7.5 percent higher in 2010 than in 2009. Moreover, the growth in the negative amount of the other items (net) was telling, and primarily reflected higher time deposits held by the nonmonetary financial institutions.



**Table 2.7: Nonmonetary financial institutions<sup>1)</sup>**  
(end of period, in Afl. million, unless stated otherwise)

	2006	2007	2008	2009	2010
1. Net foreign assets	671.8	797.4	570.9	694.1	800.2
2. Domestic claims	1,542.6	1,671.9	1,733.1	2,025.8	1,994.8
Government	693.5	739.1	678.0	836.6	834.8
Nonfinancial public enterprises	58.0	51.9	86.6	90.4	87.6
Enterprises	238.5	286.9	325.6	436.5	393.1
Individuals	552.6	594.0	643.0	662.3	679.4
- Consumer credit	103.1	108.9	116.1	118.1	128.6
- Housing mortgages	449.5	485.1	526.9	544.1	550.8
3. Total assets = total liabilities	2,214.4	2,469.4	2,304.0	2,719.9	2,795.1
4. Borrowings and deposits	38.5	37.8	37.0	39.0	38.9
Government	36.6	36.6	36.6	38.6	38.6
Other residents	1.8	1.2	0.4	0.4	0.3
5. Pension fund provisions	1,750.4	1,835.0	2,396.4	2,452.7	2,628.5
6. Insurance reserve fund	400.0	445.7	510.5	603.8	649.1
7. Other items (net)	25.5	150.9	-640.0	-375.6	-521.5
8. Key indicators					
Net foreign assets in percent of GDP <sup>2)</sup>	15.5	17.0	11.6	15.5	18.6
Total assets in percent of GDP <sup>3)</sup>	75.3	75.7	72.7	92.0	101.9
Share in total housing mortgage market	37.4	38.0	39.6	39.8	38.8

Source: CBA.

<sup>1)</sup> Comprising mortgage banks, pension funds (including the APFA), life insurance companies, finance companies, the AIB Bank N.V., the Social Security Bank (SVB), and the IBA Corporation N.V. (established in October 2003 to support the settlement of the takeover of the Interbank Aruba N.V. by the Aruba Bank N.V.). As of the third quarter of 2009, nonlife insurance companies also are included in the statistics of the nonmonetary financial institutions.

<sup>2)</sup> Ratio of net foreign assets of the nonmonetary financial institutions to nominal GDP.

<sup>3)</sup> The calculation of this ratio cannot be derived from this table, because in the “other items (net)”, the other assets components are netted out with other liabilities.

## 2.4 Government finance

The declined economic activity further aggravated the government finances in 2010. On a cash basis, the financial deficit as a proportion of GDP reached 4.9 percent, equivalent to Afl. 210.0 million (Table 2.8 and Chart 2.8). The deficit was brought about by an increase in expenditures of

Afl. 129.2 million, a decline in grants of Afl. 46.4 million, and a deterioration of Afl. 20.1 million in other nontax revenues. The decreases in grants and other nontax revenue were compensated to some extent by an Afl. 141.4 million rise in tax income.

Most of the growth in tax revenue can be explained by the incidental receipt of

**Table 2.8: Government financial operations<sup>1)</sup>**  
(in Afl. million)

	2006	2007	2008	2009	2010
1. Revenue and grants	985.2	1,034.0	1,365.1	1,108.9	1,183.8
Tax revenue	850.2	882.2	977.0	928.9	1,070.3
Nontax revenue	135.0	151.8	388.1	180.0	113.4
- Grants <sup>2)</sup>	32.7	34.1	275.5	52.4	6.0
- Other nontax revenue	102.3	117.7	112.7	127.6	107.5
2. Expenditures	1,097.6	1,084.2	1,290.5	1,229.1	1,358.3
Personnel-related outlays	542.2	530.4	580.4	579.2	602.6
Goods and services	203.1	186.9	215.6	205.2	221.1
Interest payments	97.4	106.9	139.7	116.4	126.9
Investments	66.5	57.6	77.8	82.2	75.7
Transfer to the AZV	119.7	85.1	138.2	127.6	155.7
Items n.i.e.	68.9	117.4	139.0	118.4	176.4
- Transfers	55.4	56.9	68.4	72.3	59.8
- Subsidies	26.3	23.6	23.7	25.9	26.1
- Other	-12.8	36.9	46.9	20.3	90.5
3. Lending minus repayments	7.1	21.3	23.1	42.9	35.4
4. Financial deficit (-)	-119.5	-71.4	51.4	-163.1	-210.0
5. Net foreign capital	58.2	29.7	72.6	19.2	57.3
6. Net domestic capital <sup>3)</sup>	109.4	38.4	22.1	104.2	18.3
7. Net recourse to the monetary sector	48.1	-3.3	146.1	-39.7	-134.4
8. Memorandum items					
Unmet financing requirements <sup>4)</sup>	159.4	196.4	64.4	62.8	43.2
Expenditures (including net lending) on a cash-adjusted basis <sup>5)</sup>	1,028.5	1,142.5	1,181.6	1,270.4	1,374.1
Financial deficit <sup>6)</sup>	-43.3	-108.4	183.4	-161.6	-190.4
Total government debt <sup>7)</sup>	2,012.2	2,140.0	2,049.7	2,223.1	2,377.8
- Domestic debt	1,015.2	1,105.9	980.9	1,136.6	1,246.1
- Foreign debt <sup>8)</sup>	997.0	1,034.2	1,068.9	1,086.5	1,131.7

Source: DF; Tax Collector's Office; CBA.

<sup>1)</sup> Preliminary figures on a cash basis, including imputed noncash transactions. This item also includes transactions related to foreign development cooperation.

<sup>2)</sup> The 2008 figure includes the receipt from the Dutch government of part of the proceeds of the sale of the shares of the Plant Hotel N.V., and the debt restructuring funds.

<sup>3)</sup> Net long-term capital attracted from nonmonetary sectors, in most cases by issuing government bonds and private loans. The borrowing from commercial banks is included under item 7, while that of nonresidents is included under item 5.

<sup>4)</sup> Comprising reported unsettled payment obligations to other sectors, irrespective of the timeframe in which they mature.

<sup>5)</sup> Expenditures on a cash basis, including the allocation of changes in unmet financing requirements.

<sup>6)</sup> This item includes the changes in unmet financing requirements.

<sup>7)</sup> Preliminary end-of-period figures.

<sup>8)</sup> At year-end exchange rates.



Afl. 259.9 million associated with the tax settlement reached with the VEC.<sup>10</sup> This settlement entailed that the VEC would effectively pay Afl. 211.6 million of the agreed amount to the Aruban government. The difference (Afl. 48.3 million) was recorded as government expenditure and included in other expenditures. Needless to say, without the mentioned incidental receipt, tax revenue would have contracted by Afl. 118.5 million in 2010, basically because of a sizable decline in both the BBO revenue (for the most part the result of the tariff reduction as of January 2010) and the profit tax (where the economic recession played a part). Unlike the above taxes, the hotel room tax receipts were boosted (+Afl. 8.1 million) in part by two subsequent rate hikes (May 2010 and September 2010). The increased rates reflect the government's intention to institute two funds with the purpose of financing the costs of international promotion of Aruba as a tourist destination and enhancing the Aruban tourist product.

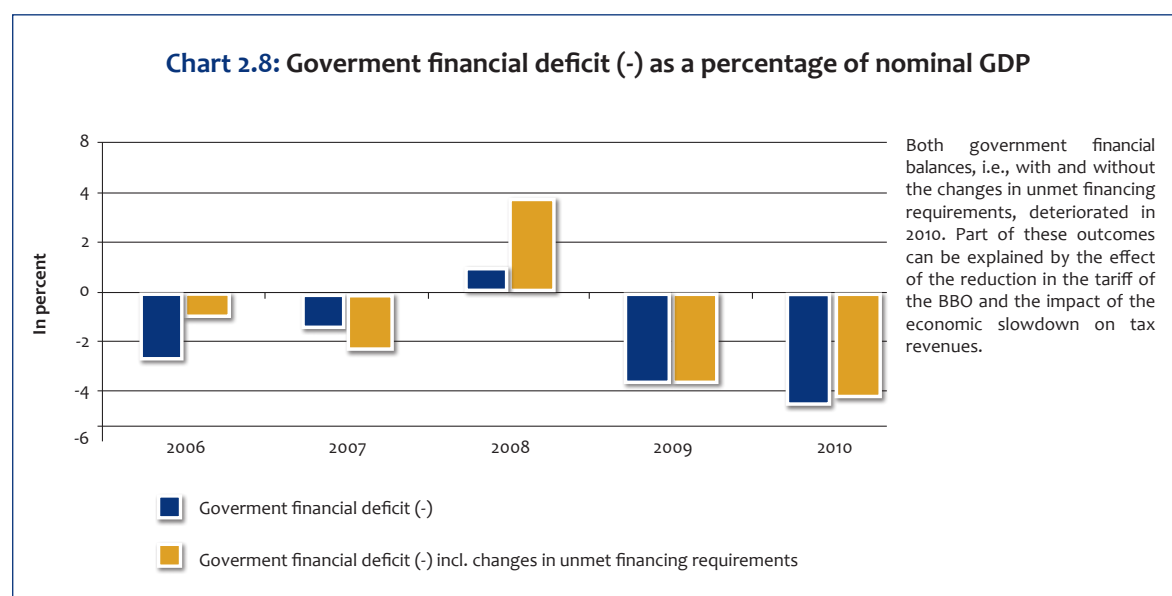
Government expenditures (cash basis, including net lending) grew by Afl. 121.7 million to Afl. 1,393.7 million in 2010, primarily the result of higher personnel-related outlays, transfer to the General Health Insurance (AZV), interest payments, and payments for goods and services.

A reduction in the unmet financing requirements (-Afl. 17.6 million) to Afl. 43.2 million at the end of 2010 indicated that overall expenditures (on a cash-adjusted basis, including net lending) expanded by Afl. 107.7 million to Afl. 1,376.1 million.

Total financing needs of the government reached Afl. 371.4 million in 2010. To cover these required finances, the government issued a series of bonds on the domestic market: Afl. 23.5 million (May 2010), Afl. 180.0 million (June 2010), and Afl. 144.5 million (December 2010). On balance, bank deposits of the government (including the FDA deposits) ended Afl. 15.0 million lower at Afl. 283.1 million.

During 2010, Aruba's outstanding public debt reached Afl. 2,377.8 million or 55.2 percent of nominal GDP (Tables 2.8 and 2.9). The government issued bonds on the domestic market totaling Afl. 348.0 million, and nonresidents (including institutional investors from Curaçao) bought Afl. 133.0 million (38.2 percent) of these bonds. On the other hand, the government repaid Afl. 109.7 million on its domestic debt and Afl. 41.8 million on its foreign debt. In the end, the government's domestic debt rose by Afl. 109.5 million to Afl. 1,246.1 million (52.4 percent of the total debt), while foreign debt expanded by Afl. 45.2 million to Afl. 1,131.7 million.

**Chart 2.8: Government financial deficit (-) as a percentage of nominal GDP**



<sup>10</sup> This receipt consisted of Afl. 211.6 million in turnover tax receipts, Afl. 13.2 million in wage tax receipts, and Afl. 35.1 million in income tax receipts.

### Box 2.2: Social Dialogue

The Social Dialogue was introduced in June 2010, as a forum to find solutions for the structural challenges and fiscal imbalances confronting Aruba. It was modeled after the Dutch Polder Model of economic policy consensus, with representation from labor unions, employer organizations, trade unions, and, of course, the government.

Meetings were held in July and August 2010, resulting in the Protocol of August 27, 2010, in which a number of critical challenges were identified, and where the participating members agreed on a number of economic and social reforms and stimulus packages. Under the Protocol, initial reforms were realized for the civil servants pension fund (APFA), the General Health Insurance (AZV), and the general old age pension system (AOV), all representing large financial responsibilities of the government. Reforms to the APFA included: (1) the computation of pension claims on the basis of average career wages instead of final wages; (2) an increase in the retirement age from 55 to 60 years; and (3) the calculation of APFA pensions net of AOV pension claims. On the other hand, the AOV premium income ceiling was raised and individualized for married couples, while the AZV premiums were increased by 2 percentage points, half to be borne by the employer and the other half by the employee. The government also agreed to several welfare measures aimed at helping the less fortunate, including increased social benefits and tax allowance for those earning a monthly income below Afl. 2,500.

An initial analysis indicates that implementation of these measures will result in a net improvement of government finances in 2011, compared to a situation in which none of these measures was implemented.

**Table 2.9: Additional key indicators of government financial operations**  
(in percent of nominal GDP, unless stated otherwise)

	2006	2007	2008	2009	2010
Financial balance <sup>1) 2)</sup>	-1.0	2.3	3.7	-3.6	-4.4
Revenue and grants	22.7	-22.1	27.8	24.8	27.5
Expenditures (including net lending, on cash-adjusted basis)	23.7	24.4	24.0	28.4	31.9
Primary balance <sup>1) 2)</sup>	1.4	0.1	6.1	-0.9	-1.5
Interest payments <sup>2)</sup>	2.4	2.4	2.3	2.6	3.0
Total debt	46.4	45.7	41.7	49.6	55.2
Foreign debt in percent of exports <sup>3)</sup>	40.3	37.5	35.5	37.9	38.6
Foreign debt service in percent of exports <sup>3)</sup>	3.8	4.6	5.4	3.7	4.7
Difference between actual and budgeted revenue and grants to the budget (in Aflmillion)	-39.9	-47.9	201.1	11.2	40.7
Difference between actual and budgeted expenditures on a cash-adjusted basis compared to the budget (in Afl. million)	-72.1	-47.9	-32.3	-74.3	52.4

Source: DF; Tax Collector's Office; CBA.

<sup>1)</sup> Minus (-) sign denotes a deficit.

<sup>2)</sup> Including change in unmet financing requirements.

<sup>3)</sup> Exports of goods and services, excluding the oil sector.



### **Box 2.3: Main conclusions of the IMF 2010 Article IV Consultation Mission**

In its October 2010 Staff Report within the framework of the 2010 Article IV Consultation Mission, the IMF made evaluations and recommendations with respect to public finances, monetary policy, and financial sector supervision in Aruba. Five main points stand out in mentioned report:

1. *Aruba's economy is gradually recovering from a severe recession but there is no immediate going back to normalcy ...*

A slow and gradual recovery is underway in Aruba, but the growth rates from the pre-crisis years will most likely remain illusive for some time, given lower than expected growth in U.S. consumption (Aruba's main trading partner) and limits to a further quantitative expansion of Aruba's tourism industry.

2. *Serious fiscal challenges still need to be addressed ...*

Aruba's health care and pension schemes have long been structurally underfunded, giving rise to sizeable fiscal liabilities. Recent tax cuts, notably the reduction in half of the rate of the business turnover tax, along with increased spending to combat the recession have further contributed to a large underlying fiscal deficit. The IMF postulated that if left unaddressed, this fiscal deficit would push public debt further on an unsustainable path. The reforms agreed in the context of the Social Dialogue enhance the soundness of Aruba's pension and health care schemes and reduce longer-term downside risks to the fiscal outlook. However, their budgetary impact in the short run is limited.

3. *A medium-term fiscal adjustment program to safeguard the sustainability of the public finances is encouraged ...*

The IMF recommended a program aimed at structurally bringing down the public debt (measured as a share of GDP) even under cautious assumptions about future growth. Such a program will limit the government's interest expenditures, while maintaining access to domestic and external financing at attractive rates, and leaving some room to maneuver in case Aruba is again confronted with external shocks, such as those of 2001/02 and in 2009. Although the IMF agreed with the authorities' intention to achieve a large part of the needed fiscal adjustment through expenditure cuts, recourse to revenue-enhancing measures seems unavoidable given the size of the fiscal gap. For this reason, the IMF advised considering a tax reform that balances fiscal constraints with social priorities. A key component could be a value-added tax designed to fit Aruba's specific needs.

4. *The switch in the CBA's key monetary policy tool is welcomed...*

The IMF embraced the recent shift in the CBA's monetary policy instruments, whereby the credit ceiling was eliminated, and the reserve requirement was simultaneously introduced. However, the transition to the new monetary instruments and the associated risks need to be managed carefully. As long as credit conditions remain depressed, the CBA should continue to leave excess liquidity in the market. Once demand for credit rebounds, the CBA has to be prepared to use the reserves requirement up to its full potential to protect the foreign reserves position in order to safeguard the currency peg.

5. *Challenges to prudential regulation and supervision will likely increase...*

The absence of a credit ceiling may result in more aggressive lending, which in turn could trigger deterioration in banks' lending standards. Therefore, supervisors will be required to monitor market developments closely as well as the strategies and actions of the individual institutions. The IMF further recommended the fostering of competition within the banking sector in Aruba, while safeguarding Aruba's reputation. With respect to the latter, the off-shore financial sector, while small, still carries a potential for reputational risk. The IMF recognized that the conservative regulatory requirements imposed by the CBA together with the high underlying profitability have helped Aruba's banking system get through the tough economic conditions without major strains.

Source: IMF, Kingdom of the Netherlands-Aruba: 2010 Article IV Consultation-Staff Report, October 2010.

The picture of public finances is incomplete if the government's legal obligation to cover the financial deficit of the AZV is not included in the analysis. This responsibility represents an open commitment that, if uncontrolled, will have a structurally dominating effect on government expenditures. Over recent years, the government has gradually increased its financial contribution to the AZV to help cover the operations of this institution. As of January 2011, the AZV premium was up by 2 percentage points as agreed-upon during the Social Dialogue in 2010 (Box 2.2). Considering the expected aging of the Aruban population in the coming years, additional measures must be taken to reform the AZV scheme, making its operations sustainable.

Another potential threat to public finances is the financial situation of the SVB, in particular the General Old Age Pension Fund (AOV). As with the AZV, the government is also responsible for covering the deficit of this fund, which has been running structural deficits in recent years, as the premium contributions to this fund have been less than the paid-out claims. The aging of the Aruban inhabitants plays a role here as well, and this trend of structural deficits will probably continue if no changes are made to the current pension scheme. The SVB has indicated on many occasions that without proper reform, the fund will exhaust its reserves in the near future, and the government will be burdened with the deficits. Therefore, to ensure the sustainability of the fund, the AOV pension age has to be increased in the very short term.

Finally, the significant underfunding of the civil servants pension fund (APFA) forms a latent risk to public finances. Fortunately, some important steps were taken by the government to reform the fund following the agreements reached within the context of the Social Dialogue (Box 2.2). In addition, the APFA has been placed under the supervision of the CBA as of January 1, 2011 and is required to submit a recovery plan in the short term for the CBA's review and approval to improve the financial viability of this pension fund.

## 2.5 Balance of payments

During 2010, the current account of the balance of payments recorded a deficit of Afl. 734.3 million, in contrast to the surplus of Afl. 234.5 million in 2009

(Table 2.10). The inactivity in the oil sector played a large part in the end result, as both exports of refined petroleum products and imports of crude oil were anemic.

The capital and financial account (including items not yet classified) posted an Afl. 567.3 million net inflow in 2010, overshadowing the Afl. 28.3 million net outflow in 2009. This turnaround reflected to a large extent a net inflow of the oil sector in the form of supplier credit received to finance crude oil imports. In contrast, the non-oil sector registered a net outflow of Afl. 130.4 million, attributed to outflows of other investment and direct investment.

The overall result of the balance of payments exhibited a deficit of nearly Afl. 167.0 million in 2010, contrary to a surplus of Afl. 206.2 million a year earlier. The resulting decline in net international reserves was partially mitigated by an Afl. 62.7 million revaluation of gold and foreign exchange holdings. External transactions were conducive to a major fall-off in the net international reserves of the monetary system (including revaluation differences of gold and foreign exchange holdings) of Afl. 104.3 million, reflecting itself in an Afl. 148.1 million contraction in net foreign assets of the commercial banks and an increase of Afl. 43.8 million in the official reserves. Despite the poor performance in the net international reserves, both the 12-month average merchandise import coverage ratio and the coverage ratio of the current account payments improved in 2010 to 12.4 months and 6.3 months, respectively.

The current account balance of the oil sector posted a deficit of Afl. 825.4 million in 2010, as export receipts fell at a faster pace than import payments. The goods account landed in a deficit position (-Afl. 731.9 million), whereby export receipts and import payments were down by the respective amounts of Afl. 2,145.0 million (-89.1 percent) and Afl. 938.8 million (-48.6 percent). The preparation work on the restart of the operations at the refinery still required imported materials, but foreign payments for import-related freight and insurance services were down, resulting in lower deficits on the sector's services account and current transfers account.

The current account of the non-oil sector registered a surplus of Afl. 91.1 million, equivalent to 2.1 percent of nominal GDP, in contrast to the deficit of Afl. 20.3 million in 2009 (Chart 2.9). This improvement reflected smaller deficits on the



**Table 2.10: Balance of payments by sectors<sup>1)</sup>**  
(in Afl. million, unless stated otherwise)

	2006	2007	2008	2009	2010
1. Current account (net)	-45.0	-157.6	-295.2	234.5	-734.3
Oil sector	562.8	80.6	-107.8	254.8	-825.4
Non-oil sector	-607.77	-238.5	-187.4	-20.3	91.1
- Goods	-1,395.4	-1,391.5	-1,473.1	-1,328.1	-1,196.5
- Services	1,136.6	1,433.1	1,617.4	1,538.2	1,591.1
- Income	-187.2	-137.5	-193.2	-111.7	-193.6
- Current transfers	-161.7	-142.6	-138.5	-118.6	-109.9
2. Capital and financial account (net)	117.5	211.5	858.3	-4.3	560.5
Oil sector	-332.9	14.9	249.6	-184.2	697.8
Non-oil sector	450.3	196.6	608.7	179.9	-137.2
- Capital account transactions	37.8	33.9	281.0	60.9	12.4
- Direct investment	524.5	231.4	354.4	126.8	-68.4
- Portfolio investment	-78.6	78.1	103.6	4.6	18.7
- Financial derivatives	-4.8	1.8	-18.4	-1.7	0.0
- Other investment	-28.7	-148.5	-112.0	-10.8	-100.0
- Loans	-81.9	-66.8	-55.6	-26.7	23.5
- Other financial transactions	53.2	-81.7	-56.4	15.9	-123.5
3. Items not yet classified <sup>2)</sup>	-16.7	9.4	-10.8	-24.0	6.8
4. Overall balance (= 1 + 2 + 3)	55.8	63.0	552.3	206.2	-167.0
5. Total reserves of the monetary sector <sup>3)</sup>	759.5	859.2	1,427.5	1,577.0	1,472.7
of which: official reserves	713.9	828.0	1,247.3	1,251.8	1,295.6
6. Import coverage in months of merchandise imports <sup>4)</sup>					
- End-of-period	5.1	5.7	9.4	11.2	10.2
- 12-month average	5.2	5.8	7.2	11.2	12.4
7. Import coverage in months of current account payments <sup>5)</sup>					
- End-of-period	2.6	2.8	4.8	5.9	5.0
- 12-month average	2.7	3.0	3.8	5.9	6.3

Source: CBA.

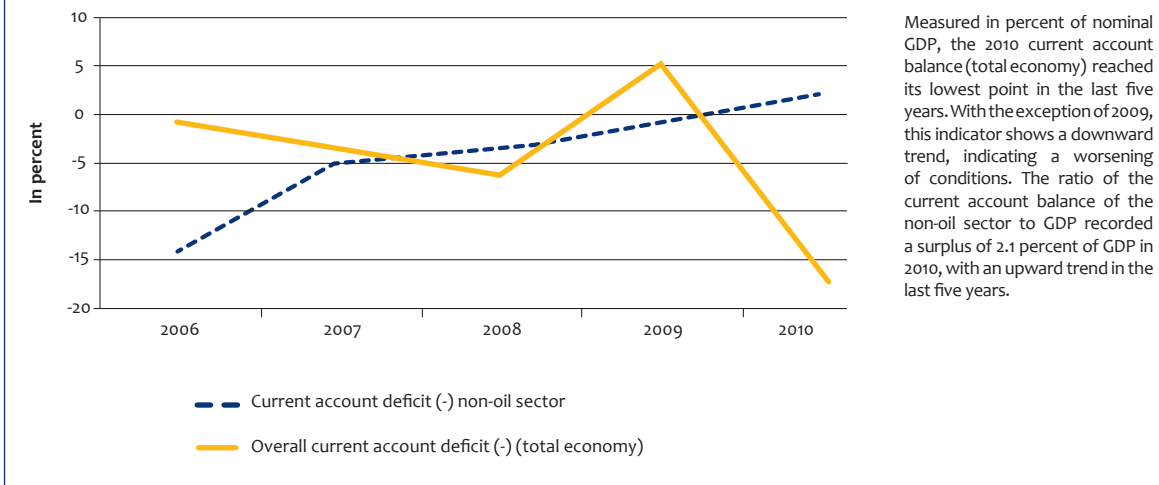
<sup>1)</sup> On a cash basis.

<sup>2)</sup> Including errors and omissions.

<sup>3)</sup> Including net foreign assets of the commercial banks and revaluation differences of gold and foreign exchange holdings.

<sup>4)</sup> Coverage of merchandise imports by total reserves of the monetary system. Imports of the oil sector are excluded.

<sup>5)</sup> Coverage of total payments for merchandise imports, services, income, and current transfers (excluding the oil sector) by total reserves of the monetary system.

**Chart 2.9: Current account deficit (-) as a percentage of nominal GDP**

goods account and the current transfer account, in combination with a larger surplus on the services account.

Merchandise import payments of the non-oil sector were 5.3 percent below the 2009-level, credited mostly to lower purchases of building materials, and to a lesser extent to consumer goods including durable goods such as cars. The contraction in construction activities and weakened consumption bore responsibility for this outcome. The improvement on the services account balance reflected a 2.2 percent increase in tourism receipts, together with decreased services payments abroad, as construction and freight services were in a passive state. On the other hand, higher dividend payments by domestic corporations to nonresident shareholders contributed mostly to the deficit on the income account equivalent to Afl. 81.9 million.

During 2010, the capital and financial account balance of the oil sector shifted to a surplus of Afl. 697.8 million, which mirrored increased net inflows of direct and other investment. The latter was related to the aforementioned supplier credit received to finance crude oil imports. On balance, the transactions of the oil sector were responsible for a net outflow of funds in the amount of Afl. 127.7 million.

In contrast, the capital and financial account of the non-oil sector ended 2010 with a deficit of Afl. 137.2 million, after a comforting surplus of Afl. 179.9 million in 2009. This turnaround

mirrored first and foremost a net outflow of direct investment in connection with the repayment of intercompany loans, the sale of Aruban equity stakes by nonresidents to residents, and lower investment by nonresidents in the domestic real estate market (in, among other things, timeshares). Moreover, other investment also recorded a net outflow because the private sector acquired a smaller amount in short-term credit from abroad and paid advances on imports of goods and services, while an outflow related to other long-term assets as well as an increase in balances of foreign accounts of resident holders resulted in a net outflow of other investment. On the other hand, portfolio investment posted an Afl. 18.7 million net inflow in 2010, in part because of the net selling of foreign money market instruments held by residents together with fewer purchases of foreign debt securities. On the other hand, foreign equity holdings by residents remained at virtually the same level as a year earlier.

## 2.6 Economic outlook

The assumptions underlying the CBA's projections for the short-to-medium term take into account future policy measures that are likely to be implemented. Both projections and policy assumptions are generally based on information available to the CBA at the time of running the regressions.



The scenario of the current projections indicates that the Aruban economy, measured by the growth in real GDP, is expected to rebound in 2011, after experiencing two years of recession. The forecast assumes that the restart of the oil refinery in January 2011 will be the major contributor to the expected economic growth in 2011. Moreover, the construction of the Ritz Carlton Hotel is expected to gain full momentum in 2011, and, together with other investment projects currently in the pipeline, such as investments by the WEB, the Aruba Airport Authority N.V. (AAA), the beautification of Downtown Oranjestad, the renovation of the hospital, and the Aruba Linear Park will contribute to an increase in investment. Meanwhile, the tourism sector will show an improved performance according to current estimates.

The spurt in total investment is translated into a 15.6 percent growth in the gross capital formation component of the GDP (Table 2.11). Both private and public sector investment activities are anticipated to increase by double digits. It is important to note that total private investment contributed an average of 37.4 percent of real GDP during the period 2007-2009 (Chart 2.10). Total consumption in real terms is expected to increase by 0.9 percent in 2011. The CBA's projections indicate that private consumption (+3.1 percent), which accounted for 57.6 percent of the real GDP between 2007-2009, will be the major contributing

factor to total consumption, as government consumption is projected to decrease by 4.5 percent. Imports are predicted to rebound in 2011, with the refinery fully active together with expected increases in both investment and consumption. Exports are likely to show a build-up in 2011, with the refinery being operational the whole year.

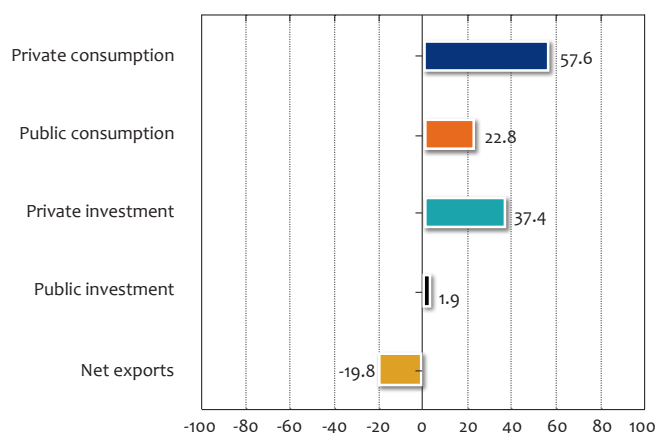
### *The tourism sector*

After the moderate recovery in tourist arrivals and tourism receipts in 2010, the projection for tourism in 2011 looks more positive. The growth in tourism is supported by the prospect of continued economic recovery in the United States in 2011. It is important to note that the recovery in the United States remains fragile, with unemployment still at historically high levels, and a weak U.S. housing market. This optimistic scenario for tourism also calls for a greater degree of planning and effective long-term marketing, advertising, and promotional efforts.

### *Monetary developments*

Although large growth is expected in economic activities in 2011, this improvement is unlikely to be reflected in the demand for credit, which is projected to show a positive but moderate growth of 2.0 percent. The expected net

**Chart 2.10: Contribution of GDP components during 2007 - 2009**  
(in percentages of GDP)



Private consumption was, on average, the main driver of real GDP during the period 2007-2009, contributing 57.6 percent. Private investment and public consumption followed with contributions of 37.4 percent and 22.8 percent, respectively. Government investments did not make an inspiring contribution in the analyzed period, and the influence of the external sector was negative.

**Table 2.11: GDP components and indicators**  
(percentage change, unless stated otherwise)

	2007	2008	2009	2010	2011
<b>1. Aruba: Real GDP and its components<sup>1) 2)</sup></b>					
Gross domestic product	2.0	0.2	-11.0	-2.8	8.9
Final consumption	4.7	-4.2	-3.7	0.7	0.9
Private consumption	6.2	-5.7	-4.4	-0.3	3.1
Public consumption	0.9	-0.2	-1.9	3.3	-4.5
Gross capital formation	-3.6	2.0	-16.6	-9.9	15.6
Private gross capital formation	-3.0	1.0	-17.7	-9.9	15.8
Public gross capital formation	-15.7	27.8	6.1	-10.1	11.6
Exports	3.8	1.7	-12.5	-10.0	20.4
Imports	3.1	-1.7	-8.4	-8.1	12.3
<b>2. Selected economic indicators</b>					
<b>Aruba:</b>					
Nominal GDP (in Afl. million)	4,681.4	4,914.3	4,478.4	4,306.1	4,768.9
Mid-year population	1.1	1.2	1.2	0.8	1.5
Unemployment <sup>3)</sup>	5.8	5.5	10.1	9.0	7.9
CPI <sup>4)</sup>	5.4	9.0	-2.1	2.1	3.4
Core CPI <sup>4)</sup>	3.0	3.3	1.8	-0.3	1.2
Real GDP per capita	0.9	-1.1	-12.1	-3.6	7.7
Stay-over visitors	11.2	7.1	-1.7	1.6	2.5
Tourism receipts	14.1	11.0	-9.8	2.2	3.8
<b>United States:</b>					
Real GDP	2.0	1.1	-2.4	2.9	3.0
CPI <sup>4)</sup>	2.9	3.8	-0.4	1.6	2.0
<b>International market:</b>					
Oil price (WTI) <sup>5)</sup>	72.29	99.59	61.66	79.43	99.00

Source: CBA; CBS Aruba; DEZHI; BEA; BLS; IMF.

<sup>1)</sup> The figures for 2007 through 2009 are preliminary estimates based on nominal data from the CBS. These figures were deflated using a GDP deflator based on the weighted average of the deflators calculated by the CBA for each individual GDP component.

<sup>2)</sup> The figures for 2010 and 2011 are preliminary estimates and projections, calculated by the CBA.

<sup>3)</sup> In percent of the labor force.

<sup>4)</sup> Period average.

<sup>5)</sup> Period average oil price in U.S. dollar.

borrowings from abroad by the government, together with the anticipated net inflow from the operations of the refinery and the increase in gross tourism receipts, tend to work in favor of

a higher level of net foreign assets. On the other hand, the demand for imports is expected to play a somewhat offsetting role. On balance, an expansion in the money supply can be expected.



## Prices

Inflation is anticipated to rise on average by 3.4 percent in 2011, reflecting for the most part a continued, albeit more moderate rebound in energy prices caused by higher oil prices in the international market. The expectation for increased oil prices in 2011 stems from a reduction in fears of another downturn of the U.S. economy. Another factor that might spill over into domestic prices is the strong hike in the price of international food commodities. Moreover, the weakening U.S. dollar and concerns about an international currency war leading to competitive devaluations may push investors towards assets such as oil to hedge against the currency risk. In this context, a prolonged spike in oil prices resulting from the political unrest in the Middle East will enhance the upward pressure on domestic energy prices. The forecast for inflation in Aruba assumes that consumer prices in the United States will rise at a similar pace in 2011 as in 2010.


### *Risk to the projections*

The main risks to the “smooth landing” scenario represented in the CBA’s projection are threefold and interrelated.

First, a risk to the above forecast scenario is that the performance of the world economy may not meet the expected real GDP growth of nearly 4.2 percent for 2011. This risk is reflected by still weak labor and housing markets in the United States and increasing fiscal deficit and government debt. The risk of subpar growth of

the world and U.S. economies has risen because of the currently unstable political situation in the Middle East and Northern Africa, which is driving up oil prices. On the other hand, a large number of domestic investment projects, both public and private, are in the pipeline in Aruba. The projection includes only those projects for which sufficient information was available. Consequently, this risk factor is reduced, because the number of investment projects executed in 2011 could exceed the projected number.

A second risk factor is the estimate for inflation. The inflation forecast remains extremely sensitive to the development of the price of oil in the international markets and, therefore, to geopolitical events, and their effect on the energy and non-energy items in the CPI basket. Therefore, a larger or smaller increase in the oil price than assumed in the baseline forecast severely affects the inflation outcome.

The third risk, especially related to the short-term projections for public consumption expenditures and public investments, involves the uncertainty concerning the financial situation of the government and public-related investments, heretofore not included in the government budget. Four particular issues –the AZV, the APFA, the AOV, and the relatively high personnel costs in the budget– pose major risks to the government finances and the economic outlook of Aruba. Some steps in the right direction have been taken to address these issues through the agreements reached in the context of the Social Dialogue, with additional cost-reducing measures still needed. 



Given the high technology-based environment and the associated risks to the institution, the CBA continuously focuses on further improving its IT security and data integrity in order to improve performance and functionality and to guarantee support regarding technical issues.



The CBA must adhere to the highest standards of responsibility and integrity to accomplish its mission of safeguarding financial stability.





## 3 Financial sector supervision

### 3.1 Major challenges in 2010

Financial sector supervision is aimed at maintaining the soundness and integrity of Aruba's financial system. This section presents an overview of the main developments in Aruba's financial sector and discusses their policy implications.

In 2010, the implementation of the FATF recommendations in connection with the third mutual evaluation report on Aruba (October 19, 2009) received much attention. This FATF report identified many weaknesses and deficiencies in the legislative and regulatory framework on Anti-Money Laundering and Combating Financing of Terrorism (AML/CFT). The report recommended that the CBA significantly strengthen its AML/CFT oversight over the supervised financial institutions, and expand its AML/CFT oversight responsibilities to a number of sectors currently not under its

supervision (e.g., investment business). In 2010 major efforts were undertaken by the legislature and also by institutions like the CBA to strengthen the overall AML/CFT framework (Box 3.1).

With the assistance of an external consulting firm, an action plan was drafted by the Aruban authorities. The plan was based upon a methodology developed by the World Bank to remedy the identified deficiencies in the AML/CFT framework. Also, at the beginning of 2010, a national AML/CFT strategy group was installed under the chairmanship of the Prime Minister. The main objective of this group is to monitor the timely execution of the action plan and to discuss and decide on policy matters in this area. Members of this group also include the Ministers of Finance, Justice, and Economic Affairs, the Public Prosecutors' Office, the Financial Intelligence Unit (FIU), the Government's Legislative Department,

#### **Box 3.1: Progress made on the implementation of FATF recommendations**

During 2010, several steps were undertaken to strengthen the AML/CFT framework. On January 19, 2010, an amended Ministerial Regulation on the supply of information with respect to judicial documents came into effect, granting the Prosecutor General the authority to pass along data from the judicial records to the CBA. This action has enhanced the CBA's ability to conduct a more in-depth fit and proper testing of directors and shareholders of the supervised financial institutions.

On February 10, 2010, the Aruban Parliament approved a state ordinance transferring the oversight of the compliance with the provisions of the State Ordinance on the Obligation to Report Unusual Transactions (SORUT) from the "Meldpunt Ongebruikelijke Transacties" (MOT), which is Aruba's Financial Intelligence Unit (FIU), to the CBA, with respect to the financial institutions supervised by the CBA.

On June 25, 2010, the Aruban Parliament approved the Sanctions State Decree to Combat Terrorism and Terrorist Financing (Sanctions State Decree). This decree put into effect the Sanctions Ordinance of 2006 and requires service providers to freeze all funds and other assets of persons and organizations mentioned on the so-called Consolidated List kept by the United Nations (UN), Al Qaeda and Taliban Sanctions Committees (in accordance with United Nations Security Council Resolution 1267) or on the domestic Aruban list kept by the Aruban authorities (pursuant to United Nations Security Council Resolution 1373). The latter list, which is currently in the process of being established, includes a mechanism for listing and de-listing persons and organizations that may be involved in terrorist financing.

In addition to the aforementioned improvements, a number of legislative changes are in the pipeline. In 2010, the CBA drafted a proposal for a new and comprehensive State Ordinance on the application of Customer Due Diligence (CDD) and the reporting of unusual transactions by financial institutions and designated nonfinancial businesses and professions. The financial institutions covered under this state ordinance include, but are not limited to, banks, insurance

*Continues* 



companies, money transfer companies, investment companies, and insurance brokers, while the nonexhaustive list of designated nonfinancial businesses and professions comprises trust service providers, casinos, lawyers, and civil notaries, as well as traders in precious metals or stones and dealers in high values, like jewelers, car dealers, and real estate agents. This proposal is based on the relevant FATF Standards as well as the Dutch AML/CFT Act and will soon replace both the State Ordinance on Identification when Providing Services (SOIPS) and the SORUT.

Moreover, the CBA drafted a law proposal to strengthen the various supervisory laws and also to extend their scope by, among other things, (1) bringing the so-called pawn shops and leasing and factoring companies explicitly under the scope of the State Ordinance on the Supervision of the Credit System (SOSCS); (2) bringing insurance brokers under the scope of the State Ordinance on the Supervision of the Insurance Business (SOSIB); and (3) broadening the scope of the State Ordinance on the Supervision of Trust Service Providers (SOSTSP) to include trust service providers that provide trust services to companies active on the Aruban market. This draft law gives extended possibilities to exchange information with foreign supervisors and also provides the CBA with additional tools to enforce the supervisory laws. In addition, in 2010 the CBA started drafting a law proposal to regulate the investment business.

To enhance compliance with AML/CFT standards, the CBA drafted a Handbook that covers the legal obligations of the financial institutions within the scope of the new AML/CFT State Ordinance. In addition, the Handbook provides directives on how the CBA expects these institutions to meet their obligations and also gives hands-on guidance on best practices. Moreover, the CBA organized a consultation round with all relevant entities with respect to the Handbook and received comments from 12 of these entities. In a public response matrix, the CBA commented on the more than 180 topics raised by these entities. Since the statutory obligations set out in the Handbook are a reflection of the standards contained in the current draft AML/CFT State Ordinance, a final version of the Handbook will be issued as soon as this State Ordinance goes into effect.

To enhance regulatory transparency and make institutions more aware of their legal responsibilities and regulatory expectations with respect to AML/CFT, the CBA organized five information sessions in 2010. These sessions covered: (1) the draft AML/CFT State Ordinance; (2) the AML/CFT Handbook; (3) the draft proposal for a state ordinance regulating the investment business; and (4) the draft personal questionnaires for, among others, directors and shareholders of the supervised financial institutions.

On November 15 and 16, 2010, the CBA organized a Symposium on Enhancing Integrity in close cooperation with the Dutch central bank (“De Nederlandsche Bank”), the CBCS, and the Dutch Authority Financial Markets (“Autoriteit Financiële Markten”). The first day of the symposium was directed towards the supervisory authorities. The financial institutions active in the Dutch Caribbean were invited for the second day. Prominent keynote speakers shared their views on carrying out effective and efficient integrity supervision and on recent developments in legislation and supervision in the area of AML/CFT. The discussions among the supervisory authorities focused on how to identify and classify money laundering and terrorist financing risks and how to establish reasonable controls based on the risks identified.

and the CBA. The Secretariat of the AML/CFT strategy group is assigned to the CBA. During 2010, the AML/CFT strategy group met four times to discuss, among other things, the progress made vis-à-vis the action plan and the bottlenecks encountered.

Given the assessment that Aruba's compliance with the FATF Standards was at a low level, the FATF decided to place Aruba under the enhanced follow-up-procedure, which requires Aruba to report back to the FATF during each FATF Plenary Meeting. During the FATF Plenary Meeting of February 2010 (in Abu Dhabi), Aruba presented its first follow-up report together with an action plan, which was approved by the Plenary with some comments for consideration. Based upon the comments received, a revised action plan was designed and submitted to the FATF. During the third Plenary (France, October 2010), the Plenary concluded that Aruba had made significant progress and should report back to the Plenary of June 2011 instead of February 2011.

Apart from the FATF-related concerns, other challenges required the attention of the CBA during 2010. One of these challenges was the continuous monitoring of the aftermath effects of the global economic and financial crisis on the supervised financial institutions. All of these financial institutions in Aruba, with the exception of three company pension plans whose coverage ratios fell below the minimum requirement of 100 percent in 2008, were able to continue to operate within the prudential parameters set by the CBA in the area of solvency and liquidity. Those three company pension funds subsequently had to submit recovery plans to address their shortfall within a reasonable period of time. All three have succeeded in bringing their coverage ratio above the minimum requirement of 100 percent as per end-December 2010.

In addition, the financial position of Aruba's civil servants' pension fund, the APFA, remains worrisome. As of January 1, 2011, the CBA is entrusted with the supervision of the APFA. In view of the APFA's significant coverage deficit, meaning that assets do not meet the pension liabilities, the APFA is required to submit a recovery plan for the approval of the CBA in the short term.

The global financial crisis has clearly demonstrated the need for banks to have sufficient capital and liquidity buffers in place to absorb

unforeseen losses in their loan and investment portfolios and to deal with unexpected cash withdrawals. In view hereof, the CBA decided, after consultation with the Aruban Bankers' Association, to increase both the minimum risk-weighted capital asset ratio (to 14 percent) and the prudential liquidity ratio (to 15 percent) for commercial banks as of January 1, 2010. For the same reason, the CBA also decided to increase the minimum risk-weighted capital asset ratio for bank-like institutions from 12 percent to 14 percent as of April 1, 2010. Additionally, the CBA drafted a policy paper on liquidity risk management aimed at providing guidance to the banks in the area of sound liquidity risk management practices. This policy paper, which is based on the "Principles for sound liquidity risk management and supervision" (September 2008) issued by the Basel Committee on Banking Supervision, provides high level recommendations in the area of liquidity risk management. Based on the comments received, a revised draft will be sent out for consultation. The CBA expects that the final version of this policy paper will be issued at the end of the second quarter of 2011.

### 3.2 Other legislative changes in 2010

During 2010, some amended and new legislation came into effect with respect to the charging of supervision costs to the supervised sectors. Both the State Decree on the charging of supervision costs to the insurance companies and the State Decree on the charging of supervision costs to the money transfer companies were amended by State Decree of March 26, 2010, and became effective as of April 5, 2010. In accordance with these state decrees, the amounts that can be charged on a yearly basis to the insurance sector and the money transfer sector are Afl. 300,000 and Afl. 150,000, respectively.

In accordance with the Ministerial Decree of November 5, 2010, which was ratified on November 12, 2010, an annual fixed amount of Afl. 75,000 will henceforth be charged to the supervised company pension funds. Furthermore, the State Decree on the passing on of supervision costs to the credit institutions came into effect as of January 21, 2011. A fixed amount of Afl. 800,000 will be charged each year to the supervised credit institutions for the costs incurred by the CBA with respect to the execution of the SOSCS.



### 3.3 Sectoral developments

This section covers briefly the main financial developments in the various sectors under the supervision of the CBA. A more extensive discussion is provided in the CBA's bulletin of the fourth quarter of 2010.

#### *Commercial banks*

In 2010, the aggregated balance sheet total of the four commercial banks rose by Afl. 80.9 million (+1.9 percent) to Afl. 4,386.5 million, equivalent to 99.8 percent of the estimated GDP for 2010. This increase mirrored increments in the combined investment portfolio (+Afl. 121.9 million or +79.2 percent) and other assets (+Afl. 15.0 million or +8.3 percent), which were offset in part by a reduction in cash and due from banks (-Afl. 55.0 million or -3.7 percent). An increase in government bond holdings (+Afl. 126.3 million or +167.5 percent) contributed predominantly to the rise in the combined investment portfolio. Moreover, expansions in accounts receivables and prepayments (+Afl. 9.6 million or +39.0 percent) and in premises and equipment (+Afl. 7.2 million or +7.2 percent) contributed substantially to the surge in other assets.

On the other hand, contractions in time deposits and demand deposits of, respectively, Afl. 117.7 million (-34.2 percent) and Afl. 38.2 million (-9.7 percent) placed at foreign banks caused a decrease in cash and due from banks. Increased deposits of Afl. 107.1 million (+16.3 percent) held with the CBA, however, countered this effect in part.

On the liability side, deposits and other liabilities rose by Afl. 69.7 million (+1.9 percent) and Afl. 17.7 million (+11.4 percent), respectively, while capital and reserves were Afl. 6.5 million (-1.2 percent) lower. The higher deposits originated from a surge in time deposits (+Afl. 156.5 million or +14.8 percent) and savings deposits (+Afl. 58.6 million or +6.4 percent), which were partially offset by a contraction in demand deposits (-Afl. 145.4 million or -9.0 percent). The decrease in capital and reserves was caused mostly by dividend payments in 2010, partially offset by additions of net profit to the general reserves.

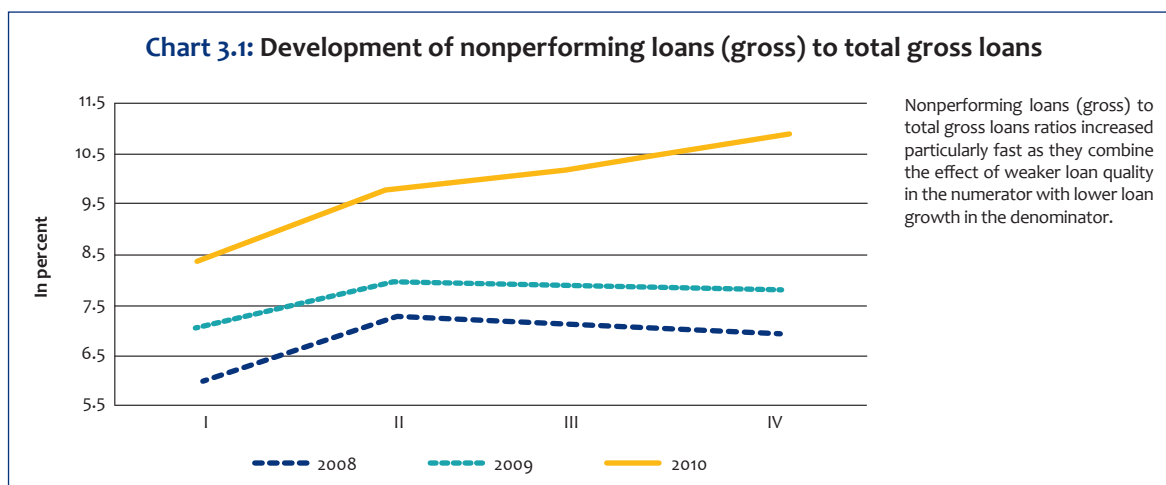
The various macroprudential ratios indicate that the commercial banking sector

remained sound and profitable in 2010 (Table 3.1). The commercial banks' aggregated risk-weighted capital asset ratio went up slightly from 17.8 percent at the end of December 2009 to 18.5 percent at the end of December 2010, well above the required minimum of 14 percent. The increase of the mentioned ratio resulted from a rise in the aggregate regulatory capital (numerator) of Afl. 14.4 million (+3.3 percent), combined with a decline in the total risk-weighted assets (denominator) of Afl. 11.7 million (-0.5 percent). The banks' aggregated prudential liquidity ratio declined by 1.0 percentage point to 29.1 percent at end-December 2010, but remained significantly above the required minimum of 15 percent. Also, the loans to deposits ratio contracted further to 65.8 percent at the end of 2010, staying below the maximum of 80 percent. The aforementioned ratios are indicative of the high levels of liquidity in the banking sector.

The quality of the loan portfolio of the commercial banks continued to deteriorate, reflected by increases in the nonperforming loan ratios. Problems with loan repayments became more apparent in 2010, predominantly because of a still fragile economy. As a result, the aggregated nonperforming loans (consisting of all loans past-due for more than 90 days) to gross loans ratio increased from 7.9 percent (end-December 2009) to 10.8 percent at the end of December 2010 (Chart 3.1).

The banking sector remained profitable in 2010, although net profit continued to decline (-Afl. 1.5 million or -1.5 percent) because of increases in total expenses of Afl. 5.6 million (+2.9 percent), partially offset by a rise in total income of Afl. 4.1 million (+1.4 percent). Salaries and employee benefits were the main factors affecting the spike in total expenses (+Afl. 4.6 million or +5.5 percent). Net interest income grew by Afl. 8.1 million (+4.3 percent), but was partially offset by a decrease in operating income (-Afl. 4.0 million or -3.7 percent). The higher operating income in 2009 was mostly the result of net gains on financial assets recorded in 2009, which did not recur in 2010. All in all, both return on assets (after taxes) and return on equity (after taxes) experienced decreases of 0.1 percentage point to 1.7 percent and 1.4 percentage points to 16.0 percent, respectively (Table 3.1).

The ratio of net interest income to gross income went up by 1.9 percentage points to 64.7



**Table 3.1: Core set of macroprudential indicators of the commercial banks**  
(end-of-period figures, in percent, unless stated otherwise)

	2006	2007	2008	2009	2010 <sup>1)</sup>
<b>1. Capital adequacy</b>					
a. Risk-weighted capital asset ratio (= Regulatory capital to risk-weighted assets)	13.5	13.0	14.7	17.8	18.5
b. Tier 1 capital ratio	7.2	7.2	8.3	10.6	11.4
<b>2. Asset quality</b>					
a. Nonperforming loans to gross loans	6.3	6.7	6.9	7.9	10.8
b. Nonperforming loans (net of ALLP) to gross loans <sup>2)</sup>	3.4	4.0	3.9	4.5	6.9
c. Nonperforming loans (net of ALLP) to regulatory capital <sup>2)</sup>	26.4	32.6	28.5	27.4	40.6
d. Large loans to regulatory capital <sup>3)</sup>	109.2	102.8	98.8	77.1	72.9
<b>3. Earnings and profitability<sup>4)</sup></b>					
a. Return on assets (after taxes)	2.4	3.1	2.3	1.8	1.7
b. Return on equity (after taxes)	32.1	38.4	24.7	17.4	16.0
c. Net interest income to gross income	66.4	60.5	62.4	62.8	64.7
d. Noninterest expenses to gross income	70.1	65.7	71.1	75.0	76.5
<b>4. Liquidity</b>					
a. Loans to deposits ratio	75.1	74.7	69.4	67.1	65.8
b. Prudential liquidity ratio	28.0	29.0	34.7	30.1	29.1
c. Liquid assets to short-term liabilities	81.2	82.6	88.7	71.5	76.8
<b>5. Sensitivity to market risk</b>					
a. Interest rate margin <sup>5)</sup>	7.2	6.8	7.5	7.2	8.2

Source: CBA; commercial banks.

<sup>1)</sup> Preliminary figures.

<sup>2)</sup> ALLP: allocated loan loss provision.

<sup>3)</sup> Large loans: all loans or lines of credit in excess of 15 percent of the institution's test capital.

<sup>4)</sup> Yearly averages.

<sup>5)</sup> Weighted averages related to transactions during the indicated period.



percent at the end of 2010, as the increase in net interest income (numerator) was higher than the expansion in gross income (denominator). The ratio of noninterest expenses to gross income increased by 1.5 percentage points to 76.5 percent at the end of 2010, reflecting a surge in noninterest expenses, chiefly salaries and employee benefits.

### *Offshore banks*

The number of offshore banks registered in Aruba stayed at two. One of these offshore banks is a local entity affiliated with Citibank, therefore falling under the consolidated supervision of the U.S. supervisory authorities.

The offshore banks' aggregated balance sheet contracted by Afl. 140.4 million (-25.2 percent) to Afl. 415.8 million at the end of December 2010, reflecting significant decreases in other assets (-Afl. 114.2 million or -33.7 percent) and cash and due from banks (-Afl. 47.7 million or -70.6 percent). On the other hand, the combined investments surged by Afl. 16.9 million (+32.3 percent), while the loans portfolio rose by Afl. 4.6 million (+4.7 percent). The descent in other assets reflected for the most part declines in accounts receivables and other prepayments of Afl. 114.2 million (-33.8 percent), related to prior year adjustments on cross currency swaps and foreign exchange transactions. Also, lower demand and time deposits placed at other foreign banks contributed to a large extent to the contraction in cash and due from banks. The increase in investments was related mostly to an expansion in marketable securities of Afl. 13.1 million (+366.3 percent).

On the liability side, deposits at the offshore banks increased by Afl. 35.8 million (+19.8 percent) in 2010, while capital and reserves went down by Afl. 184.1 million or 53.4 percent. This decline in capital and reserves stemmed from a huge net loss incurred in 2010. As a result, the aggregated risk-weighted capital asset ratio of the two offshore banks declined from 29.7 percent to 16.0 percent in 2010.

The two offshore banks reported a net loss of Afl. 251.1 million in 2010. The loss originated largely from a decrease of Afl. 352.2 million in the operating income, which was due mostly to adjustments made in the fourth quarter of 2010 related to the restatement of foreign exchange transactions and the mark-to-market adjustments

on cross-currency swap transactions. On the other hand, the combined total expenses contracted by Afl. 94.1 million (-95.6 percent) because of a significant decline in general expenses of Afl. 92.0 million or 94.7 percent. The significantly higher amount of general expenses recorded in 2009 was due to fair value adjustments. No such adjustments took place in 2010.

### *Bank-like institutions*

The three bank-like institutions are engaged largely in mortgage lending to individuals, financing of social housing projects, long-term project financing, and/or granting of personal loans for consumption and home improvement purposes. They finance these activities mostly by attracting funds from their parent company, other (local) financial institutions, and/or institutional investors.

The aggregated balance sheet of the bank-like institutions decreased by Afl. 22.4 million (-3.2 percent) to Afl. 686.6 million at the end of 2010. The combined loan portfolio and cash and due from banks contracted by Afl. 17.7 million (-3.6 percent) and Afl. 12.0 million (-20.3 percent), respectively. However, an Afl. 8.1 million (+5.8 percent) growth in other assets somewhat offset this effect. At the end of 2010, the combined loan portfolio amounted to Afl. 468.5 million, equivalent to 10.7 percent of the estimated nominal GDP for 2010.

The contraction in the combined loan portfolio resulted from repayments made by several commercial and individual clients on their loans, while the inflow of new loans remained relatively low. The contraction in cash and due from banks was mostly related to decreases in demand deposits of Afl. 5.6 million (-10.7 percent) and time deposits of Afl. 6.3 million (-100.0 percent). Furthermore, the increase in other assets resulted from an expansion in accounts receivable and prepayments of Afl. 5.1 million (+9.2 percent).

On the liability side, borrowings diminished by Afl. 29.9 million (-7.5 percent) to Afl. 371.4 million, while capital and reserves rose by Afl. 12.4 million (+4.6 percent) to Afl. 282.9 million. A reduction in commercial borrowing by Afl. 39.9 million (-12.4 percent) was the main factor that caused the decrease in the combined borrowings. An expansion in government borrowing of Afl. 10.0 million (+14.0 percent) countered this

effect to some extent. Additions from net income to the general reserves contributed substantially to the growth in capital and reserves.

The various macroprudential indicators show that the bank-like institutions' sector remained sound and profitable in 2010 (Table 3.2). The aggregated risk-weighted capital asset ratio of these institutions (51.4 percent) remained far above the minimum requirement of 14 percent. This outcome resulted from a growth in the aggregated regulatory capital (numerator) of Afl. 12.4 million (+4.7 percent), stemming from additions of net income to the general reserves and retained earnings. At the same time, the aggregated risk-weighted assets (denominator) decreased by Afl. 15.1 million (-2.8 percent) in 2010. On the other hand, the quality of the loan portfolios of the bank-like institutions deteriorated further in 2010, reflecting continued increases in the nonperforming loans ratios (Chart 3.2). The aggregated nonperforming loans to gross loans ratio (all loans past due for more than 90 days divided by gross loans) rose by 5.6 percentage

points to a record high of 19.2 percent at end-December 2010. The expansion in the commercial mortgage nonperforming loans category as well as a decrease in the combined gross loans of the bank-like institutions were the main factors that caused this ratio to grow to a worrisome level.

The bank-like institutions as a whole operated with favorable net results in 2010, albeit at lower levels than in 2009. Net profit (before taxes) declined by Afl. 9.8 million (-44.7 percent) to Afl. 12.1 million in 2010, as aggregated operating expenses went up by Afl. 6.0 million (+14.5 percent), while total income decreased by Afl. 1.8 million (-2.9 percent). The combined additions to the loan loss provisions (+Afl. 4.3 million or +51.8 percent) were the primary cause of the increase in operating expenses. The end result was that return on equity (after taxes) contracted by 3.6 percentage points to 4.8 percent in 2010, substantially lower than the return realized by the commercial banking sector.

Maximization of shareholders' value, however, is not the prime objective of all the

**Table 3.2: Core set of macroprudential indicators of the bank-like institutions**  
(end-of-period figures, in percent, unless stated otherwise)

	2006	2007	2008	2009	2010 <sup>1)</sup>
1. Capital adequacy					
a. Risk-weighted capital asset ratio (= Regulatory capital to risk-weighted assets)	46.3	41.8	47.5	47.7	51.4
b. Tier 1 capital ratio	40.0	36.0	41.0	40.2	45.0
2. Asset quality					
a. Nonperforming loans to gross loans	7.8	7.4	8.5	13.6	19.2
b. Nonperforming loans (net of ALLP) to gross loans <sup>2)</sup>	6.7	6.6	6.9	10.9	14.9
c. Nonperforming loans (net of ALLP) to regulatory capital <sup>2)</sup>	14.7	15.6	15.4	21.4	26.9
3. Earnings and profitability <sup>3)</sup>					
a. Return on assets (after taxes)	2.1	4.0	2.1	3.0	1.8
b. Return on equity (after taxes)	6.4	11.8	6.2	8.4	4.8
c. Net interest income to gross income	67.4	58.3	69.5	63.2	66.6
d. Noninterest expenses to gross income	74.1	58.2	74.1	68.4	79.6

Source: CBA; bank-like institutions.

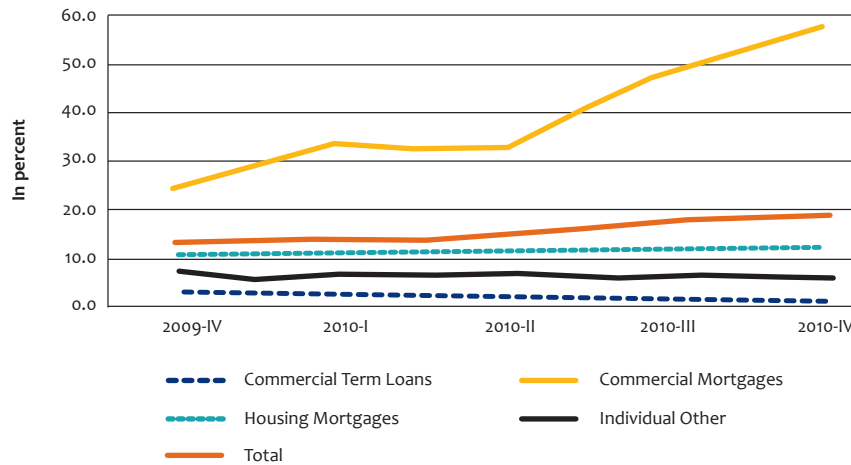
<sup>1)</sup> Preliminary figures.

<sup>2)</sup> ALLP: allocated loan loss provision.

<sup>3)</sup> Yearly averages.



**Chart 3.2: Nonperforming loans (gross) to total gross loans**



Overall, the ratio of non performing loans to gross loans of the bank-like institutions sector deteriorated primarily because of an expansion in the nonperforming loans in the commercial mortgage category.

institutions operating in this market segment. The ratio of net interest income to gross income extended by 3.4 percentage points to 66.6 percent in 2010, essentially because of a larger decrease in gross income (denominator) relative to the decrease in net interest margin (numerator). The noninterest expenses to gross income ratio grew by 11.2 percentage points to 79.6 percent in 2010, in general because of a growth in additions to loan loss provisions.

### Money transfer companies

The amount of outgoing transfers executed by the four registered money transfer companies contracted by Afl. 9.6 million to approximately Afl. 109.1 million in 2010 (Table 3.3), while the corresponding number of outgoing transfers went down by approximately 19,000 to about 264,000. Colombia remained the major destination for funds transfer via money transfer companies (49.1 percent), a position held for many years (Chart 3.3). Foreign workers who provide their relatives in their country of origin with financial support for their living expenses (including alimony and other family-related remittances) are the main reason for transfers to abroad.

In 2010, the money transfer companies processed close to 23,000 incoming transfers, amounting to approximately Afl. 18.4 million. Like previous years, transfers from the Netherlands

and the United States were the main source of origin of these transactions, and the indications are that family-related remittances are the key reason for these inflows (Table 3.4).

### Trust service providers sector

In 2010, the CBA commenced conducting on-site examinations at the trust service providers. The focus of these examinations is primarily on the integrity of the owners, directors, and principal persons as well as that of their clients. Trust service providers need to know who their clients are (i.e., the ultimate beneficial owners), as well as the source and use of the funds going through the companies for which they conduct trust services. By implementing sound know-your-customer policies and procedures and conducting ongoing monitoring of transactions, the trust service providers are able to reduce the risk of their services being used for illicit activities.

### Insurance sector

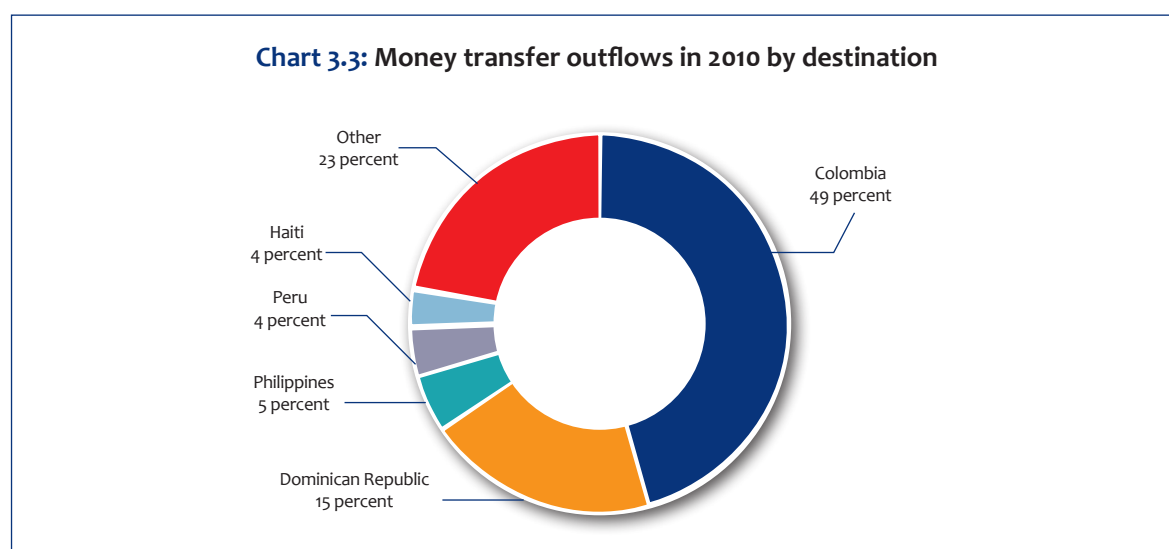
At the end of December 2009, the aggregated balance sheet of the 13 nonlife insurance companies expanded by Afl. 21.2 million to Afl. 236.8 million, reflecting a growth in the combined investment portfolio (+Afl. 13.7 million or +11.0 percent) and current assets (+Afl. 6.4 million or +11.4 percent). Increases in both time

**Table 3.3: Outgoing money transfers by countries of destination**  
(in Afl. thousands)

	2006	2007	2008	2009	2010 <sup>1)</sup>
Total	113,262.1	116,721.4	121,011.6	118,673.6	109,084.2
1. Colombia	64,659.1	63,896.3	64,189.9	60,271.1	53,593.3
2. Dominican Republic	13,983.9	17,377.6	17,455.2	18,253.1	16,213.2
3. Philippines	5,811.9	5,957.6	6,641.7	6,634.9	5,270.5
4. Peru	5,195.3	5,185.2	5,339.4	5,062.1	4,735.7
5. Haiti	3,989.4	4,335.6	4,756.0	4,736.4	4,440.2
6. Other	19,622.5	19,969.1	22,629.4	23,716.0	24,831.3

Source: CBA; money transfer companies.

<sup>1)</sup> Preliminary figures.



**Table 3.4: Incoming money transfers by countries of origin**  
(in Afl. thousands)

	2006	2007	2008	2009	2010 <sup>1)</sup>
Total	11,691.9	13,877.5	17,418.1	16,351.3	18,403.4
1. Netherlands	4,407.0	4,867.6	6,807.6	6,187.2	6,225.7
2. United States	3,170.1	3,743.3	3,636.0	3,323.9	3,879.8
3. Colombia	606.3	800.9	1,005.7	1,040.0	1,719.5
4. Netherlands Antilles	736.3	712.0	916.0	892.6	995.8
5. Spain	314.2	662.6	691.7	551.6	533.5
6. Other	2,458.0	3,091.1	4,361.1	4,356.0	5,049.1

Source: CBA; money transfer companies.

<sup>1)</sup> Preliminary figures.



deposits (+Afl. 8.3 million or +13.3 percent) and bond holdings (+Afl. 5.2 million or +9.1 percent) were the main contributing factors to the upward movement in the combined investment portfolio. The expansion in current assets was associated largely with higher cash in hand and at banks of Afl. 4.4 million (+27.3 percent). The liability side shows growth in both combined amounts due to affiliated companies (+Afl. 17.4 million or +21.5 percent) and the capital and reserves (+Afl. 4.4 million or +8.1 percent). The rise in amounts due to affiliated companies was caused mainly by capital commitments in connection with some corporate restructurings that took place in 2009. Higher issued and paid-in capital, resulting from the same corporate restructurings, contributed to the expansion in capital and reserves.

Net profit (before taxes) increased by Afl. 4.5 million to Afl. 9.3 million in 2009, reflecting first and foremost higher net premiums earned (+Afl. 7.1 million or +11.5 percent), for the most part in motor vehicle and in personal and commercial property indemnity lines. The pick-up in management expenses of Afl. 2.0 million (+9.5 percent) somewhat offset this outcome.

In 2009, both the liquidity ratio and the return on investments ratio grew further to 26.4 percent and 6.9 percent, respectively (Table 3.5). The coverage ratio went up to 279.1 percent, almost threefold the minimum requirement of 100 percent (Chart 3.4). This outcome is a result of an Afl. 2.3 million (+1.2 percent) growth in weighted assets to cover technical provisions (numerator), while the aggregated technical provisions (denominator) stayed virtually unchanged.

At the end of 2009, the aggregated balance sheet of the seven supervised life insurance companies expanded by Afl. 90.0 million (+14.6 percent) to Afl. 708.1 million. This significant expansion reflected substantial increases in the combined investment portfolio and amounts due from affiliated companies of Afl. 93.5 million (+19.1 percent) and Afl. 50.3 million (+225.6 percent), respectively.

On the other hand, current assets declined by Afl. 53.2 million (-53.0 percent) related to a decrease in uncollected premiums. Both the expansions in bonds (+Afl. 66.0 million or +26.4 percent) and time deposits placed at local banks (+Afl. 25.5 million or +27.2 percent) had a major effect on the increase in the combined investment portfolio. The capital receivable, following corporate restructurings in 2009, caused a surge in the amounts due from affiliated companies. Capital and reserves went up by Afl. 45.1 million (+65.2 percent).

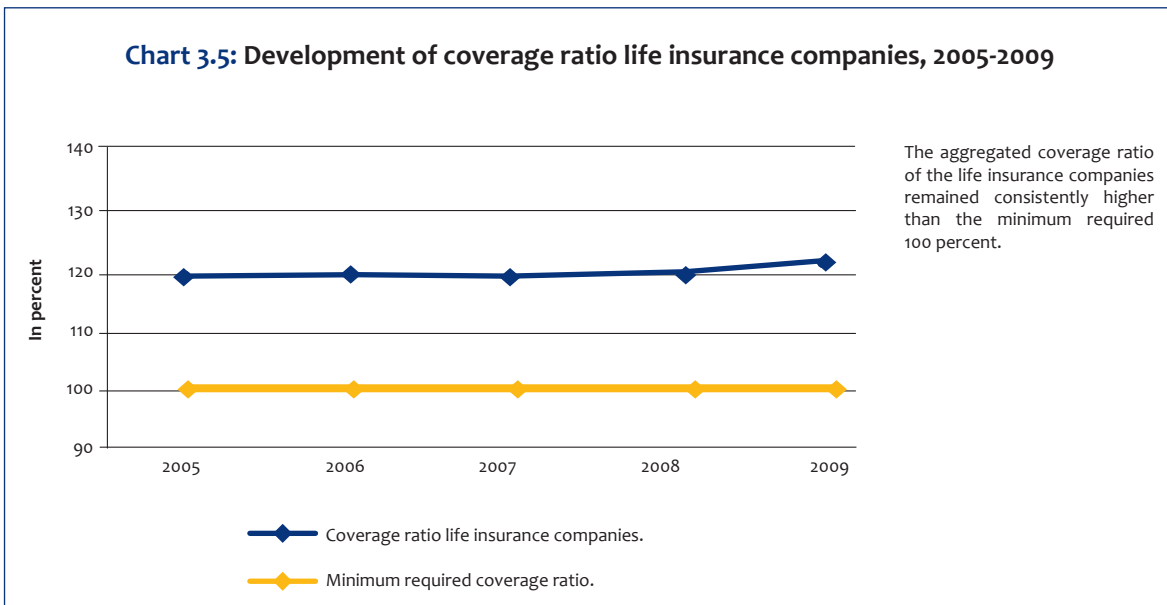
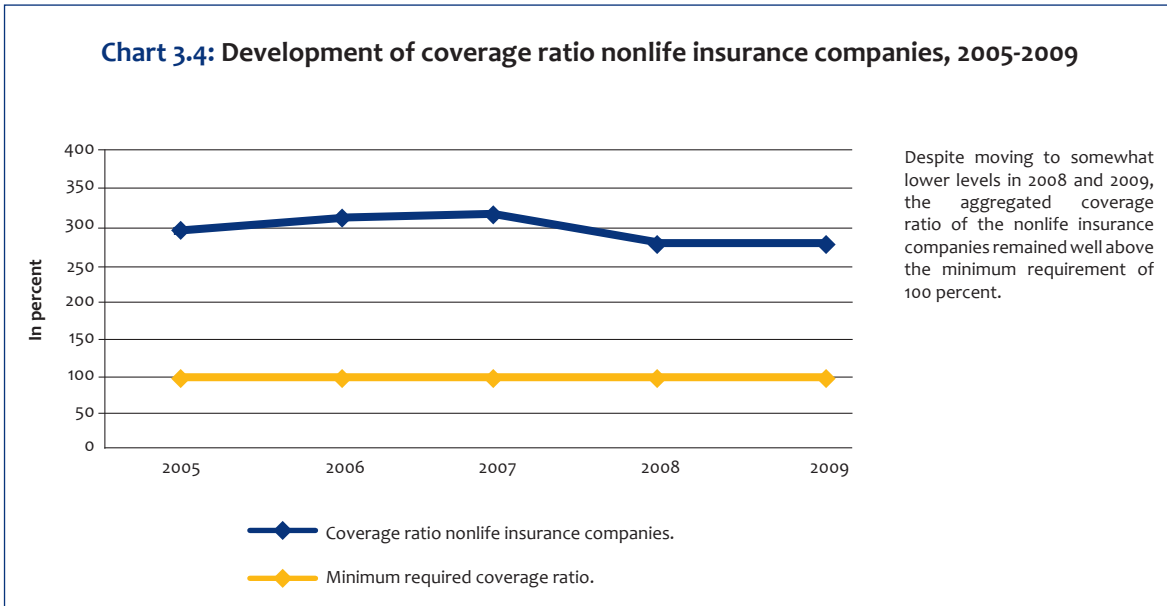
Moreover, the growth in the aggregated capital and reserves reflected mostly increases in the issued and paid-in capital of Afl. 33.2 million (+384.2 percent) as well as additions from net income to retained earnings of Afl. 11.0 million (+23.0 percent). As a result, the aggregated coverage ratio improved from 118.6 percent in 2008 to 121.0 percent in 2009, well above the minimum solvency requirement of 100 percent (Chart 3.5). On the other hand, the liquidity ratio of the life insurers contracted by 9.5 percentage points to 6.7 percent in 2009, resulting from the decline in current assets (Table 3.6).

**Table 3.5: Financial ratios of the nonlife insurance companies**  
(end-of-period figures, in percent, unless stated otherwise)

	2005	2006	2007	2008	2009
1. Liquidity ratio (= Current assets to total assets)	27.4	25.1	23.9	26.0	26.4
2. Return on investments ratio <sup>1)</sup> (= Investment income to average invested assets)	5.0	5.3	5.5	5.9	6.9
3. Coverage ratio (= Weighted assets less borrowings to technical provisions)	294.9	305.7	309.9	276.1	279.1

Source: CBA; nonlife insurance companies.

<sup>1)</sup> Yearly average.



The life insurance companies realized a net profit (before taxes) of Afl. 27.1 million in 2009, an increase of Afl. 15.2 million (+127.7 percent) compared to 2008. Lower additions to the technical provisions (-Afl. 39.7 million or -60.6 percent) was the main contributing factor to this outcome. Furthermore, net premiums fell by Afl. 26.4 million (-25.9 percent) caused mainly by incidental premiums recorded in 2008 that did not recur in 2009. The growth in investment income of Afl. 6.3 million (+20.3 percent) in 2009 resulted in a

small increase in the return on investments (+0.4 percentage point) to 7.0 percent (Table 3.6).

#### Company pension funds

The global financial crisis of 2008/2009 had a significant impact on the supervised company pension funds because these funds have substantial foreign investment portfolios (54.7 percent in 2009). Three company pension funds saw their coverage ratio fall below the minimum



**Table 3.6: Financial ratios of the life insurance companies**  
(end-of-period figures, in percent, unless stated otherwise)

	2005	2006	2007	2008	2009
1. Liquidity ratio (= Current assets to total assets)	13.0	13.1	11.8	16.2	6.7
2. Return on investments ratio <sup>1)</sup> (= Investment income to average invested assets)	6.4	6.8	6.9	6.6	7.0
3. Coverage ratio (= Weighted assets less borrowings to technical provisions)	119.0	118.0	119.4	118.6	121.0

Source: CBA; life insurance companies.

<sup>1)</sup> Yearly average.

requirement of 100 percent at the end of 2008. These pension funds had to submit recovery plans to the CBA. By the end of December 2010, all three had succeeded in bringing their coverage ratio above the required minimum.

The assets of the supervised company pension funds (excluding the Lago Annuity Foundation, whose pension obligations are covered by a guarantee from the Exxon Mobil Corporation) grew by Afl. 25.8 million (+12.0 percent) at the end of 2009, as the conditions on the financial markets around the world started to improve. The latter led to respective surges in bond holdings (+Afl. 14.4 million or +19.1 percent) and shares (+Afl. 5.3 million or +10.7 percent).

On the liability side, the improvement in the balance sheet of the company pension funds reflected increases in both pension fund provisions (+Afl. 15.5 million or +8.0 percent) and capital and reserves (+Afl. 11.9 million or +66.9 percent). The increase in capital and reserves was foremost the result of net profit added to the general reserves.

The company pension funds registered an Afl. 11.9 million profit in 2009, a significant improvement compared to the Afl. 18.2 million loss incurred in 2008. This favorable outcome reflected to a large extent the positive investment return in 2009 (+Afl. 41.9 million or +229.0 percent), partially offset by higher additions to the technical provisions (+Afl. 12.1 million or +366.7 percent). The return on investments ratio rebounded sharply (+11.3 percent) after a negative ratio in 2008 (-8.4 percent) (Table 3.7).

Following the positive financial results, the aggregate coverage ratio of the company pension funds improved from 103.0 percent in 2008 to

107.0 percent in 2009 (Table 3.7 and Chart 3.6). With one exception, all company pension funds met the minimum coverage requirement of 100 percent at end-2009. By the end of December 2010, this company pension fund was able to bring its coverage ratio above the minimum requirement.

Three company pension funds (the Stichting Pensioenfond N.V. Aruba Bank, the Stichting Pensioenfond RBTT Bank Aruba II, and the Stichting Pensioenfond Martijn Trading Company N.V.) are in liquidation, all having decided to transfer their pension obligations to life insurance companies in Aruba. In 2010, one of these pension funds (the Stichting Pensioenfond Martijn Trading Company N.V.) was removed from the register of supervised company pension funds as the liquidation process was completed in that year. Until the liquidation process is completed, the other two company pension funds will remain under the CBA's supervision.

#### *Stichting Algemeen Pensioenfond Aruba (APFA)*

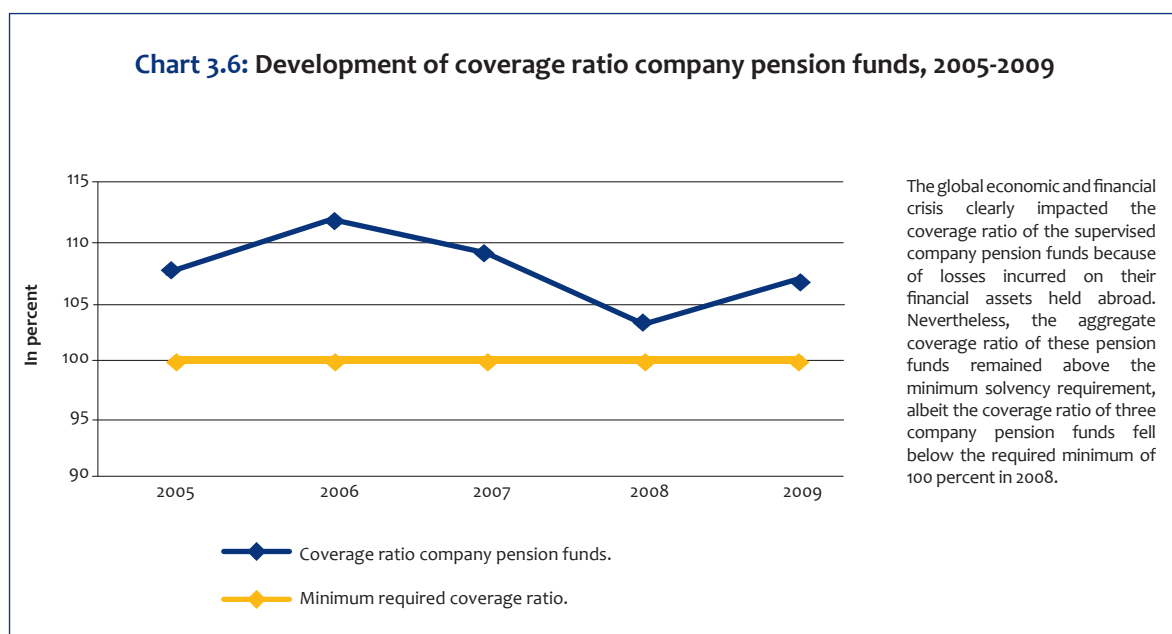
As of January 1, 2011, the APFA falls under the supervision of the CBA. In view of its significant underfunding, and notwithstanding the important steps taken by the GOA following the agreements reached within the context of the Social Dialogue to improve the fund's financial viability, APFA has to submit a recovery plan in the short-term to the CBA for review and approval. In light of the start of the CBA's oversight of the APFA, a summary of the financial developments of APFA in 2009 is presented below.

**Table 3.7: Financial ratios of the company pension funds**  
(end-of-period figures, in percent, unless stated otherwise)

	2005	2006	2007	2008	2009
1. Liquidity ratio (= Current assets to total assets)	9.9	5.9	6.0	8.0	8.1
2. Return on investments ratio <sup>1)</sup> (= Investment income to average invested assets)	7.3	8.5	7.0	-8.4	11.3
3. Coverage ratio (= Investments & cash minus volatility cushion to technical provisions)	108.0	112.0	109.0	103.0	107.0

Source: CBA; company pension funds.

<sup>1)</sup> Yearly average.



The global financial crisis had a significant impact on the financial position of this pension fund, which contributed to the substantial losses incurred in 2008. Fortunately, the outcome for 2009 is more positive. However, the underfunding of the APFA remains substantial and may require additional corrective measures in the future.


The balance sheet total of the APFA was Afl. 1,705.3 million at end-2009, a 14.3 percent expansion over 2008. As a result of the recovery on the international stock markets, the financial assets were valued upwards. Both investments and current assets went up by Afl. 147.8 million

(+10.5 percent) and Afl. 64.9 million (+96.1 percent), respectively. The growth in investments and current assets is reflected in the increases in the holding of bonds and treasury bills (+Afl. 96.5 million), shares and convertible bonds (+Afl. 55.1 million), and liquid assets (+Afl. 53.1 million). At the end of 2009, foreign investments amounted to Afl. 500.2 million (32.2 percent of the APFA's total investment portfolio), Afl. 82.9 million (+19.9 percent) higher than in 2008 (Afl. 417.3 million), mirroring the increased value of the foreign assets following the recovery on the international stock markets. On the liability side, the technical

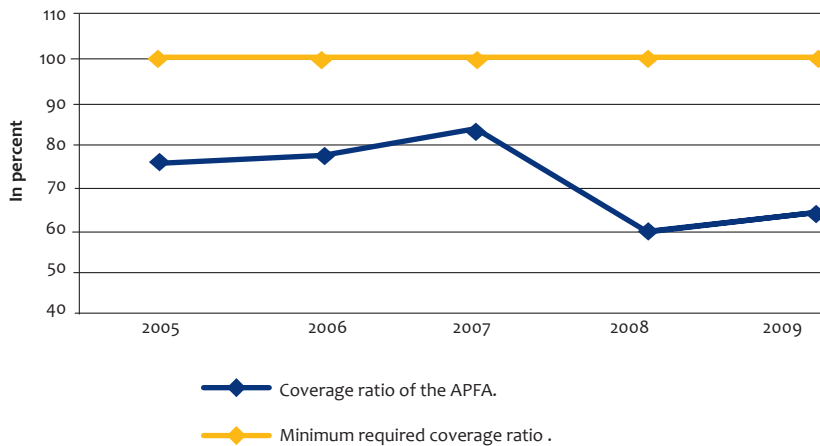


provisions grew further (+Afl. 108.9 million or +5.0 percent) to Afl. 2,285.5 million at the end of 2009. The APFA's negative equity position declined from Afl. 691.1 million to Afl. 585.7 million, resulting from the favorable net result in 2009.

The operations of the APFA resulted in a net profit of Afl. 105.4 million in 2009, sharply contrasting the net loss (-Afl. 658.2 million) incurred in 2008. Both an expansion in investment income (+Afl. 294.0 million or +227.9 percent) and lower additions to the technical provisions (-Afl. 442.7 million or -80.3 percent) had a major impact on the profitability of the APFA. The result was that the return on investments ratio improved from a negative 9.1 percent in 2008 to a positive 11.1 percent in 2009.

The liquidity ratio of the APFA went up by 3.3 percentage points to 7.8 percent in 2009, as its liquid assets grew by Afl. 53.1 million (+284.0 percent). Its coverage ratio improved by 4.5 percentage points to 63.1 percent in 2009, but remained far below the minimum required coverage ratio of 100 percent, applicable to company pension funds (Chart 3.7). The higher coverage ratio underscored an expansion (+Afl. 167.5 million or +13.1 percent) in investments plus cash minus the applicable volatility cushion (numerator), offset in part by an increase in technical provisions (denominator) of Afl. 108.9 million (+5.0 percent). 

**Chart 3.7: Development of coverage ratio APFA, 2005-2009**



The sharp fall in the coverage ratio in 2008 was caused mainly by a change in the actuarial interest rate and the global economic and financial crisis, which, respectively, led to a huge increase in the technical provisions and significant losses to the foreign financial assets of the APFA. The improved results in 2009 led to a slight improvement of the coverage ratio. However, the underfunding remains substantial and may require additional corrective measures in the future.





**Annex 1: Overview of the supervisory and AML/CFT laws of which the execution is entrusted to the CBA**

**Table A: Supervisory and AML/CFT Laws**

1. State Ordinance on the Supervision of the Credit System (SOSCS)	AB 1998, No. 16
2. State Ordinance on the Supervision of the Insurance Business (SOSIB)	AB 2000, No. 82
3. State Ordinance on Company Pension Funds (SOCPF)	AB 1998, No. GT 17
4. State Ordinance on the Supervision of Trust Service Providers (SOSTSP)	AB 2009, No. 13
5. State Ordinance on the Supervision of Money Transfer Companies (SOSMTC)	AB 2003, No. 60
6. State Ordinance on Identification when Providing Services (SOIPS)	AB 1995, No. 86
7. State Ordinance on the Obligation to Report Unusual Transactions (SORUT)	AB 1995, No. 85
8. Sanctions State Ordinance	AB 2007, No. 27

Source: CBA.



## Annex 2: Financial institutions under the supervision of the CBA (December 31, 2010)

1. Banking sector<sup>1</sup>
  - 1.1 Commercial banks
    - Aruba Bank N.V.
    - Banco di Caribe (Aruba) N.V.
    - Caribbean Mercantile Bank N.V.
    - RBTT Bank Aruba N.V.
  - 1.2 Offshore banks
    - Citibank Aruba N.V.
    - BBA Bank N.V.
  - 1.3 Mortgage banks
    - Fundacion Cas pa Comunidad Arubano
  - 1.4 Credit unions
    - Coöperatieve Spaar- en Kredietvereniging Douane Aruba
    - Cooperativa di Ahorro y Prestamo Aruba (CAPA)
  - 1.5 Finance companies
    - Island Finance Aruba N.V.
  - 1.6 Other financial institutions
    - AIB Bank N.V.
2. Money transfer sector<sup>2</sup>
  - 2.1 Money transfer companies
    - G.F.P. International N.V.
    - Global Access Corporation N.V.
    - Post Aruba N.V.
    - Union Caribe N.V.
3. Trust sector<sup>3</sup>
  - 3.1 Trust service providers
    - AMTR N.V.
    - ANT Management (Aruba) N.V.
    - Aruba International Trust Company N.V.
    - Arulex Trust Services N.V.
    - Ascor Trust (Aruba) N.V.
    - ATC Trustees (Aruba) N.V.
4. Institutional investors' sector
  - 4.1 Company Pension Funds<sup>4</sup>
    - Lago Annuity Foundation
    - Stichting Bedrijfspensioenfonds Aruba
    - Stichting Fondo di Pensioen di Trahadornan di Empresanan y Fundacionnan Publico
    - Stichting Pensioenfonds Caribbean Mercantile Bank N.V.
    - Stichting Pensioenfonds Havenwerkers Aruba
    - Stichting Pensioenfonds META Bedrijven Aruba
    - Stichting Pensioenfonds N.V. Aruba Bank<sup>5</sup>
    - Stichting Pensioenfonds RBTT Bank Aruba I
    - Stichting Pensioenfonds RBTT Bank Aruba II<sup>5</sup>
    - Stichting Pensioenfonds Tourist Sector Aruba
5. Insurance Companies<sup>6</sup>
  - 5.1 Life insurance companies
    - American Bankers Life Assurance Company of Florida Limited, Agency

<sup>1</sup> Supervision by virtue of the State Ordinance on the Supervision of the Credit System (AB 1998, No. 16).

<sup>2</sup> Supervision by virtue of the State Ordinance on the Supervision of Money Transfer Companies (AB 2003, No. 60).

<sup>3</sup> Supervision by virtue of the State Ordinance on the Supervision of Trust Service Providers (AB 2009, No. 13).

<sup>4</sup> Supervision by virtue of the State Ordinance on Company Pension Funds (AB 1998, No. GT 17).

<sup>5</sup> In liquidation.

<sup>6</sup> Supervision by virtue of the State Ordinance on the Supervision of the Insurance Business (AB 2000, No. 82).



- American Life Insurance Company, Aruba Branch<sup>7</sup>
- British-American Insurance Company (Aruba) N.V.<sup>7</sup>
- Ennia Caribe Leven (Aruba) N.V.
- Fatum Life Aruba N.V.
- Guardian Life of the Caribbean Limited, Aruba Branch<sup>8</sup>
- Sagicor Life Aruba N.V.<sup>7</sup>

- 5.2 Captive insurance companies
- Bancarib Real Insurance Aruba N.V.
  - Fides Rae Insurance Company N.V.
  - MCB Risk Insurance N.V.
  - Mondis Manufactures Insurance Company N.V.

5.3 Nonlife (general) insurance companies

**Table B: Nonlife (general) insurance companies**

	Accident & health	Motor vehicle	Maritime, transport, & aviation	Fire & other property	Other indemnity
1. American Home Assurance Company Ltd.; Agency	X	X	X	X	X
2. Atradius Credit Insurance N.V.; Aruba Branch					X
3. Bupa Insurance Company, Agency	X				
4. Elvira Verzekeringen N.V.					X
5. Ennia Caribe Schade (Aruba) N.V.	X	X	X	X	X
6. Fatum General Insurance Aruba N.V.	X	X	X	X	X
7. Nagico Aruba N.V.	X	X	X	X	X
8. Netherlands Antilles & Aruba Assurance Company (NA&A) N.V.	X	X	X	X	X
9. TRESTON Insurance Company (Aruba) N.V.	X	X	X	X	X
10. Royal & Sun Alliance (Antilles) N.V.; Aruba Branch	X	X	X	X	X
11. Stichting Fondo Nacional di Garantia pa Vivienda					X
12. The New India Assurance Co. Ltd.; Aruba Branch	X	X	X	X	X
13. United Insurance Company N.V.	X	X	X	X	X

Source: CBA.

<sup>7</sup> Pursuant to section IX of the Implementation Ordinance on the State Ordinance on the Insurance Business (AB 2001, No. 91), subject insurance companies also are allowed to conduct nonlife insurance business in the indemnity group “accident and health insurance”.

<sup>8</sup> Portfolio will be transferred to Fatum Life Aruba N.V.

### Annex 3: Changes in the registers of supervised institutions and shareholding

#### Banking sector

- On June 11, 2010, in accordance with section 16, paragraph 1, sub e of the SOSCS, the CBA granted RBTT Bank Aruba N.V. approval for the change in its statutory book year from January 1 - December 31 to November 1 - October 31.
- On November 30, 2010, in accordance with section 16, paragraph 1, sub b of the SOSCS, the CBA granted AIB Bank N.V. permission to hold 100 percent of the shares of South Shore Real Estate N.V. through Alicante Properties N.V.

prohibits the conduct of the business of a trust service provider in or from Aruba without a license from the CBA. Pursuant to section 33, paragraph 1 of the SOSTSP, trust service providers registered at the Chamber of Commerce of Aruba before the state ordinance was ratified had a grace period of one year to obtain a license from the CBA if they wanted to continue to offer the trust services mentioned in section 1 of the SOSTSP after February 5, 2010. At the end of 2010, 15 trust service providers possessed a license as meant in section 2, paragraph 1 of the SOSTSP (Table C).

#### Trust service providers sector

- On February 5, 2009, the SOSTSP came into effect. Section 2, paragraph 1 of the SOSTSP

#### Insurance sector

- On January 5, 2010, and in accordance with section 1, paragraph 1 of the State Decree

**Table C: Overview of trust service providers licensed in 2010**

1. Euro Trust International N.V.	February 5, 2010
2. C.T.F. (Aruba) N.V.	February 5, 2010
3. IMC International Management & Trust Company N.V. whether or not through intermediation of IMC Management Services (Aruba) N.V., IMC Management Company (Aruba) N.V., Oyens Aruba Management Corporation N.V., ATS Management N.V. and IMC Corporate Services (Aruba) N.V.	February 9, 2010
4. ANT Management (Aruba) N.V.	March 1, 2010
5. AMTR N.V. whether or not through intermediation of AMTR Management N.V.	March 3, 2010
6. United Trust Management (Aruba) UTM N.V.	March 10, 2010
7. Orangefield Trust (Aruba) N.V.	March 10, 2010
8. Ascor Trust (Aruba) N.V.	March 12, 2010
9. Aruba International Trust Company N.V.	April 1, 2010
10. Nazca Services N.V.	April 1, 2010
11. ATC Trustees (Aruba) N.V.	April 6, 2010
12. C.M.S. Corporate Management Services N.V.	April 6, 2010
13. Van Lanschot Aruba Management Company N.V.	April 7, 2010
14. Arulex Trust Services N.V.	April 9, 2010
15. Curado Trust (Aruba) N.V.	October 21, 2010

Source: CBA.



Qualifying Holding Insurance Companies (AB 2003, no. 11) (SDQHIC), the CBA granted a declaration of no objection to American Home Assurance Company Ltd. and American International Group, Inc. with regard to its restructuring plan. This reorganization entailed that 100 percent of the common stock of Chartis, Inc. was transferred from American International Group, Inc. to American International Underwriter Holdings, LLC., which were then transferred from American International Underwriter Holdings, LLC. to Chartis Holdings, Inc.

- On November 17, 2010, and in accordance with section 1, paragraph 2 in conjunction with paragraph 3 of the SDQHIC, the CBA authorized Boogaard Aruba Holding N.V.,

as well as Mr. M. Mattke and Mr. G. Mattke to increase their qualifying holdings in New Treston Insurance Company N.V. to, respectively, 47.54 percent, 33.64 percent, and 32.54 percent.

On November 24, 2010, the CBA issued a declaration of no objection to New Treston Insurance Company N.V. for the change of its name to TRESTON Insurance Company (Aruba) N.V.

### **Company pension funds**

- On October 11, 2010, the CBA removed the Stichting Pensioenfonds Martijn Trading Company N.V. from its company pension fund register, following the final dissolution of this pension fund.

## Annex 4: Overview of supervisory activities and the organizational structure of the Supervision Department

Financial sector supervision is conducted mainly via targeted onsite examinations, ongoing offsite surveillance, and meetings with key personnel of the supervised institutions as well as the relevant representative organizations.

### *Onsite examinations*

During 2010, the Supervision Department conducted 16 targeted on-site examinations at nine credit institutions, three insurance companies, three money transfer companies, and one trust service provider. Of these on-site examinations, the CBA carried out targeted reviews in the area of AML/CFT at four commercial banks, three money transfer companies, one life insurance company, and one trust service provider.

### *Offsite surveillance*

The offsite surveillance encompasses, inter alia, the following activities:

- Bilateral meetings with the supervised institutions and the representative organizations on specific (e.g., AML/CFT) and general supervisory issues.
- Analysis of monthly, quarterly, and annual reports submitted by the supervised institutions, and reporting to the management of the CBA on the findings.
- Analysis of annual statements, regulatory filings, and management letters, and reporting the findings afterwards to the management of the CBA.
- Execution of regular risk profile exercises of the supervised entities.
- Filling out of questionnaires, surveys, and other information requests in the area of prudential and integrity supervision.

### *Organizational structure*

As of January 1, 2011, the Integrity Unit became a separate department within the CBA. The

decision to split the Supervision Department into a Prudential Supervision Department (PSD) and an Integrity Supervision Department (ISD) was motivated by the increasing size and complexity of the oversight in the broad area of integrity supervision, including the prevention and combating of money laundering and financing of terrorism, thereby requiring specialized personnel.

The main tasks of the ISD are: (1) to conduct fit and proper testing on an ongoing basis of managing and supervising directors as well as individual shareholders; (2) to oversee compliance with the laws and regulations in the area of AML/CFT at the supervised financial institutions; (3) to identify parties that operate on the Aruban financial market without a license or registration from the CBA; and (4) to closely monitor international developments in the area of AML/CFT, including the translation of these developments into supervisory directives and practices. In addition, the ISD is entrusted with the execution of the state ordinances that are primarily focused on maintaining a high level of integrity of the financial system (SOSTSP, SOSMTC). In the ordinances with dual objectives, the PSD has the lead, but will work closely with ISD if some issues are related to AML/CFT.

The main tasks of the PSD are: (1) to monitor the financial soundness of the institutions that attract funds from the public; (2) to evaluate various requests for approval emanating from the different supervisory laws, such as changes in group structure, changes in business plans, new license requests; (3) to conduct regular onsite examinations in the areas of corporate governance, asset quality, and prudential requirements; (4) to conduct periodic stress tests on the banking sector; and (5) to monitor international developments in the area of prudential supervision and to translate these into supervisory policy directives, policy papers and incorporate them in the CBA's supervisory practices.



The CBA's objective is to deploy its employees as efficient as possible, which allows the CBA to operate in several important areas with a relatively small staff number.



