ANNUAL REPORT 2002

CENTRALE BANK VAN ARUBA

cover:

Continuous vision

At night the building is a feast to the eye with its carefully designed illumination of all facades, accentuating its harmonious shapes and subtle details. It was designed to be viewed from all sides and angles; therefore, it does not have a typical "back".

Centrale Bank van Aruba

Annual Report and Financial Statements for the Year

2002

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Photographs
by
Diane Keijzer

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Centrale Bank van Aruba
Mission Statement

Working towards Financial Stability
for the Benefit of the People

Board of Supervisory Directors, Management and Senior Officers

(as of May 9, 2003)

Government Supervisory Director

Chairman of the Board of Supervisory Directors

A.J. Swaen

Members of the Board of Supervisory Directors

E.G.R. Cohen-Henriquez-Jansen

A.M. Nemecek

T.R.L. Vingal

R.E. Yrausquin

Executive Committee

President

A.R. Caram

Executive Directors

K.A.H. Polvliet

J.R. Figaroa-Semeleer

Department Managers

Audit

C.A. Connor

Operations

R.M. Geerman

Information Systems

J.S. Fräser-Blijden

Accounting

J.F. Kock-Kelly (acting)

Economic Policy

M.M. Tromp-Gonzalez

Supervision

P. Mungra

Secretariat and Archives

O.A. van der Biezen

Cash and Vault

H.M. Dacal-Oduber

Personnel and Organization,
Security, General Affairs

F.P. Meijer

Valuable monumentality

The building stands proudly in the middle of its beautifully landscaped environment, radiating stability, value, integrity, and monumentality. The latter is achieved by following the rules of symmetry, as well as keeping sufficient distance from the entry and borders. Designed and shaped in a distinctive way, it represents a modern version of the classical colonial Aruban architecture.

A Monument at the crossroads

The Centrale Bank van Aruba (the Bank) was established on January 1, 1986, when Aruba obtained its "Status Aparte" within the Kingdom of the Netherlands. At that time, the Bank was accommodated in an office just west of the Protestant Church in the center of Oranjestad. This building soon became too small, and some departments had to move to an offsite location, causing a lot of inconvenience. In due course, the need for more and better space kept growing. Finally, in July 1990, the first steps were initiated to construct a new office building.

The Bank's Management contracted us to make a design. The so-called Dr. Eloy Arends Building and the former Hotel Colombia, two historical and monumental buildings dating to the beginning of the twentieth century, were selected to be restored and integrated with a new complex. The design showed interesting architectural and functional features. However, due to the lack of parking space and the traffic congestion, a better location was needed. After considering several options, the site near the new commercial park at the Irausquin Boulevard was chosen: a perfect spot, lying just outside the town center, at the crossroads of the boulevards leading to the major hotels and shopping malls.

As the architect, it was certainly a challenge to create a building that met all of the functional requirements, such as sufficient office, working, and storage spaces, harmonious interrelations in a comfortable and efficient environment, as well as security. Also, the building needed to radiate confidence, serenity, dignity, durability, and, perhaps most of all, monumentality, without being too presumptuous and outrageous in its appearance. Moreover, it was stipulated in the terms of reference that the style must relate to the traditional local architecture.

In April 2001, the construction of the building finally began; it was inaugurated on November 15, 2002. Because of its impressive appearance and architectural qualities, the edifice has gained the admiration of the general public and has become a landmark. We are fortunate to add this building to our list of projects. I would like to express my appreciation to the Bank for the given trust. It is my sincere hope that the building will always be a pleasant place to work in and an inspiration to others.

Earon Matthew,
Architect and Manager of PLAN'D2 in Aruba.

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During 2002, the economy of Aruba again was confronted with a considerably adverse external climate. The United States, its main trading partner, saw a certain recovery, supported by accommodative monetary and budgetary policies. However, in the latter part of the year, consumer confidence and the business climate in that country worsened, due to, inter alia, a sequence of geopolitical tensions, the bursting of the stock market bubble, and corporate accounting scandals. Investment remained subdued. International trade was affected by the then still-strong dollar and much weaker recoveries in most other parts of the world economy.

Under these circumstances, people were reluctant to travel abroad. The number of Americans visiting Aruba, who represent about two-thirds of Aruba's tourists, declined by almost 3 percent, following a similar fall in 2001. Furthermore, developments in Aruba's second largest tourism market, Venezuela, were plainly dramatic. The serious political and social turbulence in that country resulted in a crumbling domestic production. As a consequence, 25 percent fewer Venezuelan tourists came to Aruba.

Overall, the total number of nights that visitors spent on the island fell by almost 6 percent in 2002, compounding the 2 percent decline in 2001. Although the performance of Aruba's tourism industry was less dismal than the Caribbean average, regional production increased by an estimated 5 percent cumulatively during the past two years, due to the higher degree of diversification and the execution of counter-cyclical expenditure policies in some of these countries. In contrast, Aruba's gross domestic product fell by one percent in 2001, and by 4 percent in 2002. Nominal per capita product declined to US$ 20,000, although it remained one of the highest in the region. The income distribution is quite uneven, however, and a large part of income accrues to nonresidents.

The malaise in tourism has had a profound impact on the Aruban economy. Both directly and indirectly, this sector generates an estimated 60 percent of gross domestic product, while its share in the current foreign receipts (excluding oil) amounts to a significant 80 percent. Export earnings were affected because prices for tourist facilities came under downward pressure. Moreover, private capital outlays remained low. Public sector investment was scaled down to a mere 0.5 percent of gross domestic product, as the government struggled with liquidity shortages, while the funds available to the Fondo Desaroyo Aruba hardly were mobilized due to administrative and organizational bottlenecks.

Despite the ongoing recession in Aruba, final consumptive spending in real terms increased by an estimated 2 percent in the household sector and by a notable 8 percent on the government front during 2002. The former was supported by a 13 percent expansion in bank credit, compared to 5 percent in 2001. This expansion contributed to an acceleration in the increase in the money supply from 6 percent to 11 percent. These developments were related partly to the suspension of the credit ceiling system at the beginning of 2002. With this policy measure, the Bank aimed at contributing to a recovery in general business activity.

The effect of the credit growth on the local production was far too insufficient to compensate for the slump in tourism and investment, as the loans granted were directed mainly towards consumptive spending, which normally generates a relatively low domestic value added due to its large import component. This experience confirms that in a small, open, and undiversified economy, a rise in credit may stimulate spending in the short term, but by itself this monetary impulse cannot induce sustainable real growth. The latter growth requires a dynamic entrepreneurial spirit, high factor productivity, a competitive domestic cost structure, an adequate institutional framework, and a favorable international economic climate.

Simultaneously, inflationary pressures increased, due mainly to higher water and electricity tariffs and gasoline prices, following erratic movements in the world market price of crude oil, as well as the raising of certain excise and import duties. A decline in labor productivity also appears to have played a role in this respect because despite the lower production, unemployment rose modestly, forced dismissals were limited, and wage developments remained subdued. The annual average increase in the consumer price index accelerated from 2.9 percent in 2001 to 3.3 percent, resulting in a widening of the inflation differential with the United States to 1.7 percentage points. Compared to 2001, the inflation rate even reached 4.2 percent at the end of 2002. This rise is a cause for concern because inflation erodes the purchasing power of money, may undermine confidence in its future value, induces speculative transactions, discourages long-term productive investment, and threatens the economy's international competitive position.

The buoyant consumption of residents also stimulated the final merchandise imports, contributing to a weakening in the current account of the balance of payments on a cash basis. The latter was reinforced by the allocation of dividends to nonresidents in anticipation of the introduction of a dividend tax at the beginning of 2003. An overall balance of payments deficit was avoided only because the government was able to attract external commercial borrowings amounting to Afl. 136 million, while the Fondo Desaroyo Aruba received Afl. 37 million in Dutch development aid to finance projects. On balance, net foreign assets of the monetary sector rose by Afl. 57 million to a record of Afl. 756 million in 2002.

The 12-month moving average coverage ratio of net foreign assets to merchandise imports (excluding oil) increased to 7.5 months, comfortably exceeding the 5 to 6 months target range. This increase helped to preserve confidence in the fixed exchange rate between the Aruban florin and the U.S. dollar. It should be noted, however, that the foreign assets position will come under downward pressure as soon as remaining government deposits at the banking system are mobilized. One certainly should not conclude that a large part of the available foreign exchange reserves and liquidity in the banking sector could be used for granting additional loans. Thus, a cautious monetary policy stance should be maintained to preserve the peg with the U.S. dollar.

To limit the risks that excessive money creation may fuel inflation further and affect the present strong foreign assets position, the Bank, after consulting with the Aruban Bankers' Association, has decided that during 2003 the increase in commercial banks' domestic lending should not exceed 7 percent. The aim is to bring domestic money creation in line with the long-term growth potential of the economy, taking into account the autonomous imported inflation.

To ensure macroeconomic growth and financial stability, the deteriorating trend in the public finances also should be reversed without further delay. Indicative of this deterioration is that the borrowings required to cover the cash-basis deficit and maturing debts surged from Afl. 54 million in 2001 to a record Afl. 134 million in 2002 or 4 percent of gross domestic product. Consequently, outstanding debt rose to Afl. 1.2 billion or 37 percent of gross domestic product. Although the latter ratio appears low by international standards, one also should take into consideration that Aruba's debt-servicing capacity is relatively small due to its specific economic structure.

Moreover, according to the 2003 budget, further borrowings of an ample Afl. 154 million are anticipated if present policies remain unchanged. This amount is exclusive of the obligations ensuing from the settlement of the hotel guarantee and racetrack issues of the past, which requires an ample US$ 120 million or 6 percent of gross domestic product. These obligations will be covered mainly by channeling the proceeds of a long-term foreign commercial loan attracted by the telecommunications company to the government, in connection with its obtainment of a corporate status within the public sector. Moreover, the Afl. 34 million (US$ 19 million) balance in the hotel guarantee fund at the Bank was used up in May 2003.

Corrective budgetary efforts should be taken more consistently and swiftly. On several occasions, the Bank and various experts have strongly advised policymakers on the actions to take. In principle, these actions all boil down to containing consumptive spending, stimulating viable public investment, modernizing the revenue-generating system, addressing weaknesses in the tax administration, and making adequate financing arrangements.

The recently introduced New Fiscal Framework for corporations, which entails a phasing-out of the generous offshore and tax-holiday regime, is a step in the right direction. Additionally, the decline in the tax-to-GDP ratio may be reversed by the introduction of a broad-based tax on consumption, while not raising the already high tax burden on labor income. Long-delayed spending reform plans should be quickly implemented.

The creation of a lean and efficient civil service entrusted with the execution of a limited number of core tasks, the cutting back of the exceptionally expensive public employee pension system, and the reduction of the disproportionate government contribution to the general health care fund are advocated widely. The latter implies that premiums should be raised, and further cost reductions should be realized. Only if these measures are executed will it be feasible to finally reach a balanced budget as advised by the so-called Van Lennep Commission back in 1996.

Although actually restructuring the public finances is complicated and in the short term, a quite unpopular task, there is little choice. If no effective action is taken, the budgetary problems will cumulate into monetary and balance-of-payments disruptions, and the access to the capital markets may be progressively hindered. Then the budgetary policy will conflict even more with the Bank's goal of safeguarding financial stability, a situation that may affect seriously the viability of the economy.

It is generally accepted that strictly adhering to disciplinary rules of budgetary policy, supplemented by transparency and accountability, adds to fiscal consolidation and macroeconomic stabilization. Therefore, the government should follow the advice of a recent IMF Article IV Consultation mission to reduce the financial deficit by about one percentage point of gross domestic product per year. Unfortunately, measured against this benchmark, the intentions laid down in the 2003 draft budget are disappointing. The loss in anticipated revenue caused by postponing the introduction of a new indirect tax on imports and services should be compensated one way or another.

The Bank supports fiscal discipline by not granting credit to finance budgetary deficits. Also, the practice of financing the deficit through the accumulation of payment arrears should be abandoned because it undermines confidence in the public sector. Borrowing money on the local capital market should be limited to a maximum of one percent of gross domestic product, given its small absorption capacity. No recourse should be taken to the money-creating institutions, because of its monetary consequences. Any remaining deficit should be financed with foreign loans to protect the monetary sector's reserve position. Loan proceeds should not be used to finance current expenditures and to repay maturing debts, but rather to finance projects that generate additional income and foreign exchange earnings.

If these principles of effective debt management are not followed, debt sustainability will be undermined and financial stability threatened. The present problems then will simply be transferred to the future, already heavily burdened by the expected increase in pension obligations and health costs ensuing from the aging population. Calculations of the IMF mission indicate that the achievement of a budgetary balance by 2007, and a certain primary surplus thereafter, is required to maintain a sustainable tolerable debt position in the long run. A further increase in the government's debt position also may affect Aruba's present rather favorable credit rating, and lead to higher borrowing costs.

The economic outlook for 2003 remains rather uncertain, as project preparation is delaying the execution of current investment plans, particularly in the public sector. Additionally, the number of visitor nights declined by another one percent during the first three months of the year, due mainly to the enduring turbulent situation in Venezuela, new international uncertainties associated with the war in Iraq and its aftermath, as well as the threat of the spreading of the SARS virus. Also, the increase in the consumer price index continues to accelerate, reaching 5.7 percent at the end of March 2003 compared to a year earlier, while the inflation differential with the United States has widened further.

Thus, the challenge remains to revitalize the economy and more intensively exploit the comparative advantages in tourism, while at the same time diversifying the production structure to reduce Aruba's vulnerability to external shocks, and preserving financial stability. A new strategic initiative should be taken, based on public-private partnership. This strategy has borne ample fruits in the past. In this framework, good and transparent public governance should be pursued aimed at creating a climate conducive to economic growth. Entrepreneurs should take more initiatives to implement feasible projects. The national dialogue should be resumed to quickly reach a social accord on long-standing issues such as the formulation of a development program to enlarge Aruba's growth potential and the unsolved structural challenges.

Under the current circumstances, major domestic cost components should be frozen for the next two years to encourage investment and to reverse the deteriorating trend in Aruba's international competitive position. The government has set a good example by suspending the wage indexation for three years. Such measures may contribute to creating a situation where investment, not consumption, is the main engine of economic growth. To shift the structure of spending requires additional actions.

The Bank stands ready actively to assist in overcoming the present delicate economic and financial situation. In conformity with the Central Bank Ordinance, the Bank will continue its autonomous policies to preserve confidence in the future value of the florin, promote soundness, efficiency, and integrity in the financial system, supply secure bank notes, and facilitate the smooth settlement of domestic and foreign payments.

An internet-based payments-clearing system has recently become operational, and during 2003, new bank notes with additional authenticity features will be brought into circulation. On the monetary front, we will gradually switch from direct to market-based instruments of monetary policy. This switch may promote a better allocation of credit, stimulate competition within the banking sector, and reduce the current notably wide interest-rate spreads.

At the institutional level, the process of strengthening prudential and integrity supervision is being pursued in line with the recommendations of the recent IMF assessment of Aruba's financial sector. In the meantime, the supervisory scope has been broadened to the insurance sector, and legislation is underway with respect to money-transfer companies and company service providers. In due course, the government pension fund also may be brought under the Bank's supervision. Aruba recently also implemented a law requiring declaration of import and export of cash monies exceeding a certain threshold. Additional actions are prepared to become fully compliant with the guidelines of the Financial Action Task Force to combat money laundering and terrorist financing via the financial system.

The Bank also follows other relevant international standards for effective central banking and the rules of conduct of good corporate governance. Its internal management and organizational efficiency are being improved further to remain financially strong, well-equipped, transparent, accountable, and credible. Initiatives are taken to sharpen the Bank's focus on its core functions. Additional investments in enhancing the quality of its staff and in information technology are being made to improve performance. With inspiration and dedication, we will continue to provide adequate services and fulfill our responsibilities to the people of Aruba.

Frugal dignity

The use of marble on the facades and in the interior enriches the building, giving it the required allure, while this high quality material provides durability and lasting beauty without being presumptuous.

Operations of the Bank

2

2.1 Core functions

The Bank is established through the Central Bank Ordinance as an autonomous legal entity (sui generis) within Aruba's public sector. It began operations on January 1, 1986, when Aruba obtained its status as an autonomous country within the Kingdom of the Netherlands. At the same time, the Aruban florin was brought into circulation and pegged to the U.S. dollar at a rate of Afl. 1.79 = US$ 1.00. The Bank is entrusted with the following tasks and related activities:

Tasks	Related activities
a. Issue bank notes, as well as coins on behalf of the government	Bring safe and secure bank notes and coins into circulation to meet the needs of businesses and the general public
b. Promote efficiency in settling domestic payments	Operate an automated clearing system between the commercial banks and a number of government-related institutions
c. Act as the banker for the government	Execute payment orders and intermediate in the issuance of government debt papers
d. As the central foreign exchange bank, regulate the flow of international payments	Facilitate and regulate payments between residents and nonresidents and collect foreign exchange tax
e. Manage Aruba's official reserve, consisting of gold and foreign exchange holdings	Invest the Bank's foreign exchange holdings in accordance with cautious guidelines aimed at achieving its policy goals
f. Advise the Minister of Finance on financial matters	Produce relevant information and give expert advice
g. Monitor economic and financial developments	Collect and analyze financial and economic data, published in monthly, quarterly, and annual reports
h. Conduct monetary policy	Formulate and implement measures to, inter alia, regulate bank credit and liquidity, and to contribute to a solid economic performance and rising living standards for the people of Aruba
i. Supervise the financial system	Monitor developments in the risk profile of a number of financial institutions to protect the interests of their clients and to contribute to maintain financial system stability and integrity

2.2 Domestic payment system

2.2.1 Bank notes and coins

Total florin currency in circulation amounted to Afl. 163 million at the end of 2002, equal to 4.9 percent of nominal GDP. Due to the co-circulation of U.S. dollars within the Aruban economy largely associated with tourism activities, this ratio is quite low by international standards. Growth in the florin circulation amounted to 4.1 percent, despite a 0.7 percent decline in nominal GDP.

In accordance with article 7 of the Central Bank Ordinance, Aruban florin bank notes are issued in denominations of Afl.10, Afl. 25, Afl. 50, Afl. 100, and Afl. 500. At the end of 2002, their value amounted to Afl. 147.4 million, i.e., Afl. 5.6 million or 4 percent higher than in 2001. The shares of the various denominations in the total remained virtually unchanged.

The aggregated value of coins (excluding commemorative coins) issued on behalf of the government in 2002 was Afl. 15.5 million, i.e., 5.5 percent more than in 2001. In 2002, the Bank issued one collectors quality 10 florin silver coin to commemorate the royal wedding between H.R.H. Prince Willem-Alexander and Máxima Zorreguieta.

From time to time, very small amounts of counterfeit notes and coins are detected in circulation, a phenomenon that creates some turbulence and may undermine public confidence in our currency. Therefore, the Bank works closely with the law-enforcement agencies to monitor, analyze, and deter counterfeiting. Moreover, educational programs are executed to increase awareness of the key security features of the genuine bank notes and coins. After all, the best defense against counterfeiting is a well-informed public.

Commemorative coin
10 florin silver coin in commemoration of the wedding between H.R.H. Prince Willem-Alexander and Máxima Zorreguieta.

2.2.2 Automated clearing system

The Bank manages an electronic batch-clearing system, in which the commercial banks, the Ministry of Finance, WEB (Water and Electricity Company), and SETAR (the telecommunications company) are participating. It enables inter-bank check clearing, as well as fund transfers.

For the second consecutive year, both the volume and the value of checks processed declined, i.e., by 10.3 percent to 818,000 and by 2.6 percent to Afl. 2.3 billion, respectively. These declines were due to the increasing preference for using direct debit instruments as means of payment. In contrast, the value of fund transfers rose in 2002 by a notable 38.1 percent to Afl. 2.9 billion, equivalent to 86 percent of nominal GDP.

2.2.3 Interest payments

The government and several financial institutions deposit monies at the Bank. Interest is paid on certain current account balances and on all time deposits, including the required monetary cash reserves. The interest rates are based on the corresponding remunerations of the Federal Reserve Bank of New York. During 2002, interest payments declined by two-thirds to Afl. 1.7 million, Afl. 0.3 million of which was paid to the government. This decline reflected the sharp drop in U.S. money market rates.

2.2.4 Banking for the government

In accordance with article 14 of the Central Bank Ordinance, the Bank at no cost implements domestic and foreign payments for the government. These payments are cleared through the Treasury's current account, which stood at Afl. 12.3 million at the end of 2002. Deposits held in both earmarked and development fund accounts increased by Afl. 12.2 million to Afl. 51.9 million and by Afl. 16.6 million to Afl. 47.9 million, respectively.

The Bank arranged the periodic renewals of two maturing three-month treasury bill issues totaling Afl. 40 million, which yielded between 1.03 percent and 3.6 percent, as well as Afl. 8 million in six-month cash certificates at annual yields of 1.06 percent and 1.10 percent. One 6.25 percent bond issue of Afl. 30 million was placed primarily on the domestic market. To safeguard monetary stability, the Bank does not grant loans to the government.

2.3 International payment system

2.3.1 Daily exchange rate fixing

In 2002, about 84 percent of all international payments were settled in U.S. dollars, significantly less compared to a year earlier, because more payments were carried out in euros. The Bank's buying and selling rates for the U.S. dollar from and to the commercial banks remained fixed at Afl. 1.7895 and Afl. 1.7905, respectively. Daily quotations for a number of other foreign currencies are published, based on data provided by the European Central Bank.

The exchange rate of the euro vis-à-vis the Aruban florin, the second most important currency for the settlement of international payments, fluctuated between Afl. 1.54 and Afl. 1.89, or within a margin of 23 percent. At the end of 2002, the euro stood at Afl. 1.89, implying a 19 percent appreciation compared to a year earlier.

2.3.2 Foreign exchange policy

In accordance with IMF recommendations, the Bank further liberalized its foreign exchange policy. As of July 1, 2002, the upper limits to execute capital transactions without any administrative restrictions were raised from Afl. 200,000 to Afl. 300,000 annually for natural persons, and from Afl. 500,000 to Afl. 750,000 for legal entities (excluding commercial banks and institutional investors). In general, special licenses for amounts exceeding the indicated limits are granted quite liberally in the case of regular transactions. Current payments are not subjected to any restriction.

During 2002, the Bank granted 94 foreign exchange licenses, amounting to about Afl. 610 million, i.e., Afl. 137 million less than in 2001. This decrease was associated mainly with significantly lower refinancing of local and foreign loans, as well as less loans related to infrastructural projects. The refinancing component constituted 23 percent of the total amount granted.

2.3.3 Foreign exchange tax

The State Ordinance on foreign exchange commission stipulates that residents must, in general, pay a 1.3 percent tax on payments to nonresidents. The government is responsible for determining the policy, while the Bank is entrusted with the collection thereof. Transactions in Netherlands Antillean guilders are exempted on the basis of an agreement between the two governments. Certain groups of companies (mainly government-related) also are exempted by virtue of the State Decrees on foreign exchange commission exemption of 1995, 1998, and 2001.

Additionally, based on article 12 of the State Ordinance on the free zone of July 2000, the companies concerned may request an exemption to the extent that their payments for goods and services are linked to re-exports. Offshore companies that have been exempted from a number of provisions of the State Ordinance on foreign exchange transactions, as well as Aruba Exempt Corporations, are considered nonresidents and are, therefore, not subject to this tax.

Due to the verdict of the Common Court of Justice of the Netherlands Antilles and Aruba of July 17, 2002, the Bank no longer collects foreign exchange tax on payments to nonresidents that are not executed through a local commercial bank or exchange office, checking account transfers settled in foreign currencies, and payments made by a foreign corporation for and on behalf of affiliated residents settled via inter-company accounts.

In 2002, total collections declined by 10.9 percent to Afl. 21.8 million. Of this amount, Afl. 14.4 million was transferred to the Treasury. The share of the latter in total tax receipts fell from 4.1 percent to 2.4 percent.

2.4 Managing the official foreign exchange reserve

Pursuant to article 12, sub 1, of the Central Bank Ordinance, the Bank is entrusted with the management of the country's official foreign exchange reserve. Its profits are predominantly derived from this activity. Investment is made through asset managers in U.S. government and (explicitly or implicitly) government-guaranteed paper, bonds issued by qualifying supranational financial institutions, and money-market instruments of and accounts with at least double A-rated credit institutions. The Bank also deals directly with a number of foreign credit institutions.

A framework of stringent guidelines has been established to contain the various risks inherent in holding these investments, and also to ensure that, if necessary, sufficient assets can be liquidated swiftly without appreciable losses to settle foreign obligations to preserve Aruba's international liquidity position and to safeguard confidence in the stability of the value of the florin.

2.5 Monetary policy

At the beginning of 2002, the Bank temporarily suspended the credit ceiling system, following the slowdown in general economic activities. However, the commercial banks were asked to exercise self-discipline to avoid excessive growth in lending. As this was not done, and the increase in credit amounted to an ample 13 percent at the end of 2002, the Bank decided formally to re-introduce the credit ceiling system to maintain financial stability. After consulting with the Aruban Bankers' Association, it was decided that during 2003 the increase in credit should be limited to 7 percent to bring it more in line with the long-term growth potential of the economy, taking into account the expected autonomous inflation.

Given the still existing large potential credit demand, containing credit growth will require a shift from consumptive to more productive lending. To encourage such a shift and to improve the information provided to the public, as of March 1, 2003, the commercial banks must explicitly indicate the effective annual interest rates in advertisements on loan products to consumers, if, directly or indirectly, reference is made to the price of such products.

The B-9 arrangement, which regulates the distribution of the foreign exchange reserves between the commercial banks and the Bank, as well as the 7 percent monetary cash reserve requirement, remained unchanged.

2.6 Prudential supervision

The Bank's activities related to prudential supervision continued to aim at preventing, as much as possible, financial institutions from taking unacceptably high risks that could harm the interests of depositors and policyholders or endanger the stability and integrity of the financial system. With this aim, continuous off-site surveillances and periodic risk-oriented on-site examinations are conducted. Moreover, regular discussions are held with the management of individual institutions, as well as with the various representative organizations. Please refer to chapter 4 for an elaborate discussion on prudential supervision.

2.7 Financial highlights

- In 2002, the Bank's total assets increased by Afl. 106.8 million or 17.8 percent to Afl. 706.1 million. This increase was attributed mainly to a 15.7 percent surge in foreign currency claims to Afl. 608.1 million.

- Total income (net of interest expenses) was Afl. 25.5 million, Afl. 8.2 million or 24.2 percent lower than in 2001 due to a significant decline in yields on foreign investment as U.S. dollar interest rates reached historical lows.

- Expenses totalled Afl. 8.9 million, i.e., Afl. 0.4 million or 4.2 percent lower than in 2001, ascribed largely to a decline in depreciation costs and printing costs of bank notes. Personnel costs remained unchanged at Afl. 6.2 million.

- On balance, profit amounted to Afl. 16.7 million or Afl. 7.8 million less than in 2001. Pursuant to article 4 sub 2 of the Central Bank Ordinance, and with approval of the Minister of Finance, Afl. 12.6 million was distributed to the Treasury, while the remainder was added to the general reserve.

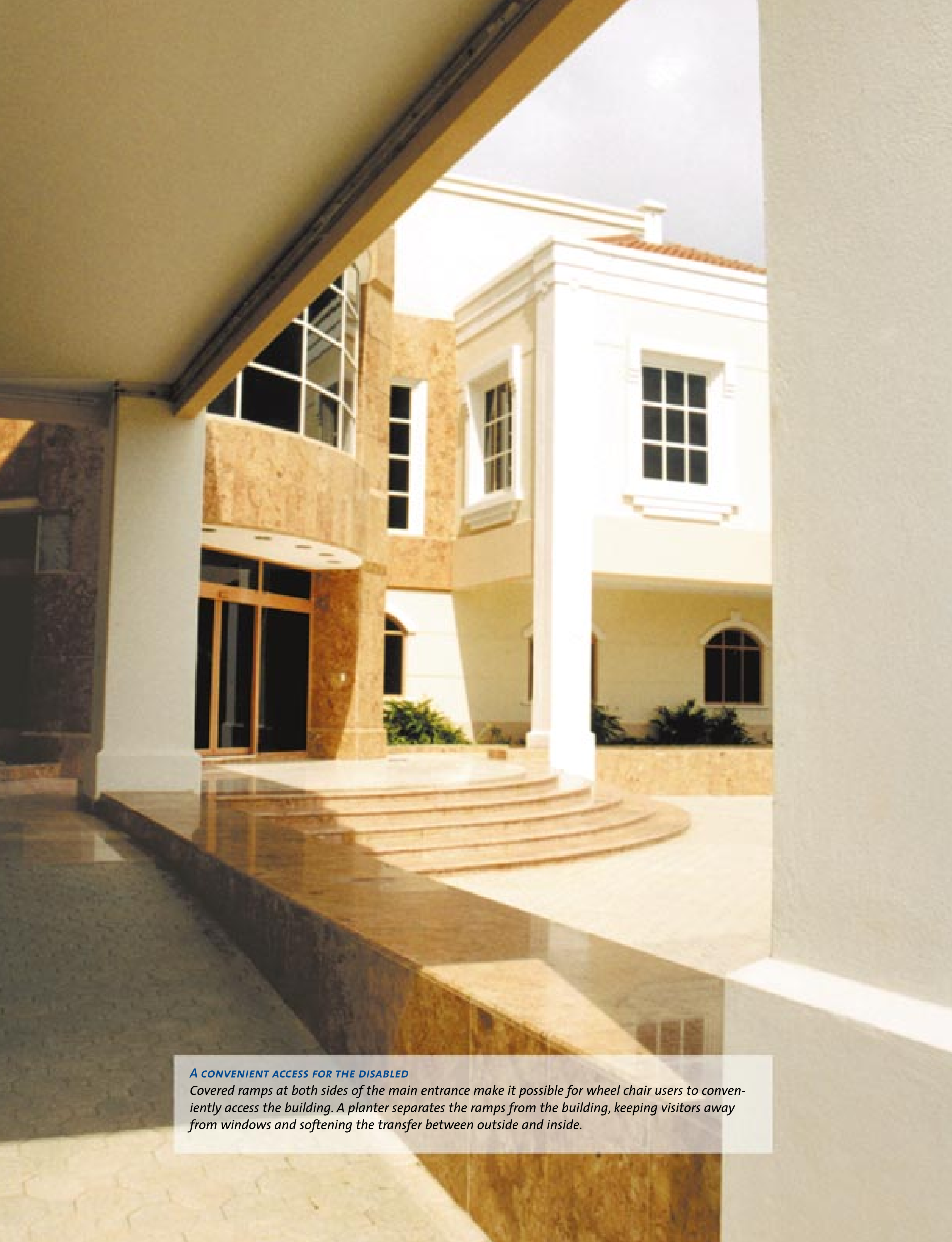
2.8 Organizational affairs

In compliance with article 25 of the Central Bank Ordinance, the Board of Supervisory Directors and the Executive Committee held four joint meetings during 2002. Moreover, the Chairman of the Board and the President of the Bank held weekly bilateral meetings.

During 2002, the Bank enhanced its internal management so it could effectively deliver its commitment to the people of Aruba. Major initiatives have been undertaken to sharpen the focus on its core functions and to perform according to best corporate practices. The Bank's employees again were called upon to meet a number of challenges, which they have done in a dedicated and professional manner. Moving into a new office building in September 2002 greatly improved the quality of the working environment. The Executive Committee wishes to express its appreciation to the staff for their loyalty and service. The number of employees remained unchanged at 54.

Members of the Board of Supervisory Directors, l.-r.:
A.M. Nemecek, E.G.R. Cohen-Henriquez-Jansen, A.J.Swaen, T.R.L. Vingal, and R.E. Yrausquin.

The Executive Committee, l.-r.:
K.A.H. Polvliet, J.R. Figaroa-Semeleer, and A.R. Caram.



A CONVENIENT ACCESS FOR THE DISABLED

Covered ramps at both sides of the main entrance make it possible for wheel chair users to conveniently access the building. A planter separates the ramps from the building, keeping visitors away from windows and softening the transfer between outside and inside.

Economic and Financial Developments

3

3.1 The international environment

During 2002, recovery of the global economy was weak and hesitant. The growth rate of world output edged up only slightly, i.e., from an estimated 2.3 percent in 2001 to 3.0 percent, and unemployment rose further, despite a rebound in international trade. Major factors contributing to this disappointing performance were rising uncertainties associated with geopolitical tensions in the build up to the war in Iraq, the bursting of the stock market bubble, and the ensuing fallout in demand for goods and services. These uncertainties also were reflected in higher prices for crude oil and gold, but in the advanced economies, the increase in consumer prices decelerated from 2.2 percent to 1.5 percent.

The recovery was led mainly by the United States, which initially benefited, inter alia, from accommodating monetary and fiscal policies, strong productivity growth, and buoyant consumer spending. However, in the course of the year, the business sector's investments were cut back due to the uncertainties referred to earlier, as well as the public disclosure of certain corporate governance scandals. In contrast, economic activity in Japan remained virtually stagnant; its GDP grew by a mere 0.3 percent, reflecting modest increases in both domestic and foreign demand. Economic development in the euro area continued to disappoint. Although rising exports helped to initiate a recovery, the increase in domestic spending again was weak, especially in Germany. Consequently, the growth rate decelerated from 1.4 percent to 0.8 percent. The Dutch economy recorded a similar performance.

In the Asia-Pacific region (excluding Japan) there was an impressive expansion, particularly in China and South Korea, mainly because of surges in exports and higher domestic demand. Meanwhile, Latin American countries continued to be affected by the severe crisis in Argentina, the political uncertainty in Brazil, and lower capital inflows due to the risk-averse international financial environment. Economic activities were particularly harsh in Venezuela, where the political and economic crisis resulted in a notable 8.9 percent decline in real GDP. The Caribbean region continued to suffer from the worldwide malaise in tourist travel. Even so, the average growth rate accelerated somewhat, i.e., from 1.9 percent to 2.8 percent in 2002.

Global recovery is expected to continue at a relatively subdued pace in 2003, inter alia, because of only limited signs of a revival in investment. The United States will again take the lead if the uncertainty dissipates, confidence is restored, and additional fiscal stimulus is provided. However, the world economy faces major downside risks. U.S. dollar interest rates are likely to start moving upwards due to increased inflation expectations. Activities in the euro area and Japan may grow only modestly because domestic demand is still weak. Latin America may recover somewhat from the recession, but the situation in Venezuela will probably deteriorate further, while growth in the Caribbean will remain relatively low. Moreover, further appreciation of the euro against the dollar will be detrimental to European exports.

3.2 The domestic real sector

In 2002, the Aruban economy remained in recession. GDP in real terms contracted for the second consecutive year, by an estimated 3.9 percent (2001: -1.2 percent). This unfavorable development was caused mainly by a decline in tourism activities, due to geopolitical uncertainties and the social turbulence in Venezuela, Aruba's second main tourist market. Consequently, on a transactions basis, export of goods and services fell by 11 percent in real terms, while imports shrank by 2 percent. An excessive expansion in bank credit contributed to a 4 percent increase in consumption. After three consecutive years of contraction, investment grew by 3 percent, fully ascribable to the private sector. Due to liquidity constraints, investment by the government was scaled down to a mere 0.5 percent of nominal GDP. On balance, real GDP per capita fell by a notable 5 percent (see table 1).

Table 1 Main economic indicators

	2000	2001	2002
1. Gross domestic product			
Nominal GDP (x Afl. million)	3,326	3,381	3,357
Population (period average)	90,600	91,852	93,279
GDP per capita (in Afl.)	36,711	36,809	35,987
Real GDP growth (in percent)	3.6	-1.2	-3.9
2. Labor market 1)			
Unemployment rate (in percent)	4.7	6.4	8.1
Participation rate (in percent)	64.9	64.6	64.2
3. Tourism			
Tourism receipts (x Afl. million) 2)	1,538.3	1,605.1	1,616.7
Stay-over visitors (x 1,000)	721.2	691.4	642.6
Visitor nights (x 1,000)	5,248	5,145	4,863
Average hotel occupancy rate (Aruba)	75.9	75.6	71.7
Average hotel occupancy rate (Caribbean)	67.7	63.8	63.5
Average daily rate hotels (US$) (Aruba) 3)	130	136	138
Average daily rate hotels (US$) (Caribbean)	141	150	145
Revenue per available room (US$) (Aruba) 3)	72	75	69
Revenue per available room (US$) (Caribbean)	95	96	92
Cruise visitors (x 1,000)	490.0	487.3	582.2
Aruba's market share in the Caribbean			
- stay-over visitors	3.6	4.0	3.8
- cruise tourism	3.5	3.4	3.7
4. Price developments			
Inflation (end of period, in percent)	3.5	2.6	4.2
Inflation (period average, in percent)	4.0	2.9	3.3
Real exchange rate index (1995 = 100) 4)	102.0	102.0	103.8

1) Preliminary estimates by CBA.
2) Gross receipts from stay-over and cruise tourism as well as other tourism-related income (including, inter alia, the sale proceeds of time-share units) as recorded on a cash basis in the balance of payments.
3) Including time-share.
4) Relative to the U.S.A. Based on CPI period-average.

Aruba's tourism performance was somewhat less bleak than that of the other countries in the region. During the past two years, the number of tourists visiting the Caribbean declined by 16 percent on a cumulative basis, compared to 11 percent in Aruba. Also with respect to cruise tourism, our country performed better: the number of passengers rose by 19 percent, compared to 10 percent in the region.

On a sectoral level, activities in the trade sector in 2002--as monitored by the Central Bureau of Statistics through its Partial Economic Activity Index (PEAI)--were 4 percent lower than in 2001. Hotel and restaurant sales were down by 5 percent, reflecting the malaise in tourism. Additionally, activities in the construction sector were 16 percent lower despite the ongoing building of the Marriott Surf Club. The utility sector experienced a modest growth of about one percent.

The annual increase in the consumer price index accelerated by 0.4 percent to 3.3 percent. By the end of December 2002, the inflation rate reached 4.2 percent, up by 1.6 percentage points compared to a year earlier. This increase was attributed largely to higher prices for clothing, utilities, gasoline, and related products. The inflation differential with Aruba's major trading partner, i.e., the United States, widened by 1.6 percentage points to 1.7 percentage points; the real exchange rate index of the Aruban florin vis-à-vis the U.S. dollar rose accordingly to 103.8, putting additional pressure on Aruba's competitive position. Adjusted for the energy-related components (i.e., water, electricity, and gasoline), the index increased only marginally to 2.9 percent.

3.3 The financial sector

During 2002, monetary conditions were dominated by a notable Afl. 154 million net domestic money creation in contrast to an Afl. 27 million destruction in 2001. This dramatic increase was brought about mainly by an upsurge in commercial bank loans, following suspension of the credit ceiling system. The measure aimed at supporting an economic recovery via stimulating the financing of productive investment. Credit to enterprises, consumer loans, and housing mortgages rose by 13 percent, 12 percent and 10 percent, respectively (see table 2). However, the loans granted were directed largely towards consumptive spending and the importing trade sector, which generate a relatively low added value and high imports.

The financial transactions of the government with the monetary system contributed with Afl. 36 million negatively to the increase in money supply. However, there was an Afl. 39 million net inflow of funds from abroad attributed predominantly to large public sector borrowings on commercial terms and a grant from the Netherlands. Monetary growth accelerated sharply, i.e., by 5 percentage points to 11 percent. Consequently, the money supply-to-GDP ratio surged by 6 percentage points to 61 percent. Narrowly-defined money and quasi-money rose by 20 percent and 4 percent, respectively.

Table 2 Causes of changes in the money supply
(in Afl. million or stated otherwise)

	2000	2001	2002
1. Net domestic money creation	86.0	-27.4	**154.0**
a. Net domestic credit	117.6	31.8	**157.9**
1. Public sector	-13.4	-24.7	**-36.2**
2. Private sector	131.0	56.4	**194.1**
b. Other domestic factors	-31.6	-59.1	**-3.9**
2. Inflow of foreign funds 1)	-46.8	129.7	**38.9**
a. Current account (net)	527.9	729.3	**-451.1**
b. Capital and financial account (net) 2)	-574.7	599.6	**490.0**
3. Broad money creation	39.2	102.3	**192.9**
a. Money	5.8	104.7	**143.4**
b. Quasi-money	33.3	-2.4	**49.5**
4. Key indicators (in percent)			
a. 12-month change in money supply	2.3	5.9	**10.5**
b. Broad money coverage 3)	30.5	35.9	**34.4**
c. Money supply to GDP	52.3	54.4	**60.6**

1) Revaluation differences of gold and official foreign exchange holdings are excluded to approximate the net import of foreign funds by the nonmonetary sectors.
2) Including items not yet classified and errors and omissions.
3) Ratio of reserves to broad money.

Source: CBA.

In contrast, activities of the nonmonetary financial institutions increased only slightly. Claims on the government and the private sector rose by 5 percent and 1 percent, respectively, while net foreign assets declined by 8 percent. Housing mortgages went up marginally. As a result, the share of these institutions in the total market shrank to 48 percent. On the liability side, a rise in pension fund provisions was more than offset by other items. Borrowings and deposits, as well as the insurance reserve fund, increased slightly (see table 3).

Table 3 Nonmonetary financial institutions 1)
(end of period, in Afl. million or stated otherwise)

	2000	2001	2002
1. Net foreign assets	418.0	349.8	**320.3**
2. Domestic claims	961.0	1,047.9	**1,076.6**
a. Government	366.4	434.7	**454.5**
b. Private sector,	594.6	613.2	**622.1**
of which: housing mortgages	421.0	443.9	**451.2**
3. Total assets = total liabilities	1,379.0	1,397.7	**1,396.9**
4. Borrowings and deposits	62.1	54.6	**55.8**
a. Government	36.6	36.6	**36.6**
b. Other residents	25.5	18.0	**19.2**
5. Pension fund provisions	1,013.9	1,090.6	**1,145.3**
6. Insurance reserve fund	232.7	257.3	**258.3**
7. Other items (net)	70.2	-4.7	**-62.5**
8. Key indicators			
a. Net foreign assets in % nominal GDP	12.6	10.3	**9.5**
b. Total assets in % nominal GDP 2)	68.0	71.5	**73.6**
c. Share housing mortgages in total market (in %)	51.2	49.9	**47.9**

1) Comprising mortgage banks, pension funds (including APFA), life insurance companies, finance companies, the Aruban Investment Bank, and the Social Security Bank.
2) Ratio of total (gross) assets to nominal GDP.

Source: CBA.

3.4 Government finance

In 2002, total receipts increased by 3 percent to Afl. 751 million, due mainly to an Afl. 37 million grant from the Dutch government to the Fondo Desaroyo Aruba (FDA), earmarked for certain development projects. Tax revenue grew slightly, largely reflecting the raising of some excise taxes and import duties as of September, and higher property tax receipts. Foreign exchange taxes were affected by a court sentence referred to in paragraph 2.3.3 on the nonadmissibility of levying such taxes on certain payments to abroad. Nontax revenue fell by 17 percent; it was incidentally high in 2001 due to the transfer of retained profits from the telecommunications company (SETAR) to alleviate the liquidity needs of the government (see table 4).

Estimated government spending on a cash basis surged by 14 percent to Afl. 816 million. The transfers to the General Health Insurance (AZV) again were a large burden to the budget. The government's annual contribution, employers' premium payments, and advances to cover the deficits of this institution, amounted to Afl. 144 million or 18 percent of its total cash expenses. More than half of these cash expenses were related to personnel costs, which rose by 17 percent, due largely to higher employer contributions to the General Pension Fund of Aruba (APFA), premium payments to the AZV, and the hiring of additional staff. Payments for goods and services and interest outlays grew further. In contrast, investment outlays were scaled down to merely 0.5 percent of nominal GDP, also because spending by the FDA was delayed due to organizational and administrative bottlenecks. Lending minus repayments turned negative, as the cash advances to the AZV referred to above were completely offset by early debt repayments by Utilities N.V. and the Aruban Investment Bank N.V.

Table 4 Government financial operations 1)
(in Afl. million or stated otherwise)

	2000	2001	2002
1. Revenue and Grants	742.2	731.8	751.2
a. Tax revenue	624.5	606.3	610.0
b. Nontax revenue	100.8	125.5	103.8
c. Grants	16.9	0.0	37.4
2. Expenditure and items n.i.e.	719.9	717.0	816.4
a. Personnel-related outlays	374.9	370.9	435.8
b. Goods and services	192.7	135.9	149.4
c. Interest payments	30.2	35.7	38.2
d. Investments	28.3	18.4	17.0
e. Items n.i.e.	93.9	156.0	176.1
3. Lending minus repayments	16.2	32.0	-3.0
4. Financial deficit (-)	6.1	-17.3	-62.2
5. Net foreign capital 2)	24.1	27.9	96.0
6. Net domestic capital 2)	-16.8	14.2	2.5
7. Net recourse to the monetary sector	13.4	24.7	36.1
8. Memorandum items			
a. Unmet financing requirements 3)	152.5	269.4	275.6
b. Financial deficit 4)	-31.2	-134.2	-68.5
c. Total government debt 5),	947.2	1,105.9	1,242.9
of which: domestic debt	571.5	712.8	719.8
foreign debt 6)	375.7	393.1	523.1
d. Outstanding government guarantees 6)	277.1	272.6	315.3
9. Key indicators			
a. Total debt in % nominal GDP	28.5	32.7	37.0
b. Foreign debt in % exports 7)	16.9	17.5	24.1
c. Debt service in % exports 8)	2.7	1.6	2.8

1) Preliminary figures on a cash basis. Includes transactions related to foreign development cooperation.
2) Net long-term capital attracted from nonmonetary sectors mainly by issuing government bonds and private loan placements. The commercial banks' part in this is included under item 7, while the nonresidents' part is included under item 5.
3) Comprising all reported unsettled payment obligations to other sectors irrespective of the time frame in which they mature.
4) Including the change in unmet financing requirements.
5) Preliminary (end-of-period) figures, but excluding government guarantees.
6) At year-end exchange rates.
7) Excluding the oil sector.
8) Related to foreign debt. Excluding the oil sector.

On balance, the financial deficit on a cash basis widened further to Afl. 62 million or 2 percent of nominal GDP. Including the increase in the registered unmet financial requirements, the deficit amounted to Afl. 69 million. This figure is still provisional and may be subject to change.

Total financing needs to cover the cash deficit and to repay maturing debt surged from Afl. 54 million in 2001 to Afl. 134 million in 2002. The latter amount was raised by taking recourse to the foreign and domestic capital markets for Afl. 136 million and Afl. 34 million, respectively. The remainder was deposited at the banking system. On balance, deposits rose by Afl. 40 million to Afl. 143 million, which were largely earmarked for several special purposes. The available free liquidity declined from Afl. 32 million to Afl. 20 million or only 2.5 percent of cash expenses made during 2002.

The borrowing mentioned above was reflected in a surge in outstanding public debt (excluding guarantees) of 12 percent to Afl. 1,243 million at the end of 2002. Total debt as a percentage of nominal GDP rose by 4 percentage points to 37 percent. Domestic debt also was pushed by a rise in short-term nonnegotiable debt, including payment arrears vis-à-vis the APFA and suppliers of goods and services. Foreign debt was inflated further by a 19 percent appreciation of the euro vis-à-vis the Aruban florin.

3.5 Balance of payments

The balance of payments surplus shrank markedly, from Afl. 130 million a year earlier to Afl. 39 million in 2002. Including the revaluation differences of gold and official foreign exchange holdings, the net foreign assets of the banking system increased by Afl. 57 million or 8 percent to a record Afl. 756 million at the end of 2002. Consequently, the 12-month import coverage ratio rose from 6.5 months to 7.5 months, well above the 5 to 6 months target range (see table 5). The official reserves of the Bank grew by Afl. 90 million to Afl. 668 million, comprising 88 percent of the monetary sector net foreign assets. The remainder was held by the commercial banks.

The current account turned around from an Afl. 729 million surplus to an Afl. 451 million deficit, equivalent to 13 percent of nominal GDP. Transactions of the oil sector were the main reason for this turnaround. Its trade account surplus crumbled because the exports of refined oil products declined more than the imports of goods for processing. The transactions of the rest of the economy also contributed to the deterioration in the overall current account. This sector's surplus with respect to goods and services shrank, primarily due to a surge in bank lending and merchandise imports. In addition, the deficit on current transfers and income accounts increased further, the former due largely to a rise in workers' remittances to abroad, and the latter because less investment income was received, while more dividends were distributed to nonresidents in anticipation of the introduction of the New Fiscal Framework in January 2003.

The capital and financial account improved notably, from an Afl. 579 million deficit in 2001 to an Afl. 482 million surplus or 14 percent of nominal GDP in 2002. This development was attributed predominantly to a surge in the intercompany liabilities of the oil sector to finance the corresponding rise in its current account deficit. Moreover, the government attracted a net amount of Afl. 133 million in foreign funds, reflecting largely an Afl. 37 million grant from the Netherlands to the FDA, a US$ 30 million bond issue, as well as a private placement on the international capital market amounting to US$ 35 million. On the other hand, residents' external account balances and other short-term foreign investments increased.

Table 5 Balance of payments by sectors 1)
(in Afl. million or stated otherwise)

	2000	2001	2002
1. Current account (net)	527.9	729.3	-451.1
a. Oil sector	456.3	620.1	-345.2
b. Free zone	-3.6	-11.6	-0.1
c. Rest of economy	75.2	120.8	-105.8
1. Goods	-978.9	-915.5	-974.5
2. Services	1,135.2	1,139.1	1,078.4
3. Income	-10.3	-52.8	-114.8
4. Current transfers	-70.8	-50.0	-94.9
2. Capital and financial account (net)	-561.2	-578.9	481.6
a. Oil sector	-417.2	-576.8	420.8
b. Free zone	0.0	0.0	0.0
c. Rest of economy	-144.0	-2.1	60.8
1. Capital account transactions	17.8	-1.5	37.4
2. Direct investment	137.4	-16.3	1.0
3. Portfolio investment	-71.1	35.6	65.1
4. Other investment	-228.1	-19.9	-42.7
4.1 Loans	-139.5	-23.6	31.9
4.2 Other financial transactions	- 88.6	3.7	-74.6
3. Items not yet classified 2)	-13.5	-20.7	8.4
4. Overall balance (1 + 2 + 3)	-46.8	129.7	38.9
5. Total reserves of the monetary sector 3)	558.9	698.7	755.5
6. Coverage in months of merchandise imports 4)			
a. End-of-period	5.2	6.7	6.6
b. 12-month average	5.7	6.5	7.5

1) On a cash basis.
2) Including errors and omissions.
3) Including gold and foreign reserves at the commercial banks.
4) Excluding the oil sector.

Source: CBA.

Transparent view

The central hall and stairwell of the building, decorated partly by a rough chipped stonewall structure, is surprisingly filled with a flood of sun and artificial light from above, giving a feeling of strength and earthiness, but also tastefulness and refinement.

Prudential Supervision of Financial Institutions

4

4.1 Introduction

The Bank is entrusted with the prudential supervision of the banking and insurance sectors, as well as company pension funds, on the basis of, respectively, the State Ordinances on the supervision of the credit system (AB 1998 No. 16), the insurance business (AB 2000 No. 82), and company pension funds (AB 1998 GT 17). The aim of these ordinances is to prevent financial institutions from taking excessive risks that could harm the interests of depositors and policyholders and endanger the soundness and stability of the financial system. Continuous off-site surveillance, as well as periodic, risk-oriented on-site examinations are conducted. Furthermore, bilateral meetings are held regularly with the institutions concerned, and with their representative organizations. In December 2002, a formal joint meeting between the Bank and the Insurance Association Aruba was held for the first time.

The Bank's supervisory activities are focused on assessing key risk areas, such as financial condition, asset quality, anti-money-laundering procedures, administrative organization, and management. Detailed reporting forms should be submitted on a weekly, monthly, quarterly, and/or annual basis depending on the type of financial institution. Furthermore, the annual audited financial statements and the management letter issued by the external auditor must be filed. The Bank analyzes these documents and discusses its findings with senior management of the institution.

Use is made of the work already done by the internal and external auditors when performming on-site examinations. The frequency of the examinations varies with the risk profile of each individual institution. Depending on the Bank's findings, corrective measures may be required. During 2002, all five commercial banks and three bank-like financial institutions were examined on-site. Additionally, reviews were held at four money-transfer companies to test compliance with the Bank's guidelines, issued in anticipation of a law regulating this sector.

4.2 Major issues and developments

4.2.1 IMF financial sector assessment of Aruba

The second half of 2002 saw the start of the implementation of the recommendations of an International Monetary Fund (IMF) mission, which assessed Aruba's regulatory and anti-money-laundering framework. The Core Principles for Effective Banking Supervision issued by the Basel Committee on Banking Supervision, the Insurance Core Principles put out by the International Association of Insurance Supervisors (IAIS), as well as the 40 recommendations of the Financial Action Task Force (FATF) on anti-money laundering, served as benchmarks for this assessment. Its findings are laid down in the Offshore Financial Center Assessment Report on Aruba dated June 2002, which is also published on the IMF and the Bank's websites. The mission concluded that, in general, substantial progress has been made in recent years to enhance the scope and quality of financial sector regulation and supervision, offshore as well as onshore, and to strengthen anti-money-laundering measures. However, further progress is needed to become fully compliant with the aforementioned internationally recognized principles.

Banks

Aruba's system for banking supervision is compliant or largely compliant with 19 of the 25 Basel Core Principles, and materially noncompliant or noncompliant with 4. Two related to foreign branches were considered not applicable. Recommendations were to focus more on the key interrelated risk areas of credit risk, loan classification, and provisioning. Subsequently, the Bank drafted additional directives, policy papers, and reporting forms for the banking sector with regard to credit risk, loan classification and provisioning, large exposures, country risk, interest rate risk, foreign exchange risk, the publication of audited financial statements, and appointment of external auditors. These regulations have already been discussed with the Aruban Bankers' Association and will become effective September 2003.

Insurance

According to the IMF, Aruba is observant or largely observant with 12 of the 17 IAIS Core Principles. It should be noted, however, that some of the principles were rated materially nonobservant or nonobservant because at the time of the assessment, the implementation of the State Ordinance on the supervision of the insurance business was still in progress, and not all of the drafted regulations were in force. Meanwhile, the legislative and regulatory framework has been strengthened by issuing state decrees on captive insurers, insurance business representatives, and qualified holding in an insurance business. Moreover, the Bank has drafted guidelines and policy papers on asset management, corporate governance, anti-money laundering, publication of audited financial statements, and appointment of external auditors. These guidelines and policy papers will become effective June 2003.

Anti-money laundering

The IMF mission acknowledged that Aruba has successfully improved its rules and systems to combat money laundering. However, the following additional actions were recommended:

- Enhance the capacity of the Reporting Center for Unusual Transactions (RCUT).
- Criminalize the laundering of all assets.
- Extend the identification and unusual transaction reporting obligation to non-life insurers, company service providers, notaries, lawyers, and accountants.
- Implement the State Ordinance on the import and export of monetary instruments (this ordinance came into effect on April 1, 2003).
- Increase the frequency of the anti-money-laundering examinations.

Furthermore, the mission was concerned that non-banking offshore corporate entities currently are virtually unsupervised and are nontransparent with regard to ownership, corporate governance, and financial condition. Thus, these entities are risky from a money-laundering perspective and may even disturb financial stability when these entities are involved in international financial transactions. Therefore, additional measures need to be taken, aimed at, inter alia:

- Acquiring full knowledge on ownership, governance, and financial condition of these offshore entities.
- Keeping and auditing or filing accounts by these entities.
- Removing 1,500 currently unresolved defunct entities from the register of the Chamber of Commerce; and
- Bringing the company service providers, which manage the offshore entities referred to above, under effective supervision.

4.2.2 Integrity of the financial system

Aruba, being part of the Kingdom of the Netherlands, is a member of the FATF as well as the Caribbean Financial Action Task Force. The former intends to conduct a third mutual evaluation in 2003. To become fully compliant with the rules and regulations of these organizations, Aruba has implemented various measures to further deter money laundering, while additional legislation is being prepared to comply with the eight additional special recommendations of the FATF on combating the financing of terrorism. As part of this framework, and in view of the relevant United Nations resolutions, the State Ordinance on the supervision of money-transfer companies and the amended Sanction Ordinance will be enacted soon.

In anticipation of legislation regulating the money-transfer companies, the Bank has issued detailed operational guidelines to which money-transfer companies should adhere when conducting their activities. Some of these guidelines are aimed specifically at preventing money laundering. Compliance is tested marginally once a year. As of May 2001, the Bank bi-annually publishes a list of companies that comply with its guidelines. Three major players in this sector have qualified to date.

The RCUT is entrusted with the execution of the State Ordinances on the reporting of unusual transactions and on the identification for rendering financial services. At present, banks, life insurance companies, casinos, money-transfer companies, and the post office fall under the reporting obligation. In due course, this obligation may be extended to other service providers, including accountants, lawyers, and notaries. The Bank also has issued anti-money-laundering guidelines for banks and insurance companies, while it is also designated as the supervisory authority with respect to the identification ordinance insofar as it concerns financial institutions under its supervision. Compliance with these guidelines and ordinances is tested during the anti-money-laundering on-site examinations. In the meantime, a memorandum of understanding between the Bank and the RCUT has been drafted, aimed at promoting cooperation and coordination.

4.2.3 International issues and cooperation

The Bank actively monitors global developments in the supervisory area, inter alia, by attending meetings of regional and international supervisory associations, of which it is a member, and by participating in seminars and courses. It was represented at meetings of the Caribbean Group of Banking Supervisors (Guyana, May 2002), the Association of Supervisors of Banks of the Americas (Argentina, May 2002), and the International Association of Insurance Supervisors (Chile, October 2002). Important issues discussed during these events were the proposed Basel II Capital Accord for banks, solvency models for insurers, anti-money laundering and combating of the financing of terrorism, the (revised) International Accounting Standards (particularly those applicable to the banking and insurance industry), corporate governance, and the core principles for insurance supervision.

Recently a formal memorandum of understanding between the Bank van de Nederlandse Antillen and the Bank was finalized, regarding the supervision of insurance companies with establishments in both countries. All insurance companies operating in Aruba are branches of international or regional insurance companies, some of which have their (regional) head office in Curaçao.

4.3 Sectoral developments

In this section, a few quantitative developments in the different financial sectors under the Bank's supervision are discussed briefly. An extensive memorandum on this matter already was presented in the Bank's bulletin for the fourth quarter of 2002.

4.3.1 Banking sector

Commercial banks

The aggregated balance sheet total of the five commercial banks increased by 11 percent to Afl. 2,690 million at the end of 2002, equivalent to 80 percent of estimated nominal GDP. During 2002, the growth in loans accelerated sharply, i.e., from 3 percent to 8 percent. On the liability side, deposits rose by 11 percent. Consequently, the loans-to-deposits ratio declined marginally to 72 percent, well below the prudential maximum of 80 percent (see table 6).

Mainly due to a sharp increase in declared dividends related to the introduction of a dividend withholding tax on January 1, 2003, the banks' aggregated risk-weighted capital asset ratio fell from 10.5 percent to 9.3 percent, but still exceeded the minimum capital requirement of 8 percent adopted by the Basel Committee on Banking Supervision. Despite the weaker macroeconomic environment, asset quality remained satisfactory.

The banks' return on equity decreased by 10 percentage points to 23 percent, due mainly to a lower net income (after taxes). Their liquidity ratio rose by a mere 1 percentage point to 28 percent, well above the minimum prudential liquidity requirement of 20 percent.

The products and services offered by the banks are mainly in the traditional retail banking area. Interest income remains their dominant source of revenue. As a result of the oligopolistic market structure, as well as the absence of economies of scale, interest rates generally are high and inflexible compared to those of industrialized countries. In connection with the slowdown of the economy, the Aruban Government has requested the commercial banks to lower their interest rates on commercial loans and mortgages. Some banks have reacted positively to this request.

Table 6 Core set of macroprudential indicators of the commercial banks
(end of period, in percentages)

	2000	2001	2002 1)
1. Capital adequacy			
a. Risk-weighted capital ratio = regulatory capital ratio	8.2	10.5	9.3
b. Tier 1 capital ratio	3.8	4.0	5.4
2. Asset quality			
a. Nonperforming loans (net of provisions)-to-gross loans	2.6	3.4	3.0
b. Nonperforming loans (net of provisions)-to-regulatory capital	33.7	34.0	34.2
c. Large exposures-to-regulatory capital	276	154	198
3. Earnings and profitability			
a. Return on assets	1.2	1.6	1.1
b. Return on equity	30.1	32.9	23.2
c. Interest margin-to-gross income	65.9	65.7	62.7
d. Noninterest expenses-to-gross income	85.1	78.7	82.6
4. Liquidity			
a. Loans-to-deposits ratio	75.6	73.1	72.0
b. Prudential liquidity ratio	24.5	27.5	28.1
c. Liquid assets-to-short-term liabilities	78.5	85.4	74.4
5. Sensitivity to market risk			
a. Interest rate margin 2)	5.8	6.2	7.3
b. Net foreign assets-to-regulatory capital	111.0	71.3	53.7

1) Preliminary figures.
2) Weighted averages related to transactions during the indicated period.

Source: CBA.

To increase transparency and to deter further excessive growth in consumer loans, as of March 1, 2003, banks are required to publish the effective interest rate offered when reference is made to the pricing of these loans in advertisements. Furthermore, as of the reporting year 2003, the Bank requires that both banks and insurance companies adhere to the existing obligation to file a copy of their audited annual report with the Chamber of Commerce.

Offshore banks

Aruba's offshore banking sector is very small by international standards. Only two such institutions are registered here. These banks, which also fall under consolidated supervision of the U.S. supervisory authorities, had an aggregated balance sheet total of Afl. 1,866 million at the end of 2002, or 56 percent of nominal GDP. This total was Afl. 4 million higher than in

2001. Profitability rose sharply, from Afl. 10 million to Afl. 57 million, due to higher revenue from foreign exchange transactions. Consequently, their aggregated risk-weighted capital asset ratio increased from 14 to 21 percent, substantially above the generally accepted minimum mentioned above.

Bank-like institutions

The four bank-like institutions are engaged mainly in mortgage lending to individuals, financing of social housing projects, long-term project financing, and/or granting of personal loans for consumptive and home improvement purposes. These activities are financed predominantly by attracting funds from their parent company, other (local) financial institutions, and/or institutional investors. The combined loan portfolio of these institutions amounted to Afl. 424 million at the end of 2002 (2001: Afl. 430 million), equivalent to 13 percent of nominal GDP or 25 percent of that of the commercial banks. Their net income (after taxes) increased from Afl. 4 million to Afl. 10 million, while the aggregated risk-weighted capital asset ratio fluctuated around a solid 57 percent.

4.3.2 Institutional investors

The number of institutions supervised in this sector decreased from 39 to 33 during 2002. With the enactment of the State Ordinance on the supervision of the insurance business as of July 1, 2001, life and non-life (general) insurance companies operating in or from Aruba have been brought under the Bank's supervision. In accordance with section V of the implementation ordinance, these companies were required to submit an application for a license within six months after its implementation. All but three applied for a license. Two applications were rejected, and two insurers withdrew their applications. The companies that did not receive a license are required to cease their activities. In 2002, the Stichting Pensioenfonds First National Bank of Aruba N.V. was added to the list of company pension funds supervised by the Bank.

Life insurance companies

At the end of 2001, the aggregated balance sheet total of the eight life insurance companies summed Afl. 514 million, a 17 percent increase compared to 2000. This increase resulted mainly from a surge in the current account with affiliated companies. On the other hand, investment declined by Afl. 40 million to Afl. 247 million, 19 percent of which were foreign assets. On the liability side, technical provisions rose by 10 percent to Afl. 256 million. Capital and reserves remained almost unchanged. This is also the case for the liquidity ratio and return on investment, while the coverage ratio improved by 7 percentage points (see table 7). These figures indicate that the life insurance sector is sound and continues to perform satisfactorily.

Non-life insurance companies

At the end of 2001, the aggregated balance sheet total of the 12 non-life insurance companies amounted to Afl. 126 million (equivalent to 4 percent of GDP), i.e., an 11 percent increase compared to 2000. Investment increased by Afl. 53 million to Afl. 77 million, 6 percent of which were foreign assets. On the liability side, technical provisions decreased by 10 percent to Afl. 47 million. Capital and reserves surged notably by Afl. 9 million or 21 percent to Afl. 51 million. The liquidity ratio was 38 percent, the profitability ratio 11 percent, and the coverage ratio 246 percent. These ratios indicate that the non-life insurance sector also is sound and performed well in 2001.

Table 7 Financial ratios of the life insurance companies
(end of period, in percentages)

	1999	2000	2001
1. **Liquidity ratio** Current assets-to-technical provisions	18	17	**17**
2. **Return on investment** Investment income-to-average invested assets	8	9	**9**
3. **Coverage ratio** Weighted assets less borrowings to technical provisions	151	179	**186**

Company pension funds

The aggregated balance sheet total of the 11 company pension funds was Afl. 192 million at the end of 2001 (equivalent to 6 percent of GDP). Investment declined by 8 percent to Afl. 181 million, 66 percent of which were foreign assets. On the liability side, technical provisions increased by 10 percent to Afl. 223 million compared to 2000. As shown in table 8, the liquidity ratio did not change, while the coverage ratio decreased by 9 percentage points, and the return on investment became negative in 2001. The latter decrease resulted mainly from the bearish international financial markets.

Meanwhile, the coverage ratio now is rapidly approaching the minimum of 100 percent. Funds with a ratio already below this critical minimum have to submit a financial recovery plan, aimed at improving the financial position within a reasonable period. Due to the continuing malaise on the global equity markets, funds may have to increase their pension premium or cut back on their pension plan.

Table 8 Financial ratios of the company pension funds
(end of period, in percentages)

	1999	2000	2001
1. **Liquidity ratio** Current assets-to-technical provisions	8	5	**5**
2. **Return on investment** Investment income-to-average invested assets	11	3	**-6**
3. **Coverage ratio** Investment & cash minus volatility cushion to technical provisions 1)	119	111	**102**

1) The volatility cushion serves as a buffer to absorb unforeseen losses.

Fluid reflections

A three-step waterfall fountain, built of limestone and granite rocks found on the island, and topped by a bronze statue of a reflecting Indian, sculpted by the Aruban artist Maritza Erasmus, enhances the inner circle of the driveway leading to the main entrance. This impressive work of art adds to the monumentality, and gives an additional dimension to the typical Aruban flavor of the project.

Financial Statements

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Balance sheet as of December 31, 2002, after profit distribution

In thousands of Aruban florin

	2002	2001
Assets		
Gold	68,232	55,044
Foreign currency	608,114	525,720
Receivables	7,242	7,490
Premises	17,629	9,588
Other fixed assets	4,895	1,499
	706,112	599,341
Liabilities		
Bank notes issued	147,402	141,849
Deposits of residents	411,721	347,169
Deposits of nonresidents	8,452	2,569
Money in custody	2,022	1,971
Payables and accrued expenses	11,674	2,825
Revaluation account	56,485	38,653
General reserve	58,356	37,305
Reserve for new premises	-	17,000
Capital	10,000	10,000
	706,112	599,341

Profit and loss account for the year 2002

In thousands of Aruban florin

	2002	2001
Net investment revenue	23,023	30,026
Net revenue foreign exchange	1,640	2,001
Net revenue coin sales	596	573
Other income	261	1,075
Total income	25,520	33,675
Cost of printing bank notes	-	178
Personnel expenses	6,226	6,232
Operating expenses	1,962	1,909
Depreciation	681	937
Total expenses	8,869	9,256
Profit	16,651	24,419
Profit distribution		
Allocated to the Treasury	12,600	12,250
General reserve	4,051	8,039
Reserve for new premises	-	4,130

Explanatory notes to the balance sheet and the profit and loss account 2002

1 General

Pursuant to article 31, paragraph 1 and 3, of the Central Bank Ordinance, the President and Executive Directors shall each year, before the first of July, prepare the Bank's draft balance sheet and profit and loss account of the previous financial year and submit these statements, after they have been audited by the Bank's external accountants, for approval to the Board of Supervisory Directors. In the first meeting following their submission, the annual accounts shall be approved by the Board and a copy sent to the Minister of Finance. The Bank's financial year is the calendar year.

2 Principles of valuation and determination of results

2.1 Comparison with previous year

The principles of valuation and determination of results remained unchanged in 2002.

2.2 Accounting policies

General

The accounting policies where applicable and those mentioned below are in accordance with the Central Bank Ordinance.

Gold

Effective December 31, 2001, gold is valued on a quarterly basis at the prevailing market price. On December 31, 2002, gold was valued at Afl. 613.52 or US$ 342.75 (2001: Afl. 494.93 or US$ 276.50) per fine troy ounce. Changes in the valuation of gold are included in the revaluation account.

Foreign currency

Comprises investment through asset managers, current account and time deposits held at foreign credit institutions, and bank notes. Investment through asset managers consists mainly of government or government-guaranteed paper denominated in U.S. dollars and is recorded at market value. Current accounts, time deposits, and bank notes are at face value. All foreign currency is converted into Aruban florin at exchange rates prevailing on the balance sheet date.

Premises

Comprise the Bank's former office building at Havenstraat 2 and the new building at J.E Irausquin Boulevard 8. The construction of the Bank's new office building at J.E. Irausquin Boulevard was completed in September 2002. In 2002, the Bank came to an agreement with the Government of Aruba regarding the sale of the premises at the Havenstraat. The conveyance of the building will be formalized in due time. Premises are valued at historical value less accumulated depreciation and are amortized according to the straight-line method over the estimated life of the premises.

Other fixed assets

These assets consist of furniture and equipment, valued at the purchasing cost less accumulated depreciation and amortized according to the straight-line method over the estimated life of the assets. Investment of less than Afl. 3,000 is charged to expenses.

Other assets and liabilities

Recorded at face value unless indicated otherwise.

2.3 Revenue recognition

The positive results on transactions are recognized in the year in which they are realized; losses are taken as soon as they are foreseeable.

2.4 Conversion of foreign currencies

Assets and liabilities denominated in foreign currencies and related forward contracts are converted into Aruban florin at the rate of exchange prevailing on the balance sheet date. Premiums and discounts on forward contracts are presented in the profit and loss account as interest. Unrealized exchange rate results are not included in the profit and loss account, but in the revaluation account. Transactions in foreign currencies during the reporting period are incorporated in the financial statements at the rate of settlement. The exchange rate for one U.S. dollar is fixed at Afl. 1.79.

3 Notes to the balance sheet

3.1 Gold

At the end of December 2002, the book value of the gold holdings increased by Afl. 13,188,596, compared to 2001. This increase also is recorded in the revaluation account. The Bank's holding of gold deposits was 111,214 fine troy ounces with a market value of Afl. 68,232,322.

3.2 Foreign currency

Comprises balances held with foreign credit institutions and investment through asset managers in (i) government and (explicitly or implicitly) government-guaranteed paper; (ii) paper issued by qualifying supranational financial institutions; and (iii) money-market instruments of and accounts with at least double A-rated credit institutions. The Bank's investment guidelines stipulate that time deposits held with an individual bank may not at any time exceed 15 percent of the Bank's foreign currency holdings in the case of triple A-rated credit institutions, and 10 percent in the case of double A-rated institutions. The Bank also deals directly with credit institutions from Canada, the Netherlands, the Netherlands Antilles, Switzerland, the United Kingdom, and the United States. Foreign currency generally is denominated in U.S. dollars, while relatively small amounts are held in euros and Netherlands Antillean guilders.

3.3 Receivables

Include mainly accrued interests from invested foreign funds, mortgage loans and advances to personnel, various other claims, and prepaid expenses.

3.4 Bank notes issued

Issued pursuant to article 7, paragraph 1, of the Central Bank Ordinance.

(in thousands of Aruban florin)

Denomination	2002	2001
5	**907**	911
10	**4,746**	4,955
25	**11,465**	12,234
50	**13,089**	9,535
100	**108,197**	105,017
500	**8,998**	9,197
Total	**147,402**	141,849

3.5 Deposits of residents

This item comprises:

(in thousands of Aruban florin)

	2002	2001
Government	**76,891**	76,715
Development funds	**47,871**	31,257
Banks:		
- current accounts	**80,066**	60,866
- monetary cash reserve	**123,000**	108,486
- time deposits	**72,116**	47,989
Other	**11,777**	21,856
Total	**411,721**	347,169

Current accounts of the commercial banks are held partly to meet clearing obligations. The monetary cash reserve is a requirement mandated by the Bank on the commercial banks for monetary policy reasons. Time deposits may range from 7 days to 24 months.

3.6 Deposits of nonresidents

Comprise florin accounts of nonresident banks and other financial institutions.

3.7 Money in custody

Consists of funds confiscated by official authorities.

3.8 Payables and accrued expenses

The payables and accrued expenses mainly comprise foreign exchange tax due to the government, short-term pension liabilities, and accrued interest payable.

3.9 Revaluation account

Pursuant to article 31, paragraph 2, of the Central Bank Ordinance, revaluation differences of gold and unrealized exchange rates are included in the revaluation account.

3.10 General reserve

This item comprises:

(in thousands of Aruban florin)

	2002
Beginning balance	37,305
Addition profit distribution	4,051
Addition by release of "Reserve for new premises"	17,000
Balance at the end of the year 2002	58,356

3.11 Capital

Pursuant to article 3, paragraph 1, of the Central Bank Ordinance, the Bank's capital amounts to Afl. 10,000,000.

4 Notes to the profit and loss account

4.1 Net investment revenue

(in thousands of Aruban florin)

	2002	2001
Revenue	24,734	35,268
Interest expenses	1,711	5,242
Net investment revenue	23,023	30,026

4.2 Personnel expenses

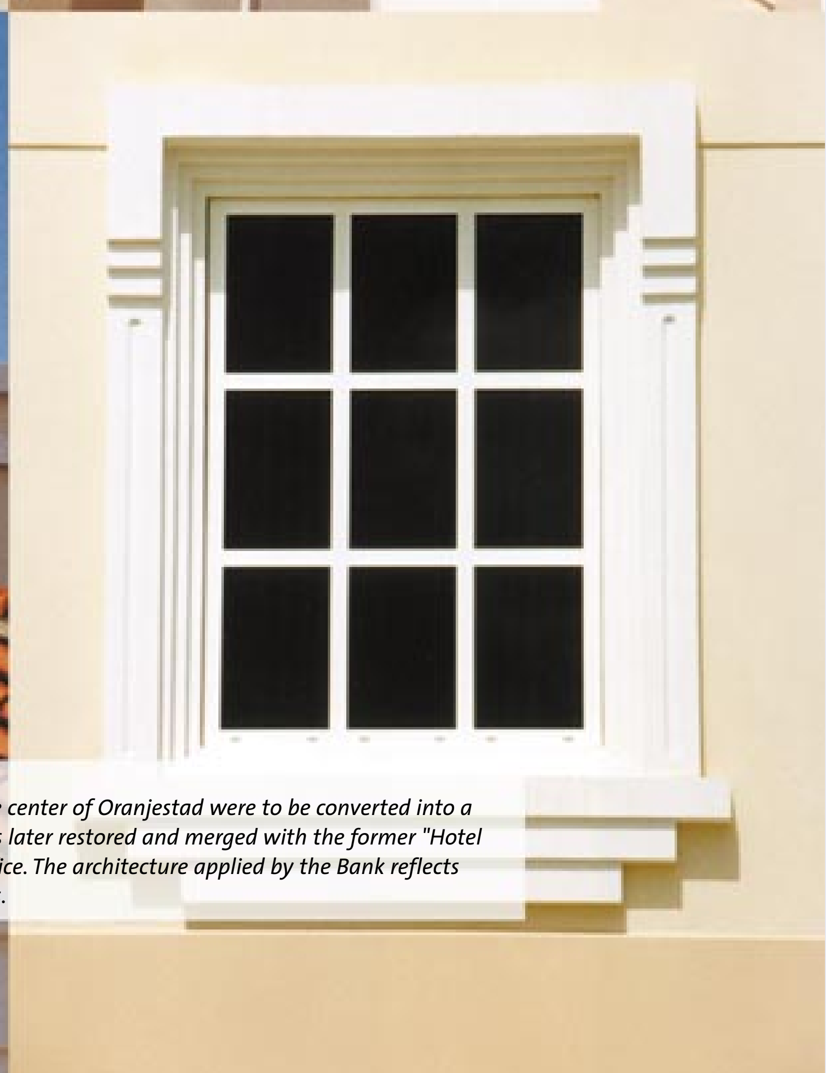
Include salaries, social security, and various personnel-related expenses. At the balance sheet date, the Bank employed 54 persons full-time.

4.3 Operating expenses

Consist mainly of expenses on utilities, rent, communications, maintenance, office supplies, courses, seminars, meetings, external auditors, and other fees.

4.4 Profit distribution

In accordance with articles 4 and 5 of the Central Bank Ordinance, the Board of Supervisory Directors has decided, with the approval of the Minister of Finance, to add Afl. 4,051,122 to the Bank's general reserve. The remaining profit amounting to Afl. 12,600,000 was allocated to the Treasury. From this amount a sum of Afl. 1,500,000 will be retained for the first of three annual payments for the sale of the former bank building to the government.



Conserving the past

Initially, two historical monuments located in the center of Oranjestad were to be converted into a new Bank office. The Dr. Eloy Arends Building was later restored and merged with the former "Hotel Colombia" to house the town hall and census office. The architecture applied by the Bank reflects some of the typical details of these two buildings.

Auditor's report

Introduction

We have audited the accompanying balance sheet of the Centrale Bank van Aruba as of December 31, 2002, and the related statement of income for the year then ended as included on pages 33 through 39 in the annual report. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audit.

Scope

We conducted our audit in accordance with generally accepted accounting principles. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion, the financial statements give a true and fair view, in all material respects, of the financial position of the Bank as at December 31, 2002, and the results of its operations for the year then ended in accordance with the accounting standards applicable.

Aruba, May 9, 2003

PricewaterhouseCoopers

PricewaterhouseCoopers