



**CENTRALE BANK VAN ARUBA**

**ANNUAL REPORT  
AND  
FINANCIAL STATEMENTS FOR THE YEAR**

**2004**

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## MISSION STATEMENT

WORKING TOWARDS FINANCIAL STABILITY  
FOR THE BENEFIT OF THE PEOPLE

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(as of April 5, 2005)

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Chairman of the Board of Supervisory Directors  
A.J. Swaen

Members of the Board of Supervisory Directors  
T.R.L. Vingal  
H.O. van Trikt

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A.V. Croes-Fleming



## A LIVING CONSTITUTION

The year 2004 marked the golden jubilee of the Charter of the Kingdom of the Netherlands. Honoring this memorable occasion, the Centrale Bank van Aruba dedicates this year's annual report to the Charter.

The signing of the Charter of the Kingdom of the Netherlands on December 15, 1954 was a moment of great historical significance for the Dutch Caribbean. This act ended centuries of colonial rule and introduced parliamentary democracy in the Netherlands Antilles, of which until 1986 Aruba formed a part. Under that constitutional structure, foreign policy and defense remained the specific responsibility of the Kingdom, while areas such as finance, education, trade, and culture were to be administered autonomously.

Undoubtedly, under the Charter Aruba has prospered significantly in the past 50 years. Its political stability and an independent judiciary have been encouraging and indispensable factors for investments and, thus, our economic development. These benefits became even more important when in 1986 Aruba seceded from the Netherlands Antilles and became an autonomous country within the Kingdom of the Netherlands.

Fifty years after signing the Charter, Aruba, the Netherlands Antilles, and the Netherlands were confronted with fundamental questions regarding their future relations within the Kingdom. An independent working group proposed changes, which, if implemented, can have far-reaching consequences.

Aruba is experiencing the effects of unfolding developments within the Kingdom and in Europe. The majority of the people of the Netherlands Antilles recently expressed their wish for a constitutional change, which may eventually lead to a different form of the present federation of the Netherlands Antilles.

The countries of Europe are moving towards a closer union. Because the Kingdom of the Netherlands is a member of the European Union, the increasing influence of the European Union is being felt in the Netherlands in the fields of taxation, trade agreements, and monetary policy. In the near future, Aruba will be invited to (re)define its relation with the European Union.

At this moment, the future constitutional structure is difficult to predict. The above-mentioned developments do inspire change in this respect. As the new relations in the Kingdom of the Netherlands are being shaped, the Charter will not only be the basis for the independence of countries within the Kingdom, but also for the dedication to certain values and standards rooted in the solidarity within this Kingdom. When the Charter will be changed with this in mind then no longer will we hear that the Charter has had its best of time. The Charter is looking at a bright future.

The Governor of Aruba

(F.J. Refunjol)

# CONTENTS

<b>1</b>	<b>Statement by the President</b>	<b>1</b>
<b>2</b>	<b>The business of the Bank</b>	<b>7</b>
2.1	Core functions	7
2.2	Domestic payment system	7
2.2.1	Bank notes and coins	7
2.2.2	Clearing system	8
2.2.3	Interest payments	9
2.2.4	Banking for the government	9
2.3	International payment system	9
2.3.1	Daily exchange rate fixing	9
2.3.2	Foreign exchange license policy	10
2.3.3	Foreign exchange tax	10
2.4	Managing the official foreign exchange reserves	11
2.5	Monetary policy	11
2.6	Prudential supervision	11
2.7	Financial highlights	12
2.8	Organizational affairs	12
<b>3</b>	<b>Economic and financial developments</b>	<b>15</b>
3.1	The international environment	15
3.2	The domestic real sector	16
3.3	The financial sector	18
3.4	Government finance	20
3.5	Balance of payments	22
<b>4</b>	<b>Prudential supervision of financial institutions</b>	<b>25</b>
4.1	Introduction	25
4.2	Major issues and developments	25
4.2.1	Legislative framework	25
4.2.2	Banking sector	26
4.2.3	Money transfer companies	26
4.2.4	Insurance sector	27
4.3	Integrity of the financial system	28
4.4	International and regional supervisory forums	29

4.5	Sectoral developments	29
4.5.1	Banking sector	29
4.5.2	Insurance sector	30
4.5.3	Other institutions	31

## 5 Financial statements 33

Balance sheet as of December 31, 2004 , after profit distribution 34

Profit and loss account for the year 2004 35

Explanatory notes to the balance sheet and the profit and loss account 2004 36

Report of auditors 43

## Tables

1	Main economic indicators	17
2	Causes of changes in the money supply	18
3	Nonmonetary financial institutions	19
4	Government financial operations	21
5	Balance of payments by sectors	23

## STATEMENT BY THE PRESIDENT

The world economy performed exceptionally well in 2004. According to estimates by the International Monetary Fund (IMF), growth stood at around 5 percent, the highest rate of expansion in nearly 30 years, and was accompanied by a surge in international trade. In several countries, this performance was supported by accommodative macroeconomic policies and a notable improvement in economic fundamentals. Private investment was triggered by increased corporate profits and low interest rates. The economic expansion also stimulated job creation and improved labor market conditions in various countries. This in turn boosted private consumption. All of these factors helped limit the economic impact of the recent oil price surges, thus keeping inflation at a moderate level.

The expansion in output was not uniformly distributed. Although growth picked up in nearly all regions and countries, performance varied notably. The United States and China, in particular, remained the driving engines of the economic upturn. Growth in Japan and the Euro area remained below their potential, while the Latin American and Caribbean economies gained momentum. However, the worsening of global imbalances is a cause for concern. For instance, the growing current account deficit and the persistent high public deficit in the United States are considered key factors in the continued weakening of the U.S. dollar in 2004.

The recovery of the world economy had a positive influence on the Aruban economic performance. The path of growth that was initiated in 2003, after two consecutive years of recession, was consolidated in 2004. Gross domestic product (GDP) at constant prices expanded further by an estimated 3.5 percent, following a 1.4 percent rebound in 2003. Consequently, nominal per capita income reached a record level of US\$ 21,878, one of the highest in the region. Main factors behind the economic growth were buoyant tourist activities, higher investments in private and public sectors, and increased consumption by both private households and the government. The labor market improved slightly. The unemployment rate fell to 7.3 percent, down from 7.9 percent in 2003. Labor productivity remained unchanged, compared to a 0.9 percent decrease a year earlier.

The expansion in production activity did not spur an acceleration of inflation. The 12-month average consumer price index decelerated to 2.5 percent, down from 3.6 percent in 2003, partly because rises in the international oil market were not fully passed on to the tariffs of water and electricity. The inflation rate decelerated below the 2.7 percent level of the United States, thus improving Aruba's international competitive position. The real exchange rate index of the Aruban florin vis-à-vis the U.S. dollar fell slightly by 0.2 percentage point to 105.0 in 2004.

Tourism performed exceptionally well in 2004. The number of stay-over visitors and their nights spent on the island registered double-digit growth rates of, respectively, 13 percent and 11 percent. Consequently, the number of stay-over visitors reached 728,157, the highest ever recorded in Aruba. This favorable outcome was driven mainly by the recovery of the U.S. economy, an improved travel confidence, increased marketing efforts, and an expanded

airlift. The average occupancy rate rose further to 80.7 percent, up from 74.4 percent in 2003. In addition, the number of cruise passenger arrivals grew by 6 percent. In comparison, the Caribbean region as a whole registered increases in total stay-over and cruise visitor arrivals of 6 percent and 11 percent, respectively. The exceptional performance in the Aruban tourism industry led to a surge in registered gross tourism receipts of 23 percent to US\$ 1.1 billion, while its contribution to current account receipts (excluding the oil and free-zone sectors) rose by 3 percentage points to 79 percent.

The outcome of the external transactions improved when compared to a year earlier. The overall balance of payments recorded an Afl. 11 million surplus, in contrast to an Afl. 61 million deficit in 2003. Consequently, net international reserves increased to Afl. 649 million. This resulted mainly from the favorable developments in the tourism sector. In addition, the activities in the oil sector expanded further after the refinery was taken over by the Houston-based Valero Energy Corporation in March 2004. However, activities in the free-zone sector remained at a low level.

Despite the positive balance of payments outcome, the erosion in the international reserve position, which started in 2002, continued in 2004. Indicative is that although tourism picked up considerably during 2004, the coverage of import of goods by international reserves declined slightly to 6.3 months, down from 6.7 months a year earlier. When relating all current account payments (thus the payment for goods, services, income, and current transfers) to international reserves, the coverage decreased to 3.4 months, down from 3.7 months in 2003.

This result is mirrored by a considerably large current account deficit of the rest of the economy (excluding the oil and free-zone sectors) of Afl. 245 million or 6 percent of GDP for the third consecutive year. Although the deficit in the current account of the balance of payments (excluding the oil and free-zone sectors) narrowed by Afl. 90 million compared to 2003, it is still a cause of concern to the Bank. Persistent current account deficits are not sustainable in the long run when the economy is small and largely dependent on an industry extremely vulnerable to cyclical or other shocks, and when access to international capital markets is limited.

In 2004, as was the case a year earlier, factors conducive to the large current account deficit were again the high level of consumptive spending of both the private and public sector, which led to a further rise of imports of goods amounting to Afl. 1.2 billion or 33 percent of GDP. The Bank undertook measures to restrain as much as possible the strong domestic demand and to curtail its negative effects on inflation. Monetary policy was tightened by limiting growth of aggregate commercial bank lending to 6 percent and introducing a penalty fee of 6 percent (on an annual basis) to be levied on those individual banks that caused an excess in lending. Consequently, growth in commercial bank lending decelerated to 6.1 percent in 2004, down from 10 percent in 2003. Still, it is worth mentioning that although overall credit was restrained quite a bit, consumer credit expanded by 10 percent in 2004, compared to 6 percent in 2003, and was influenced largely by a higher demand for car loans.

For 2005, economic expansion in real terms of 3¼ percent is estimated with an inflation rate of around 2.5 percent. However, this positive outlook is not without risks. The banking sector still has some excess liquidity, and the community has an ample demand for credit. Moreover, fiscal policy remains expansionary. Given these conditions, the Bank decided, after consulting with the Aruban Bankers' Association, not to restrict monetary policy further, but to maintain the credit limit at 6 percent. The Bank will evaluate whether to tighten monetary policy during the year if current account trends deteriorate, the level of international reserves weakens, or inflation accelerates sharply.

Although the appetite of commercial banks to purchase Central Bank Certificates so far has been very modest, the Bank will pursue its efforts to increase reliance on market-oriented instruments of monetary policy. To that end, the current instrument will be evaluated and eventually adapted to improve marketability, while new indirect instruments will be considered.

The high domestic demand also is reflected in excessive consumptive spending by the government. This spending is predominantly the result of the large wage bill and significant budgetary contributions to both the Civil Servants Pension Fund (APFA) and the General Health Insurance (AZV). These categories absorb a large portion of total tax revenue – almost 90 percent in 2004, thus leaving practically no room for other necessary government spending, such as infrastructure investments and education, and repayment of maturing debt.

This spending pattern of the government has led to a structural weakness in public finances. Instead of cutting back on its spending, the government only raised import duties and excises, which was not sufficient to cover the resulting deficits. Consequently, it resorted regularly to commercial borrowings on the capital market to cover its budgetary deficits and refinance maturing debt. As a result, the government's total outstanding debt has risen steadily during the years to Afl. 1.7 billion or 45 percent of GDP as of end-2004. The debt was almost evenly distributed between the domestic and foreign components – Afl. 876 million and Afl. 843 million, respectively.

In particular, the government resorted regularly to the foreign capital market to cover its financial deficits. Consequently, total commercial foreign loans (excluding concessional loans from the Netherlands and the European Investment Bank) ballooned to Afl. 613 million, equal to 94 percent of the net international reserves. The Bank supports the approach of resorting to the foreign capital market, but underscores also the accompanying negative effects. The Bank advises the channeling of borrowed funds primarily to productive investments. In that way, the costs of those loans can be recovered for repayment at maturity.

However, when foreign loans are spent on consumptive outlays, the negative effects are exacerbated. Specifically, the lack of budgetary discipline exerted, given the ample supply of foreign funds, pushes outstanding debt even higher. In addition, the borrowed funds injected as high-powered money into the economy will expand into excess liquidity within

the system. Moreover, the acquired funds exert a temporary upward effect on the level of foreign exchange reserves, thus creating a false sense of security, because the improvement in these reserves results from borrowed funds rather than earnings from the actual production process. Also, the sharp increase in its foreign debt-servicing obligations accentuates future external vulnerability. Without fiscal adjustment, debt most probably will continue to rise rapidly and, subsequently, will adversely affect financial and economic developments.

Until now, monetary policy has been tightened to curtail domestic demand and to preserve financial stability. Fiscal policy, on the other hand, has remained too accommodative. This situation has created an unbalanced macroeconomic policy mix, and combined with serious disallocations in the economic process, is unsustainable in the long run. Also taking into account the aging population, measures should be taken without hesitation to tighten the fiscal stance to rebalance the policy mix.

The government ultimately has implemented some expenditure reforms. In December 2004, the Parliament of Aruba approved the privatization of the APFA, and, subsequently, a debt conversion agreement was reached between the fund and the government. This agreement will promote the transparency of their financial relationship. Also, the fund's scheme will be reformed as of May 1, 2005 for new entrants. However, the effects of these reforms will be visible only in the longer term. In addition, the government implemented some corrective measures to rein in the fast-increasing health care costs of the AZV, but these measures were not far-reaching enough to deliver substantive results.

The IMF Article IV Consultation Mission (the Mission) that visited Aruba in January 2005, emphasized that, in the short term, the government also should contain increases in the wage bill and reduce expenditures on goods and services. In addition, the government should simplify the personal income tax and introduce a broad-based indirect tax to enhance the effectiveness of the tax system. Furthermore, a medium-term adjustment path should be delineated to eliminate the structural budget deficit and reduce public debt to 40 percent of GDP by 2009. However, given a tax burden of 19 percent of GDP and an overall burden of social charges (including AZV and social security) of 27 percent of GDP as of end-2004, adjustments should be implemented mostly on the expenditures side. The focus should be mainly on consumptive spending of the government, in particular, the wage bill and health care expenditures. To facilitate fiscal adjustment, the Mission recommended implementing multi-year budgeting.

As a reaction to the government's expressed need for better control and monitoring tools vis-à-vis expenditures, the Bank proposed the adoption of a fiscal responsibility law (FRL) to provide credibility and a forward-looking perspective to fiscal policy and to improve transparency, accountability, and fiscal management. The main goal of an FRL is to promote fiscal discipline by reforming overall budget planning and execution practices and by establishing numeric fiscal rules. An FRL also makes fiscal policy more predictable and transparent across different

periods of time. An FRL will require the government to commit up-front to a monitorable fiscal policy strategy for a multi-year period and to report and publish fiscal outcomes and strategy changes on a regular basis.

The Minister of Finance and Economic Affairs recently asked the IMF for technical assistance in the areas of design and implementation of the FRL, but the road to fiscal sustainability will be long and covered with obstacles. The design of the FRL will take time and will require broad political consensus. Moreover, an FRL needs to be built on good practices in transparency and accountability. Still, this path must be taken to ensure financial and economic stability for future generations.

During 2004, the Bank proceeded to further strengthen the supervision of the financial sector. Preparatory work is being done to include the insurance brokers within the scope of supervision and to enhance the existing banking and insurance state ordinances. With the assistance of the Dutch Central Bank, a Risk Analysis Supervision Tool (RAST) will be applied to conduct risk assessments at the supervised commercial banks. In the area of legislation, unfortunately no progress was made on the enactment of the State Ordinance on the Supervision of Trust Companies and the revised Sanction Ordinance.

The various macroprudential indicators show that the commercial banking sector is sound and profitable. The risk-weighted capital asset ratio increased to 12 percent, well above the 10 percent minimum set by the Bank. The ratio of nonperforming loans to gross loans amounted to 2 percent, while the returns on assets and equity were 2 percent and 26 percent, respectively. Interest rates on deposits and savings were reduced somewhat because of the excess liquidity within the banking sector. Even so, the margin between average debit and credit interest rates remained relatively high at 7 percent.

In 2004, the Bank issued a revised series of florin bank notes that replaced the 1990 and 1993 series. The new series include several new security features. The issue was very successful. As of end-2004, 93 percent of the total bank notes in circulation were the 2003 series. The Bank's profit decreased to Afl. 1.0 million, mainly because of a drop in net interest revenue associated with lower yields on U.S. dollar investments. In addition, total expenses increased because of higher personnel and operating expenses.

Nonetheless, the balance sheet of the Bank reflects the strong position of the Aruban florin. As of end-2004, the official reserves of the Bank were 145 percent of base money (i.e., total bank notes in circulation and outstanding liabilities to the banking system). The Bank will continue to actively pursue its policy objectives of protecting the value of the Aruban florin, enhancing the reliability of the payment system, and promoting the soundness and integrity of the financial institutions, all for the benefit of the people of Aruba.



## THE BUSINESS OF THE BANK

### 2.1 Core functions

Established in 1986 through the enactment of the Central Bank Ordinance, the Bank has been assigned as the public institution responsible for safeguarding financial stability. The Bank's main policy objectives are:

- ◆ To protect the internal and external purchasing power of the Aruban florin,
- ◆ To enhance the safety, efficiency, and reliability of the payment systems, and
- ◆ To promote the soundness and integrity of domestic financial institutions.

In line with its policy objectives, the Bank performs 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 public in general.
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 paper. No credit is granted to the government.
d. Regulate the flow of international payments.	Facilitate and regulate payments between residents and nonresidents and collect foreign exchange tax.
e. Manage Aruba's official reserves, consisting of gold and foreign exchange holdings.	Invest the Bank's foreign exchange holdings in accordance with cautious guidelines aimed at protecting the country's liquidity and solvency position.
f. Advise the Minister of Finance on financial matters.	Produce relevant information and submit 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, thereby contributing to financial stability for the well-being of the people of Aruba.
i. Supervise the financial system.	Perform risk-based supervision on a number of financial institutions to protect the interests of their clients and to contribute to maintaining the stability and integrity of the financial system.

### 2.2 Domestic payment system

#### 2.2.1 Bank notes and coins

Following modest increases in previous years, at end-2004 total florin currency in circulation had shrunk by 1.7 percent to Afl. 162.6 million, despite a 6.1 percent increase in nominal gross domestic product (GDP). As a result, the ratio of total florin currency in circulation to nominal GDP fell from 4.6 percent in 2003 to 4.3 percent in 2004. Compared to other countries, this

ratio is rather low because of the co-circulation of U.S. dollars in Aruba generated largely through tourism activities, and an increased use of debit and credit cards.

Aruban florin bank notes are issued in denominations of Afl. 10, Afl. 25, Afl. 50, Afl. 100, and Afl. 500, in accordance with article 7 of the Central Bank Ordinance. Their aggregated value was Afl. 145.5 million at end-2004, Afl. 3.6 million or 2.4 percent less than in 2003. While the share of the Afl. 500 continued to decline, the share of the other denominations in the total of bank notes issued increased somewhat.

Coins, denominated in 5 cents, 10 cents, 25 cents, 50 cents, 1 florin, 2<sup>1</sup>/<sub>2</sub> florin, and 5 florin are issued on behalf of the government, according to article 7 of the Central Bank Ordinance. In 2004, the total value of coins (excluding commemorative coins) totaled Afl. 17.1 million, i.e., Afl. 0.8 million or 4.7 percent more than in 2003. In addition, two collectors' quality 10-florin silver coins were issued, symbolizing the native Aruban frog (*dori-pleurodema brachyops*) and fish (*mero-epinephelus morio*), which form part of a 6-coin series on endangered species. Also, a silver and a gold proof coin with a nominal value of 5 florin and 10 florin, respectively, were issued to commemorate the 50th anniversary of the Charter of the Kingdom of the Netherlands.

In February 2004, a revised series of florin bank notes was put into circulation, replacing the 1990 and 1993 series. The new series included several new security features, such as a silver-colored foil, a security thread, an electrotype watermark, and iridescent patterns. To inform the public adequately on the new security features, the Bank conducted an elaborate information campaign throughout the year. After all, a well-informed public is the best defense against counterfeiting.

### 2.2.2 Clearing system

Based on a secured web-client solution, the Bank manages a batch-clearing system through which inter-bank check clearing and fund transfers are settled. The commercial banks, the Department of Finance, the WEB (water and electricity company), the SETAR (the telecommunications company), and the Bank participate in this clearing system.

After peaking in 2000, both the volume and the value of checks processed through the clearing system continued to shrink in 2004, i.e., by 14.1 percent to about 642,000 checks and by 8.5 percent to Afl. 2.1 billion, respectively. The major factor behind this declining trend is the increased use of direct debit cards as a means of payment. The volume and value of funds transferred through the clearing system grew by 23.8 percent to 577,000 and by 14.3 percent to Afl. 4.0 billion, respectively.

### 2.2.3 Interest payments

The government and a number of financial institutions maintain current accounts and time deposits with the Bank. Interest is paid on certain current account balances and on time deposits excluding the required monetary cash reserves. The Bank's interest rates are based on corresponding interest quotations by the Federal Reserve Bank of New York. Total interest payments continued to decline in 2004, i.e., by 51.6 percent or Afl. 0.4 million. Interest payments to the government amounted to Afl. 25,267.

### 2.2.4 Banking for the government

In accordance with article 14 of the Central Bank Ordinance, the Bank effectuates free of cost the government's domestic and foreign payments. These payments are cleared through the Treasury's current account held with the Bank, which balance amounted to Afl. 5.4 million at the end of 2004. Government deposits held in earmarked accounts with the Bank fell by Afl. 0.3 million to Afl. 1.1 million, while the development funds account rose by Afl. 11.3 million to Afl. 41.7 million at end-2004.

In 2004, the Bank periodically intermediated in the renewal of two 3-month treasury-bill issues totaling Afl. 40 million and Afl. 8 million in 6-month cash certificates. The yields on these treasury bills varied between 1.33 percent and 2.21 percent; those of the cash certificates fluctuated between 2.29 percent and 3.30 percent. In addition, the Bank arranged three bond issues of Afl. 119.9 million, Afl. 57.5 million, and Afl. 25.2 million, respectively with a maturity of 10, 12, and 7 years. The yield for the first two issues was 6.8 percent and for the last issue, 6.3 percent.

## 2.3 International payment system

### 2.3.1 Daily exchange rate fixing

In 2004, the share of payments to nonresidents in U.S. dollars edged down to 88.5 percent. Payments in euros continued to shrink, reaching 3.7 percent of the total payments to nonresidents at end-2004. The official buying and selling rates for the U.S. dollar from and to the commercial banks remained unchanged at Afl. 1.7895 and Afl. 1.7905, respectively. The Bank publishes daily quotations for a number of other foreign currencies based on data provided by the European Central Bank. During 2004 the exchange rate of the florin vis-à-vis the euro fluctuated between Afl. 2.12 and Afl. 2.45 equal to a margin of 15.6 percent. At end-2004, the euro appreciated by 7.8 percent or Afl. 0.18 compared to end-2003.

### 2.3.2 Foreign exchange license policy

During 2004, the Bank's foreign exchange license policy did not change. Current foreign exchange payments are not subject to restrictions. The annual upper limits for executing capital transactions without any administrative restrictions were kept at Afl. 300,000 for natural persons and 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 when they concern regular transactions.

The Bank issued 103 special foreign exchange licenses in 2004, significantly more than in the previous year. However, the value of the transactions for the licenses granted in 2004, amounting to Afl. 471.9 million, was Afl. 137 million or 22.5 percent lower than in 2003. Significantly fewer loans were received related to refinancing and infrastructure projects.

### 2.3.3 Foreign exchange tax

The State Ordinance on the Foreign Exchange Commission stipulates that residents must pay a 1.3 percent tax on payments to nonresidents, including those payments executed through a foreign bank or foreign exchange office, checking account transfers settled in foreign currencies, and payments made by foreign corporations for and on behalf of affiliated resident companies settled via inter-company accounts.

However, certain transactions are exempt from payment of the foreign exchange tax. Exemptions include transactions in Netherlands Antillean guilders (based on an agreement between the governments), as well as transactions made by certain groups of companies (including government-related) by virtue of the State Decree on the Foreign Exchange Commission, as amended in 2001. In accordance with article 12 of the State Ordinance on the Free Zone, as amended in July 2000, free-zone companies may request an exemption to the extent that their payments for goods and services are linked to re-exports. Offshore companies, which 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, therefore, are not subject to a foreign exchange tax.

The government is responsible for determining the policy concerning the foreign exchange tax, while the Bank is entrusted with collecting it. In 2004, the Bank collected Afl. 28.3 million in foreign exchange tax, i.e., Afl. 9 million more than a year earlier. From the total amount collected in foreign exchange tax, Afl. 26.2 million was transferred to the Treasury. Currently, the government is considering the introduction of a license fee to replace the foreign exchange tax.

### 2.4 Managing the official foreign exchange reserves

The Bank is responsible for managing Aruba's official foreign exchange reserves, as stipulated in article 12, sub 1 of the Central Bank Ordinance. Its income stems predominantly from this activity. A significant part of the Bank's investments is made through external 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 double A-rated credit institutions. The Bank also deals directly with a number of foreign banking institutions.

Guidelines have been established to manage the various risks inherent in holding these investments and 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

In 2004, aggregated credit growth was in line with the 6 percent target set by the Bank. The weakening trend in the foreign reserve position, which began in 2002, continued during 2004, despite a buoyant performance by the tourism sector. For 2005 the economy is projected to grow by nearly 6 percent in nominal terms, with an inflation rate of about 2.5 percent. The Bank sees no immediate need for a further tightening of monetary policy. Therefore, the 6 percent aggregate credit growth ceiling will remain in effect. In case of any excess growth, a penalty of 6 percent (on an annual basis) will be levied on those individual commercial banks that exceed the mentioned aggregate lending limit. However, the facility to create additional credit room by attracting foreign funding has been discontinued.

Additionally, the monetary cash reserve requirement will remain at the present level of 8 percent, subject to revision on a quarterly instead of an annual basis. The Bank will closely monitor inflationary developments, current account trends in the balance of payments, and liquidity requirements within the banking system during 2005. In case of adverse developments, the Bank may alter the monetary cash reserve requirement and thus tighten monetary policy. The present arrangements concerning the banks' so-called B<sub>9</sub> position and compensating fee for any deficiency in monetary cash reserves will remain unchanged.

### 2.6 Prudential supervision

Prudential supervision is aimed primarily at maintaining the stability and integrity of the financial system. To this end, off-site surveillance and risk-based on-site examinations are carried out on a continuous basis to monitor compliance with the supervisory laws and regulations governing the banks, money transfer companies, insurance companies, and company pension funds. In addition, regular bilateral meetings are held with the management of the individual institutions as well as with the representative organizations.

In conformity with IMF recommendations, the legislative framework for the supervision of the financial system should be extended to other currently unsupervised sectors (e.g., the company service providers and the insurance brokers). In addition, the current state ordinances on the supervision of the credit system and the insurance system should be strengthened in certain areas to reach a higher degree of compliance with the Core Principles for effective banking supervision and with the Core Principles for insurance supervision issued by the Basel Committee on Banking Supervision and the International Association of Insurance Supervisors.

In April 2004, the implementation of the State Ordinance on the Supervision of Money Transfer Companies was finalized. Six companies qualified for registration, while two internationally active money transfer companies that conduct their activities via locally supervised institutions were granted an exemption in accordance with section 10 of this ordinance. Money transfer companies are required to file detailed quarterly reports on their money transfer activities as well as their financial accounts.

## 2.7 Financial highlights

- ◆ At the end of 2004, the Bank's total assets had grown by Afl. 2.1 million or 0.3 percent to Afl. 644.8 million compared to 2003. This growth was attributed largely to an increase in the value of gold holdings by the Bank.
- ◆ Total income (net of interest expenses) amounted to Afl. 13.7 million, compared to Afl. 22.6 million in 2003. A significant drop in net interest revenues due to lower yields on U.S. dollar investments and capital gains contributed to a decline in total income.
- ◆ Total expenses reached Afl. 12.7 million, i.e., Afl. 1.1 million or 10 percent higher than in 2003, largely because of an increase in personnel and operational expenditures.
- ◆ For 2004 net profit amounted to Afl. 1.0 million, i.e., Afl. 10.1 million less than in 2003. In accordance with article 33, paragraph 1 of the Central Bank Ordinance, Afl. 1.0 million was allocated to the Treasury of Government.

## 2.8 Organizational affairs

In the year under review, the Bank saw the tragic passing away of its employee, Miss J.I.J. Geerman. She was dedicated to the tasks entrusted to her as junior examiner at the Supervision Department and had great aspirations for the future.

The Bank also saw the passing away of Mr. R.E. Yrausquin, member of the Board of Supervisory Directors from March 2000–June 2004, and Mr. A.N. Nemecek, member of the Board of Supervisory Directors from December 1994–December 2004. Mr. Yrausquin and Mr. Nemecek served as dedicated members of the Board of Supervisory Directors, with wisdom and leadership.

On January 23, 2005, Mrs. E.G.R. Cohen-Henriquez-Jansen resigned as a member of the Board of Supervisory Directors, having reached the end of her tenure. During her tenure, from January 1995 - January 2005, Mrs. E.G.R. Cohen-Henriquez-Jansen made valuable contributions and acted in a committed and responsible way.

To fill the vacancies that arose, Mr. H.O. van Trikt was appointed as a member of the Board of Supervisory Directors as of April 2005.

On June 30, 2004, the tenure of Mr. A.R. Caram, President of the Bank, expired. The Executive Committee wishes to express its appreciation for his valuable contributions to the Bank and his commitment to promoting economic welfare and financial stability. As of July 1, 2004, Mr. R. Henriquez was appointed as President of the Bank.

During 2004, the Bank continued to focus on the implementation of projects to enhance business processes and on procedures to further strengthen, among other things, operational efficiency, IT security, and risk management, and to guarantee business continuity. The Bank's staff amounted to 62 at end-2004. Their high professionalism and dedication remained unchanged, as they made a sustained contribution to the Bank's obligations to the Aruban community. The Executive Committee is grateful for their commitment.



**Members of the Board of Supervisory Directors, standing l.-r.:**

T.R.L. Vingal, A.J. Swaen, H.O. van Trikt

**The Executive Committee, seated l.-r.:**

K.A.H. Polvliet, R. Henriquez, J.R. Figaroa-Semeleer

*(Photograph by Angelo Trimon)*

## ECONOMIC AND FINANCIAL DEVELOPMENTS

### 3.1 The international environment

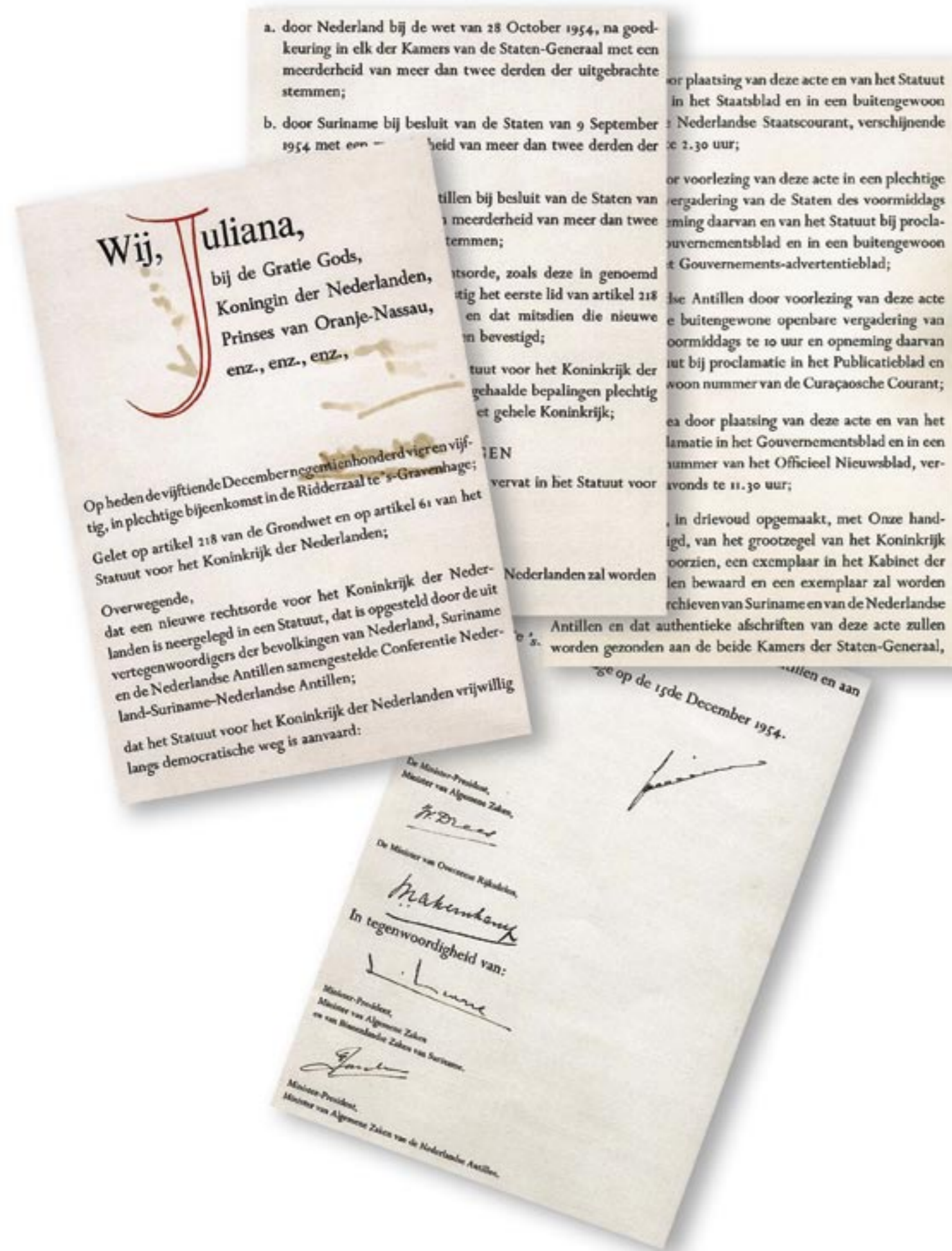
In 2004, global economic conditions strengthened further, pushing growth in overall output to the highest level in nearly 30 years – 5.1 percent, up from 4.0 percent in 2003. The United States and the emerging Asian countries, particularly China, were the main engines of growth. Business investment remained buoyant, spurred by favorable financing conditions and progress achieved in the restructuring of firms, which led to better capacity utilization. Another contributory factor was an upturn in private consumption, which resulted from improvements in labor market conditions. However, growth was somewhat restrained by the sharp increase in oil prices, which curbed the rise in household purchasing power and corporate projects. Still, inflation remained subdued, as firms were able to absorb part of the rise in the cost of commodities because of the under-utilization of production capacity in previous years combined with a recovery in profitability.

Economic growth of the United States accelerated from 3.0 percent in 2003 to 4.4 percent in 2004, accompanied by a steady decline in unemployment and increased productivity. Inflation, on the other hand, remained moderate. The expansion in output was brought about mainly by increased private investment in housing and the revival in business investments in information and communication technology equipment, as well as in machinery and transport equipment. This increased investment led to strong growth in the gross fixed capital formation of companies. Net exports of goods and services had a negative impact on economic growth because imports expanded faster than the recovering exports, stimulated by a vigorous domestic demand.

After a 1.4 percent growth in 2003, the Japanese economy expanded further by 2.6 percent in 2004, following higher private consumption, external demand, and business investment, as well as years of restructuring in the financial sector and in industry. Employment increased slightly for the first time since 1997, causing a decline in the unemployment rate. Despite the stronger economic growth, deflation persisted. Remarkably, during 2004, the Chinese economy maintained its high growth pace to reach 9.5 percent, particularly attributable to significant gains in domestic investments and exports mainly to the United States and the euro area. The strong economic growth pushed up inflationary pressures.

The euro area's gross domestic product (GDP) growth accelerated to 2.0 percent in 2004, up from 0.5 percent in 2003, spurred mainly by higher exports, particularly to the new EU Member States, China, and the United States. Despite further expansion in economic activities, employment rose fairly modestly, partly because of the use of existing manpower reserves in firms. Inflation remained unchanged at 2.1 percent.

After many years of slowdown, the economies of Latin America and the Caribbean gained momentum in 2004. A number of factors, including robust global demand, strong commodity



prices, and a pick up in private consumption and business investments contributed to this growth. Average real GDP in the region grew by approximately 5.7 percent, the highest growth rate since 1997. Exports, the strongest demand-side factor driving the recovery, grew vigorously. Still, unemployment eased very little, and inflation remained moderate.

In 2005, global output is expected to rise by 4.3 percent. Growth in the economies of the United States, the euro area, Japan, and China are expected to slow down to a more sustainable pace of, respectively, 3.6 percent, 1.6 percent, 0.8 percent, and 8.5 percent. Growth of the Latin American and Caribbean region is estimated at 4.1 percent. However, this positive outlook has some risks attached. Besides uncertainties associated with the war in Iraq and terrorism, further spikes in oil prices and the build-up of current account imbalances between the main regions of the world, in particular the large U.S. current account deficit, could hamper economic growth in 2005, triggering inflationary pressures and higher interest rates.

### 3.2 The domestic real sector

In 2004, the Aruban economy expanded for the second year in a row. GDP in real terms rose by an estimated 3.5 percent, driven again mainly by a 12 percent increase in gross investments, particularly in the private sector where large hotel projects were nearing completion. In addition, consumption by public sector and private households grew by 5 percent and 3 percent, respectively.

Exports of goods and services rose by 2 percent in real terms, up from a 5 percent decline in 2003. This improvement reflected in part a more buoyant tourism sector. Imports also rose, by 6 percent, due to higher domestic consumption and increased inbound tourism consumption following a significant rise in tourist arrivals.

In 2004, the number of stay-over visitors surged by 13 percent, the highest growth rate recorded since 1991, in contrast to a marginal contraction a year earlier. The number of nights these tourists spent on the island rose by 11 percent, up from 5 percent in 2003. In comparison, stay-over visitors in the Caribbean increased by an estimated 6 percent. With respect to cruise tourism, Aruba registered a 6 percent increase in the number of passengers, notably lower than the 11 percent average increase in the Caribbean as a whole.

All sectors of the economy, with the exception of the construction sector where output shrank by 6 percent, recorded increased activities. The output contraction in the construction sector was mirrored in a decrease in imported construction material, associated with the (near) completion of large hotel projects. The sectors "hotels and restaurants" and "transport, storage & communication" incurred output increases of 10 percent and 9 percent, respectively. In addition, both the "trade" and "housing" sectors grew by 3 percent, while "utilities" and "public administration & education" rose by 1 percent and 2 percent, respectively.

Table 1 Main economic indicators

	2002	2003	2004
<b>1. Gross domestic product</b>			
Nominal GDP (in Afl. million) 1)	3,421	3,599	3,819
Population (period average)	93,311	95,076	97,518
GDP per capita (in Afl.)	36,665	37,856	39,162
Real GDP growth (in percent)	-2.6	1.5	3.5
<b>2. Labor market 2)</b>			
Unemployment rate (in percent)	8.1	7.9	7.3
Participation rate (in percent)	64.2	63.9	63.5
Productivity growth (in percent)	-2.3	-0.9	0.0
<b>3. Tourism</b>			
Tourism receipts (in Afl. million) 3)	1,475.3	1,526.1	1,872.0
Stay-over visitors (x 1,000)	642.6	641.9	728.2
Visitor nights (x 1,000)	4,862.5	5,097.6	5,639.9
Average hotel occupancy rate (Aruba) 4)	71.7	74.4	80.7
Average hotel occupancy rate (Caribbean)	63.6	62.7	67.9
Average daily rate hotels (US\$) (Aruba) 4)	138	134	145
Average daily rate hotels (US\$) (Caribbean)	155	156	n.a.
Revenue per available room (US\$) (Aruba) 4)	69	69	82
Revenue per available room (US\$) (Caribbean)	99	83	96
Cruise visitors (x 1,000)	582.2	542.3	576.3
Aruba's market share in the Caribbean (in percent)			
- stay-over visitors	3.8	3.5	3.8
- cruise tourism	3.7	3.1	3.0
<b>4. Price developments</b>			
Inflation (end of period, in percent)	4.2	2.2	2.8
Inflation (period average, in percent)	3.3	3.6	2.5
Real exchange rate index (1995 = 100) 5)	103.8	105.2	105.0

Source: CBA; CBS; Aruba Tourism Authority; Cruise Tourism Authority; Caribbean Tourism Organization; IMF.

1) Figure for 2003 is a preliminary estimate by CBA. Figure for 2004 is a preliminary estimate by IMF.

2) Estimates by CBA. Productivity growth is defined as the percentage change of the ratio between the real GDP and the number of employed persons.

3) Gross receipts from stay-over and cruise tourism as well as other tourism-related income as recorded on a cash basis in the balance of payments.

4) Including time-share.

5) Relative to the U.S.A. Based on CPI period-average.

The annual average increase in the consumer price index decelerated to 2.5 percent, down from 3.6 percent in 2003. This deceleration resulted mainly because the water and electricity company decided not to pass on completely the increases in oil prices on the international markets to the local tariffs of water and electricity.

Estimates by the Bank indicate that 2.2 percent of the annual average inflation recorded was attributed to higher import prices, while the remainder was induced by local factors. Adjusted for energy-related components (i.e., water, electricity, and gasoline), the inflation rate amounted to 2.0 percent, i.e., 0.4 percentage point lower than in 2003. The inflation differential with Aruba's major trading partner, the United States, turned from +1.3 percentage points in 2003 to -0.2 percentage point in 2004. The real exchange rate index of the Aruban florin vis-à-vis the U.S. dollar decreased slightly to 105.0.

Output growth in 2005 is projected to decelerate slightly to 3¼ percent, in part because of constraints in hotel capacity, which would slow down tourism growth. Investment and consumption are expected to increase by 10 percent and 3 percent, respectively, thereby remaining the main sources of growth.

### 3.3 The financial sector

In 2004, monetary expansion continued albeit at a much slower pace than a year earlier. Domestic money creation amounted to Afl. 60 million, significantly lower than the Afl. 242 million growth recorded in 2003 and was related to a much smaller expansion in credit to the private sector. Contributory factors to this slowdown were the take-over of Interbank Aruba N.V. by Aruba Bank N.V., as a result of which a part of the assets of the former bank was transferred to IBA Corporation N.V. and to its former shareholder, and the tightening of monetary policy by the Bank, which included a penalty fee for noncompliance. Consequently, the lending activities of the commercial banks (corrected for the take-over effect of Interbank Aruba N.V.) rose by 6 percent, compared to 10 percent a year earlier. Credit to enterprises, consumer loans, and housing mortgages increased by 3 percent, 10 percent, and 7 percent, respectively. Transactions of the government with the monetary system, on balance, contributed Afl. 21 million to the increase in money supply.

Net foreign assets grew by only Afl. 11 million or 2 percent, despite the inflow of funds attributed to the resilient performance of the tourism industry, the annual development aid contribution of the Dutch government to the Fondo Desaroyo Aruba, and the issue by the government of Afl. 120 million (US\$ 67 million) in bonds on the international capital market.

On balance, monetary growth decelerated from 9 percent in 2003 to 3 percent in 2004. The ratio of money supply to GDP decreased by 2 percentage points to 60 percent. Both narrowly defined money and quasi money increased by 3 percent.

The activities of the nonmonetary financial institutions showed a strong increase in 2004, in part due to the inclusion of IBA Corporation N.V., which was established to support the settlement of the take-over of Interbank Aruba N.V. by Aruba Bank N.V. In addition, claims on the government and private sector went up by 9 percent and 4 percent, respectively, while net foreign assets rose by 13 percent to Afl. 452 million. The latter was more than four times the net foreign assets of the commercial banks.

The housing mortgage portfolio of the nonmonetary financial institutions grew by 5 percent in 2004. However, its share in the total housing mortgage market declined by 0.5 percentage point to 44 percent. On the liability side, pension fund provisions, borrowings and deposits, and the insurance reserve fund picked up by 8 percent, 2 percent, and 6 percent, respectively.

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

	2002	2003	2004
<b>1. Net domestic money creation</b>	154.0	241.7	60.1
a. Net domestic credit	159.0	218.5	118.7
1. Public sector	-36.2	19.3	21.3
2. Private sector	195.2	199.2	97.4
b. Other domestic factors	-5.0	23.2	-58.6
<b>2. Inflow of foreign funds 1)</b>	39.0	-61.2	11.2
a. Current account (net)	-596.7	-258.8	17.9
b. Capital and financial account (net) 2)	635.7	197.6	-6.7
<b>3. Broad money creation</b>	193.0	180.5	71.3
a. Money	143.5	88.7	27.8
b. Quasi money	49.5	91.8	43.5
<b>4. Key indicators (in percent)</b>			
a. 12-month change in money supply	10.5	8.9	3.2
b. Broad money coverage 3)	34.4	28.8	28.4
c. Money supply to GDP	59.4	61.5	59.8

Source: CBA.

- 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 net foreign assets of the monetary system to broad money.

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

	2002	2003	2004
<b>1. Net foreign assets</b>	330.3	398.5	451.6
<b>2. Domestic claims</b>	1,081.6	1,266.5	1,344.3
a. Government	463.0	506.9	551.1
b. Private sector, of which:	618.7	759.6	793.1
housing mortgages	447.3	441.3	461.8
<b>3. Total assets = total liabilities</b>	1,411.9	1,665.0	1,795.8
<b>4. Borrowings and deposits</b>	57.4	62.0	63.5
a. Government	36.8	36.8	36.7
b. Other residents	20.7	25.2	26.8
<b>5. Pension fund provisions</b>	1,156.1	1,218.4	1,313.2
<b>6. Insurance reserve fund</b>	258.7	273.3	288.4
<b>7. Other items (net)</b>	-60.4	111.3	130.7
<b>8. Key indicators</b>			
a. Net foreign assets in % nominal GDP 2)	9.7	11.1	11.8
b. Total assets in % nominal GDP	70.8	75.3	72.8
c. Share housing mortgages in total market	47.7	44.5	44.0

Source: CBA.

- 1) Comprising mortgage banks, pension funds (including the APFA), life insurance companies, finance companies, the Aruban Investment Bank, the Social Security Bank, and IBA Corporation N.V. (established in October 2003 to support the settlement of the take-over of Interbank Aruba N.V. by Aruba Bank N.V.).  
2) Ratio of net foreign assets to GDP.

### 3.4 Government finance

In 2004, the outcome of government financial transactions was influenced largely by a debt conversion agreement with the Civil Servants Pension Fund (APFA), following the parliamentary approval of its privatization in December 2004. In this agreement, Afl. 281 million in existing arrears related to premiums, cost of living allowances, and private loans extended to the government in the past years was converted into an Afl. 34 million 12-year bond and an Afl. 220 million 35-year annuity loan. Afl. 25 million will be balanced with the future wage tax on pension benefits payable by the APFA to the tax authority, and Afl. 2 million was settled between the government and the APFA in October 2004.

Government spending surged by an estimated Afl. 269 million or 31 percent to Afl. 1,143 million in 2004, attributed largely to an Afl. 118 million increase in employer contributions associated with the abovementioned debt conversion, which led predominantly to an Afl. 155 million (36 percent) rise in personnel-related expenses. When excluding the effect of the debt conversion, total spending on a cash basis expanded by Afl. 70 million or 8 percent. Specifically, expenditures on goods and services rose by Afl. 37 million (24 percent), and salary-related expenses (excluding the settlement of premium payment arrears following the earlier mentioned debt conversion) increased by Afl. 41 million (9 percent). In addition, interest payments and investment spending expanded by Afl. 17 million (39 percent) and Afl. 25 million (58 percent), respectively. In contrast, the other items n.i.e. (not included elsewhere) declined by Afl. 50 million.

Net lending came out at Afl. 51 million, mainly the result of the transfer by the government to the General Health Insurance (AZV) to cover operational deficits incurred during the period 2001 to 2003. It should be noted that the government's total transfers to the AZV, comprising the government's annual contribution and employer premium payments, as well as advances to cover deficits (which are included in net lending), remained virtually unchanged at Afl. 147 million in 2004.

Total government revenue on a cash basis amounted to Afl. 816 million in 2004. Tax revenue rose by Afl. 20 million or 3 percent to Afl. 707 million. Contributing factors were higher revenues from import duties, foreign exchange tax, and taxes on services of, respectively, Afl. 18 million, Afl. 12 million, and Afl. 13 million. In contrast, taxes on income and profit fell by Afl. 18 million because an increase in revenues from the wage tax was completely offset by a decrease in revenues from the profit tax. The latter reflected higher earnings in 2003 following the implementation of a new policy of early collection of profit taxes, which resulted in a simultaneous collection of these taxes for both 2002 and 2003.

On balance, an Afl. 378 million financial deficit was recorded in 2004, compared to an Afl. 172 million surplus in 2003. This notable deterioration is predominantly related to the earlier mentioned debt conversion with the APFA. Excluding the effects of this debt conversion, the financial deficit amounted to Afl. 179 million or 5 percent of GDP.

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

	2002	2003	2004
<b>1. Revenue and grants</b>	750.8	975.2	816.0
a. Tax revenue	609.6	687.4	707.1
b. Nontax revenue	103.8	86.1	77.8
c. Grants 2)	37.4	201.8	31.1
<b>2. Expenditures and items n.i.e.</b>	826.7	873.9	1,142.5
a. Personnel-related outlays	431.4	437.8	593.2
b. Goods and services	149.4	153.5	191.1
c. Interest payments	48.9	44.9	85.2
d. Investments	17.0	42.6	67.1
e. Items n.i.e. of which:	180.1	195.2	205.8
- transfers 3)	120.6	162.9	128.6
- subsidies	52.0	24.2	24.2
- other	7.5	8.1	53.0
<b>3. Lending minus repayments</b>	-3.0	-71.1	51.1
<b>4. Financial deficit (-)</b>	-72.9	172.4	-377.6
<b>5. Net foreign capital 2)</b>	106.7	-200.6	100.6
<b>6. Net domestic capital 4)</b>	2.5	9.0	255.7
<b>7. Net recourse to the monetary sector</b>	36.2	-19.3	-21.3
<b>8. Memorandum items</b>			
a. Unmet financing requirements 5)	275.8	300.9	152.9
b. Financial deficit 6)	-79.4	147.3	-229.6
c. Total government debt 7),	1,611.2	1,496.6	1,718.2
of which:			
domestic debt	717.5	769.6	875.7
foreign debt 8)	893.7	727.0	842.6
d. Outstanding government guarantees	5.4	5.4	0.0
<b>9. Key indicators</b>			
a. Total debt in % nominal GDP	47.1	41.6	45.0
b. Foreign debt in % exports 9)	46.4	36.8	36.7
c. Debt service in % exports 10)	5.1	7.3	2.9

Source: Department of Finance; Tax Collector's Office; CBA.

- 1) Preliminary figures on a cash basis. Includes transactions related to foreign development cooperation.
- 2) In 2003, government financial data were revised to reflect the debt forgiveness amounting to Afl. 172 million (US\$ 96 million) granted by SACE to the government as part of the settlement of the hotel guarantee issue. This amount is registered in the item "grants".
- 3) Including government's annual contribution to AZV.
- 4) 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.
- 5) Comprising all reported unsettled payment obligations to other sectors irrespective of the time frame in which they mature.
- 6) Including the change in unmet financing requirements.
- 7) Preliminary (end-of-period) figures, excluding government guarantees.
- 8) At year-end exchange rates, including the debt assumption related to the hotel guarantees issued in the past.
- 9) Exports of goods and services, excluding the oil sector.
- 10) Related to foreign debt. Exports exclude the oil sector.

The debt conversion also had an impact on the outstanding payment arrears of government vis-à-vis the APFA, which declined by Afl. 170 million to Afl. 50 million in 2004. Still, total registered unmet financial requirements of the government fell by only Afl. 148 million to Afl. 153 million, thus implying that the government increased its spending by an additional Afl. 22 million by incurring new payment arrears largely vis-à-vis suppliers of goods and services. Including the decrease in the registered unmet financial requirements, a financial deficit of Afl. 230 million was recorded in 2004, in contrast to an Afl. 147 million surplus a year earlier.

Total financing needs of the government surged from Afl. 156 million in 2003 to Afl. 475 million in 2004, reflecting the debt conversion with the APFA, the large wage bill, and contributions to the AZV. Moreover, the government borrowed, respectively, Afl. 124 million and Afl. 326 million from the foreign and domestic capital markets. On balance, bank deposits of the government decreased by Afl. 13 million.

Outstanding public debt rose by Afl. 222 million or 15 percent to Afl. 1,718 million in 2004. Consequently, the ratio of this debt to nominal GDP increased by 3.5 percentage points to 45 percent. Foreign debt surged by Afl. 116 million (16 percent) to Afl. 843 million because Afl. 120 million (US\$ 67 million) in bonds was issued on the international capital market in April 2004 to finance budget deficits. Domestic debt went up by Afl. 106 million to Afl. 876 million, due mainly to an Afl. 58 million bond issue on the local capital market in June 2004 (to finance part of the AZV deficits incurred during the years 2001 to 2003), and an Afl. 25 million bond issue in September 2004 to cover budget deficits. Furthermore, as part of the aforementioned debt conversion agreement with the APFA, an additional Afl. 34 million in bonds was issued.

### 3.5 Balance of payments

In 2004, the balance of payments recorded an Afl. 11 million overall surplus, compared to an Afl. 61 million deficit in 2003. Consequently, net international reserves of the monetary system (excluding the revaluation differences of gold and official foreign exchange holdings) went up to Afl. 714 million. The 12-month merchandise import coverage ratio fell slightly to 6.3 months, down from 6.7 months a year earlier. The official gold and foreign exchange reserves of the Bank amounted to Afl. 614 million, i.e., Afl. 6 million higher than in 2003. The remainder of the monetary sector's net foreign assets, i.e., Afl. 100 million, was in the hands of the commercial banks. It should be pointed out, however, that the weakening trend in the net international reserves, which started in 2002, was not completely reversed despite the favorable tourism performance during 2004. The balance of payments surplus was influenced largely by the government's foreign financing amounting to Afl. 101 million on a net basis. However, the remaining external transactions triggered on balance an Afl. 90 million decline in net foreign assets.

The Afl. 259 million deficit on the current account of the balance of payments in 2003 turned into an Afl. 18 million surplus in 2004, equivalent to about 1 percent of GDP. This outcome was predominantly associated with the external transactions of the oil sector. Exports of refined oil products overgrew the imports of goods for processing, resulting in a notable improvement in the merchandise trade balance of this sector. The current account of the rest of the economy showed, for the third consecutive year, a large deficit, i.e., Afl. 245 million, equivalent to 38 percent of total foreign exchange reserves and 6 percent of GDP. This deficit is Afl. 90 million smaller than in 2003, attributed mainly to a higher surplus on the services account, reflecting a 23 percent increase in tourism receipts. In contrast, the trade account deficit widened further because of a 10 percent expansion in the import of goods. Also, the deficit on the income account widened, due mainly to higher dividend and other income payments to nonresidents. Moreover, the deficit on the current transfers account rose further, mainly because of a rise in insurance premium payments related to increased imports.

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

	2002	2003	2004
<b>1. Current account (net)</b>	-596.7	-258.8	17.9
a. Oil sector	-299.0	64.7	250.9
b. Free zone	-68.0	11.5	11.9
c. Rest of economy	-229.7	-335.0	-244.8
1. Goods	-998.4	-1,098.9	-1,211.3
2. Services	1,008.8	951.4	1,210.4
3. Income	-146.1	-71.3	-103.6
4. Current transfers	-94.1	-116.1	-140.4
<b>2. Capital and financial account (net)</b>	604.3	165.4	-9.3
a. Oil sector	372.1	79.4	-176.8
b. Free zone	64.3	-1.2	-2.4
c. Rest of economy	167.9	87.3	169.8
1. Capital account transactions	38.1	180.6	32.9
2. Direct investment	104.7	222.5	159.6
3. Portfolio investment	134.1	91.4	81.7
4. Financial derivatives	-0.1	0.0	0.0
5. Other investment	-108.8	-407.2	-104.3
5.1 Loans	-65.5	24.8	-72.7
5.2 Other financial transactions	-43.3	-432.0	-31.6
<b>3. Items not yet classified 2)</b>	31.4	32.2	2.6
<b>4. Overall balance (= 1 + 2 + 3)</b>	39.0	-61.2	11.2
<b>5. Total reserves of the monetary sector 3),</b> of which: official reserves	755.5 667.9	700.3 608.9	714.2 614.4
<b>6. Import coverage in months of merchandise imports 4)</b>			
a. End-of-period	6.5	6.0	5.7
b. 12-month average	7.3	6.7	6.3

Source: CBA.

1) On a cash basis.

2) Including errors and omissions.

3) Including net foreign assets of the commercial banks.

4) Coverage of total reserves of the monetary system. Imports exclude the oil sector.

The Afl. 165 million surplus on the capital and financial account in 2003 turned into an Afl. 9 million deficit in 2004, mainly because of an increase in foreign account balances of the oil sector. On the other hand, the surplus on the capital and financial account of the rest of the economy widened to Afl. 170 million. The main contributory factor was a narrowing deficit on the other investment account, which resulted partly from a decrease in residents' foreign account balances. The debt forgiveness granted by the Italian export credit insurer, SACE, to the government amounting to Afl. 172 million (US\$ 96 million) and the repayment by the government of a short-term loan from SACE arising from the debt forgiveness agreement amounting to Afl. 98 million (US\$ 55 million), both registered in March 2003, also contributed to the improvement in the other investment account. The two transactions were related to the settlement of the hotel guarantee issue. In contrast, the surplus on the direct investment account declined, partly following the repatriation of equity capital to nonresidents and a decline in other direct investments in Aruba. In addition, the capital account surplus dropped, also reflecting the capital transfer related to the mentioned debt forgiveness.

# PRUDENTIAL SUPERVISION OF FINANCIAL INSTITUTIONS

## 4.1 Introduction

The Bank is entrusted with the prudential supervision of the banking and insurance sectors, company pension funds, and money transfer companies on the basis of, respectively, the State Ordinance on the Supervision of the Credit System (AB 1998 No. 16), the State Ordinance on the Supervision of the Insurance Business (AB 2000 No. 82), the Company Pension Funds (AB 1998 GT 17), and the Money Transfer Companies (AB 2003 No. 60).

Prudential supervision aims at preventing financial institutions from taking risks that could harm the interests of depositors, policyholders, and other creditors and endanger the soundness, stability, and integrity of the financial system. To that end, continuous off-site surveillance, as well as periodic, risk-based on-site examinations are conducted. Furthermore, bilateral meetings are held regularly with the institutions concerned and with their representative organizations.

Depending on the type of financial institution, detailed reporting forms should be submitted on a weekly, monthly, quarterly, and/or annual basis. 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.

On-site examinations are undertaken to assess key risk areas, such as the financial condition, asset quality, corporate governance, and the anti-money-laundering and terrorist financing procedures. The frequency of these examinations varies with the risk profile of each individual institution. Depending on the Bank's findings, the institution may be required to take corrective measures. During 2004, four commercial banks, two bank-like institutions, three insurance companies, one company pension fund, and one money transfer company were examined on-site.

## 4.2 Major issues and developments

### 4.2.1 Legislative framework

The legislative framework for the supervision of the financial sector has to be extended to other currently unsupervised sectors (including trust companies and insurance brokers), while the existing banking and insurance state ordinances have to be revised and strengthened. The latter recommendation is supported by the recently revised and expanded Core Principles for Effective Insurance Supervision issued in October 2003 by the International Association of Insurance Supervisors (IAIS). The Bank intends to start early 2006 with the drafting of legislative proposals to expand its supervisory activities to insurance brokers and to strengthen the banking and insurance state ordinances.



*'Autonomie-Monument' on the island of Curaçao designed by J. Fresco. The birds symbolize the then six islands of the Netherlands Antilles. The inscription states that each part is responsible for its own care while still willing to assist each other.*

#### 4.2.2 Banking sector

With the take-over of Interbank Aruba N.V. in November 2003, the number of commercial banks in Aruba has decreased to four. Even so, further concentration and/or alliances in the banking sector may be necessary in coming years to carry the increasing costs that banks face with respect to the upgrading and expansion of their automated systems. Continuous investments in this area are necessary to meet, among other things, consumer demand for state-of-the-art payment and electronic transactional facilities (including internet banking and ATM services). Also, in view of the continuous raising and expansion of the international standards governing financial institutions, banks will have to continue to invest in upgrading and improving their information and reporting systems, governance structure, and internal controls to prevent money laundering and terrorist financing practices.

In accordance with the directive on the publication of audited financial statements issued by the Bank in June 2003, all banks are required as of the reporting year 2005 to file their audited financial statements or a for the Bank acceptable extract thereof at the Chamber of Commerce. Branches are allowed to file audited statements of the group of which they are a part.

In October 2004, the Dutch Central Bank (DNB) provided technical assistance on the implementation of a Risk Analysis Supervision Tool (RAST), which is used by the DNB for conducting risk assessments at credit institutions. This tool will assist the Bank in standardizing its risk assessments at the supervised banks and also in prioritizing the risk areas that need to be examined more frequently or in more detail. Implementation of RAST is expected to be completed by mid-2006.

In June 2004, the Basel Committee on Banking Supervision adopted the Basel II framework on capital adequacy requirements. The revised framework is more risk sensitive than the 1988 Capital Accord and provides a range of options for determining the capital requirements for credit risk and operational risk. Depending on the approach used, the new capital adequacy requirements are expected to be introduced at the end of 2006 (standardized approach) or the end of 2007 (advanced approach). Most likely, only the large international banks will be able to opt immediately for the advanced approach, which may allow them to maintain a lower regulatory capital amount that is more aligned to their economic capital. The non-G10 supervisory authorities also are encouraged to adopt this revised framework in the near future. However, each national supervisor is advised to evaluate carefully the benefits of the revised capital adequacy framework in the context of its domestic banking system when developing a timetable and approach to implementation. The Bank will monitor closely the international and regional developments in this area.

#### 4.2.3 Money transfer companies

The State Ordinance on the Supervision of Money Transfer Companies (SOSMTC) became effective on August 8, 2003. Pursuant to this ordinance, a money transfer company must be registered at the Bank before it can conduct money transfer activities. The already active money transfer companies were granted a grace period of 180 days to comply with the registration

requirements stipulated in subject ordinance. Some of the main registration requirements are that shareholders and management must be fit and proper and that the administrative organization and internal controls are satisfactory. As of the reporting year 2004, all registered money transfer companies also are required to provide the Bank periodically with detailed (certified) reports on their operations and financial position.

In 2004, six registered money transfer companies qualified for registration, while two internationally active money transfer companies, i.e., Western Union and Money Gram, were granted an exemption as defined in section 10 of the SOSMTC. Meanwhile, the number of money transfer companies registered has decreased from six to five as a result of Unigiros N.V.'s decision to terminate its money transfer activities as of January 1, 2005.

In view of the significant risks money transfer companies face to be used for illicit practices, the Bank has decided to strengthen its guidelines for money transfer companies in the area of combating money laundering and terrorist financing. Pursuant to these revised guidelines, all money transfer companies are required as of September 2005, to appoint a separate compliance officer responsible for overseeing compliance with the laws and regulations governing money transfer companies.

#### 4.2.4 Insurance sector

Two insurance companies, Atradius Credit Insurance N.V. and National General Insurance Corporation N.V. (Nagico), were granted a non-life insurance license by the Bank in 2004. Consequently, the total number of insurance institutions supervised increased from 33 to 35.

In March 2005, the Bank issued draft "Pension Fund Governance" guidelines for consultation. They contain minimum requirements in the area of board oversight, administrative organization and internal controls, and disclosure of financial information. The subject guidelines are based mainly on the pension fund governance guidelines issued by the Organization for Economic Cooperation and Development (OECD) in July 2002. These guidelines will come into effect on January 1, 2006.

The financial position of the company pension funds remains worrisome. As of December 2003, three company pension funds did not comply with the minimum coverage ratio requirement of 100 percent. The Bank has required these pension funds to submit a financial recovery plan, and closely monitors the implementation of these plans.

In October 2003, the International Association of Insurance Supervisors (IAIS) revised and expanded its Insurance Core Principles and Methodology, offering guidance for the effective operation of supervisory systems around the world. The 28 principles cover all aspects of insurance industry regulation and supervision. Principles addressing such issues as transparency of the supervisory process, assessment and management of risk, consumer protection, and anti-money laundering were added. All IAIS members, including Aruba, are encouraged to conduct a self-assessment to determine whether the revised Insurance Core Principles are being observed. The Bank is in the process of conducting a self-assessment in

light of these revised principles and expects to complete it by mid-2005.

In December 2004, the State Ordinance on the Privatization of the Civil Servants Pension Fund (APFA) was enacted. The objectives of this privatization are to convert the APFA into a foundation and to introduce a new and more sustainable pension arrangement for current and future members based on the so-called average income arrangement ('middelloon-regeling'). According to this ordinance, the APFA will fall eventually under the Bank's supervision. For the time being the APFA will remain under the supervision of the Minister of Finance and Economic Affairs.

#### 4.3 Integrity of the financial system

In accordance with the preliminary conclusions of the IMF article IV Consultation Mission that visited Aruba in January 2005, the legislative process in the supervisory area as well as in the area of combating money laundering and terrorist financing should receive high(er) priority. In this respect, no significant progress has been achieved in the implementation of a State Ordinance on the Supervision of Trust Companies, while the revised Sanction Ordinance still needs to be passed by Parliament. Also, in view of the planned mutual evaluation in 2007 by the Financial Action Task Force (FATF) of Aruba's anti-money-laundering and anti-terrorist laws, regulations, and practices in light of the recently revised 40+9 FATF recommendations on combating money laundering and terrorist financing, it is of utmost importance that more decisive (legislative) action be taken in this area.

At present, banks, life insurance companies, casinos, freezone, money transfer companies, and the post office are obliged to report unusual transactions to the Reporting Center for Unusual Transactions (RCUT). The RCUT is entrusted with the execution of the State Ordinances on the Reporting of Unusual Transactions (SORUT) and on the Identification for Rendering Financial Services (SOIRFS). In accordance with the recently revised FATF recommendations, the unusual transactions reporting obligation also should be extended to other financial service providers, including trust offices, auditors, lawyers, and notaries, as well as traders in high value products (e.g., car dealers, real estate brokers, and jewelers).

The Bank has issued anti-money laundering guidelines for banks, insurance companies, and money transfer companies. The Bank also is entrusted with executing the SOIRFS insofar as it concerns the financial institutions under its supervision. Compliance with these guidelines and ordinance is tested during the on-site examinations.

In October 2004, the IAIS issued a guidance paper on anti-money laundering and combating the financing of terrorism. This guidance paper aims at tailoring the existing standards in this area to the specific practices and features in the insurance sector. The Bank intends in 2005 to revise its current guidelines for banks and insurance companies in the area of combating money laundering and terrorist financing, to align them to the prevailing international standards.

#### 4.4 International and regional supervisory forums

The Bank actively monitors global developments in the supervisory arena, 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 the annual meetings of the Caribbean Group of Banking Supervisors (Port of Spain, Trinidad and Tobago, May 2004), the Association of Supervisors of Banks of the Americas (Atlanta, U.S.A., June 2004), the International Conference on Banking Supervision (Madrid, Spain, September 2004), and the International Association of Insurance Supervisors (Amman, Jordan, October 2004). Important issues discussed during these events were the revised Basel Capital Accord for banks, the international accounting standards, and the revised Core Principles for insurance supervision.

#### 4.5 Sectoral developments

In this section, some quantitative developments in the various financial sectors under the Bank's supervision are discussed briefly. An extensive memorandum on this matter was presented in the Bank's bulletin for the fourth quarter of 2004.

##### 4.5.1 Banking sector

###### *Commercial banks*

The aggregated balance sheet of the commercial banks increased by a mere 1 percent to Afl. 3,112 million at the end of 2004, equivalent to 81 percent of estimated nominal GDP. Cash and due from banks declined by 11 percent to Afl. 720 million, while loans grew by 5 percent to Afl. 2,076 million. On the liability side, deposits rose by just 1 percent. As a consequence, the loans-to-deposits ratio increased by 3 percentage points to 76 percent, still well below the prudential maximum of 80 percent.

The banks' aggregated risk-weighted capital asset ratio increased slightly from 11 percent to 12 percent, well above the 10 percent minimum set by the Bank. The banks' return on equity declined by 6 percentage points to 26 percent, due mainly to an increase in the average shareholder's equity. Their liquidity ratio decreased slightly to 27 percent, which exceeded the minimum prudential liquidity requirement of 20 percent. Due to the overliquidity in the domestic banking sector, most banks have lowered their interest rates on deposits and savings. Consequently, the weighted average interest rate margin increased by 1 percentage point to 7 percent.

###### *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. authorities, had an aggregated balance sheet total of Afl. 1,012 million at the end of 2004, which represents a decrease of 24 percent compared to 2003. Mainly due to a significant improvement of these two banks' net income, their aggregated risk-weighted capital ratio surged from 16 percent to 37 percent, far above the Basel minimum of 8 percent. In 2004, an

Afl. 46 million profit (before taxes) was recorded, compared to a loss of Afl. 44 million in 2003, mainly the result of foreign exchange profits and a release (instead of an addition in 2003) of the loans loss provision.

#### *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) institutions, and/or institutional investors. The combined loan portfolio of these institutions amounted to Afl. 445 million at the end of 2004 (2003: Afl. 435 million), equivalent to 12 percent of nominal GDP. Their net income (before taxes) increased from Afl. 15 million to Afl. 16 million, while their aggregated risk-weighted capital ratio increased by 1 percentage point to 51 percent, well above the minimum requirement of 10 percent.

#### *Money transfer companies*

According to the 2004 preliminary figures, approximately 255,000 outgoing transfers were executed by the money transfer companies registered in Aruba with a total amount of Afl. 100 million, while approximately 15,000 incoming transfers, amounting to approximately Afl. 12 million, were recorded, resulting in a significant net outflow of funds. The large number of immigrants from Latin America and the Caribbean region financially supporting their relatives overseas is the main cause of the relatively large net outflow of funds.

### 4.5.2 Insurance sector

#### *Non-life insurance companies*

At the end of 2003, the aggregated balance sheet total of the 12 non-life insurance companies amounted to Afl. 173 million (equivalent to 5 percent of GDP), i.e., a 24 percent increase compared to 2002. This increase was related mostly to an increase in current assets by Afl. 25 million or 62 percent. Investments increased by Afl. 5 million to Afl. 82 million, 4 percent of which were foreign assets. On the liability side, the amounts due to affiliated companies nearly doubled, while the technical provisions rose by 8 percent to Afl. 54 million. Capital and reserves rose by Afl. 11 million or 20 percent to Afl. 67 million. As per the end of 2003, the coverage ratio was 303 percent, which far exceeds the minimum of 100 percent. This aggregated ratio indicates that the non-life insurance sector is sound.

#### *Life insurance companies*

At the end of 2003, the aggregated balance sheet total of the eight life insurance companies amounted to Afl. 402 million (equivalent to 11 percent of GDP), a 10 percent increase compared to 2002. This increase resulted mainly from a surge in investments of Afl. 53 million to Afl. 297 million, 13 percent of which were foreign assets. On the liability side, technical provisions rose by 10 percent to Afl. 295 million. The coverage ratio decreased slightly by 1 percentage point to 130 percent. All life insurance companies complied with the minimum solvency requirement of 100 percent.

#### *Company pension funds*

The aggregated balance sheet total of the 11 company pension funds amounted to Afl. 194 million at the end of 2003 (equivalent to 5 percent of GDP). Investment rose by 5 percent to Afl. 178 million, 53 percent of which were foreign assets. On the liability side, technical provisions increased by 6 percent to Afl. 239 million. The liquidity ratio was 7 percent, while the return on investments ratio became positive again in 2003. The coverage ratio rose slightly by two percentage points to 105 percent. Although the recovery of the financial markets caused an improvement in this ratio in 2003, the financial position of some company pension funds remains weak.

### 4.5.3 Other institutions

Other large financial institutions operating in Aruba, which do not fall under the Bank's supervision, are the Civil Servants Pension Fund, the Social Security Bank, and the General Health Insurance. In view of their importance to the Aruban economy, some brief remarks are made on mentioned institutions.

#### *The Civil Servants Pension Fund (APFA)*

Although it is encouraging that a new pension scheme has been agreed upon for the new members of the APFA, it also remains necessary, in view of APFA's weak financial position that in the short term a more sustainable pension scheme be agreed upon for the current members. Telling is that APFA's coverage ratio as of December 31, 2003, was estimated at 77 percent, far below the required minimum coverage ratio of 100 percent for company pension funds.

#### *The General Health Insurance (AZV)*

The AZV repeatedly has experienced large deficits since its inception in 2001. Although various measures have been introduced to contain health care costs, the financial position of the AZV remains weak, and creates substantial pressure on the already weak government finances. Further cost-reducing measures, such as a system of co-payments are required to bring down health care costs. Additionally, in order to break even, it seems inevitable to also raise the AZV contributions.

#### *The Social Security Bank (SVB)*

The SVB general old-age pension fund (AOV) increasingly will be confronted with the effects of the aging population. An actuarial study conducted in 2003 by the International Labor Organization confirms the need for reforms to ensure the long-term viability of the AOV. Among other things, a gradual increase in the retirement age to 62 or 65 appears inevitable in this respect.



*Evelino Fingal, designer of the commemorative coin, has chosen the Great Seal of the Kingdom of the Netherlands as a chief element to represent the 50 years of the Charter. This was ratified with signatures and provided with this Great Seal. Above the seal is the text: 'Statuut voor het Koninkrijk der Nederlanden' (Charter for the Kingdom of the Netherlands). On the obverse of the coin is a portrait of Queen Beatrix, also previously designed by Evelino Fingal.*

**BALANCE SHEET AS OF DECEMBER 31, 2004 <sup>1)</sup>, AFTER PROFIT DISTRIBUTION**

(in thousands of Aruban florin)

	2004	2003
<b>Assets</b>		
Gold	87,107	83,063
Foreign currency assets	528,808	528,445
Receivables	7,377	7,790
Printing cost of bank notes	1,491	1,896
Premises	15,940	16,542
Other fixed assets	4,105	4,965
	<u>644,828</u>	<u>642,701</u>
<b>Liabilities</b>		
Bank notes issued	145,519	149,138
Deposits of residents	331,668	327,202
Deposits of nonresidents	1,510	2,600
Money in custody	601	596
Payables and accrued expenses	22,119	22,491
Revaluation account	65,225	62,488
General reserve	68,186	68,186
Capital	10,000	10,000
	<u>644,828</u>	<u>642,701</u>

1) Abbreviated

**PROFIT AND LOSS ACCOUNT FOR THE YEAR 2004 <sup>2)</sup>**

(in thousands of Aruban florin)

	2004	2003
Net interest revenues	11,786	18,795
Foreign exchange	1,172	2,904
Coins	562	601
Various	176	327
<b>Total income</b>	<u>13,696</u>	<u>22,627</u>
Printing cost of bank notes	491	584
Personnel expenses	7,166	6,715
Operating expenses	2,921	2,241
Depreciation	2,087	1,976
<b>Total expenses</b>	<u>12,665</u>	<u>11,516</u>
<b>Profit</b>	<u>1,031</u>	<u>11,111</u>
<b>Profit distribution</b>		
Allocated to the Treasury	1,031	1,281
General reserve	-	9,830

2) Abbreviated

## EXPLANATORY NOTES TO THE BALANCE SHEET AND THE PROFIT AND LOSS ACCOUNT 2004

### 1 GENERAL

Pursuant to article 31, paragraphs 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 accountant, for approval to the Board of Supervisory Directors (the Board). 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 2004.

#### 2.2 Accounting policies

The Bank adheres to the accounting policies as stated in the Central Bank Ordinance. For the accounting policies not defined in this Ordinance, the Bank applies those of the European Central Bank (ECB) and the European System of Central Banks (ESCB) as of January 1, 2003. The application of the accounting policies of the ECB and ESCB did not lead to any changes in the principles of valuation and determination of results.

Gold, marketable securities, and on-balance sheet claims and liabilities denominated in foreign currency are valued at market prices on the last working day of the financial year. The other assets and liabilities are shown on a historical cost basis or at their nominal value.

Regarding the recognition of income, the accounting policies of the ECB and ESCB prescribe that unrealized losses should be recorded on the profit and loss account when exceeding previous revaluation gains registered in the corresponding revaluation account. This principle is not in conformity with article 31, paragraph 2 of the Central Bank Ordinance, which requires that changes in the valuation of the gold and foreign exchange reserve and business assets of the Bank occurring during the financial year should be expressed on the liability side of the balance sheet. Therefore, in the financial statements, unrealized losses have been charged to the revaluation account.

Premises and other fixed assets are recorded at historical cost less accumulated depreciation and are amortized according to the straight-line method over the estimated life of the asset, beginning from the moment of acquisition.

#### 2.3 Revenue recognition

Income and expenses are recognized in the period in which they are earned or incurred. Realized gains and losses are taken to the profit and loss account. Unrealized gains and losses are not recognized as income or expenses but are transferred directly to the revaluation account.

Premiums or discounts obtained when buying securities are calculated and presented as part of interest income.

#### 2.4 Conversion of foreign currencies

Assets and liabilities denominated in foreign currency and related forward contracts are converted into Aruban florin (Afl.) at the rate of exchange prevailing at the balance sheet date. Transactions in foreign currency 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

Effective December 31, 2001, the gold holdings of the Bank are valued on a quarterly basis at the prevailing market price for gold. On December 31, 2004, the market price for gold was US\$ 438 or Afl. 784.02 (2003: US\$ 417.25 or Afl. 746.88) per fine troy ounce. The Bank's gold stock amounted to approximately 111,103 fine troy ounces (2003: 111,214) with a value of Afl. 87.1 million at end-2004.

Gold holdings:	Fine troy ounces		Value in thousands Afl.	
	2004	2003	2004	2003
	111,103	111,214	87,107	83,063

Up to and including January 30, 2004, the gold holdings of the Bank were invested in interest-bearing short-term gold deposits. On that date, these deposits stated in gold matured and were not renewed, as the interest rate on these deposits was almost zero. The gold deposits were then converted into gold bars held with the Bank of England. The decline in troy ounces of the Bank's gold stock resulted from the sale of the troy ounces not converted into gold bars.

On May 20, 1999, the Bank entered into a gold option collar contract with a renowned institution to reduce the exposure to fluctuations in the market price of gold. On February 25, 2004, this contract was renewed. The expiration date of this contract is April 28, 2009.

#### 3.2 Foreign currency assets

These assets comprise current accounts and time deposits held at foreign credit institutions, foreign currency, bank notes, interest receivables, and investments through assets managers. These investments include:

1. Government and government-guaranteed paper denominated in U.S. dollars;
2. Paper issued by qualifying supranational financial institutions; and

3. 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, or 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 assets generally are denominated in U.S. dollars, while relatively small amounts are held in euros and Netherlands Antillean guilders.

### 3.3 Receivables

These include mainly mortgage loans and advances to the Bank's personnel, as well as various other claims, prepaid expenses, and checks in transit.

### 3.4 Printing cost of bank notes

In December 2003, a revised series of Aruban florin bank notes was printed, containing additional security features. One-fifth of the total printing costs was charged to the profit and loss account. On February 1, 2004, these notes were brought into circulation, replacing, thereby, the series 1990 and 1993. At the end of 2004, 92.8 percent of the total bank notes in circulation were from the 2003 series.

### 3.5 Premises

This item comprises the Bank's former office building at Havenstraat 2 and the new building at J.E. Irausquin Boulevard 8. The latter building will be depreciated in 20 years, renovations and terrain/landscaping in 10 years.

In 2002, the Bank reached an agreement with the government of Aruba regarding the sale of the office building at the Havenstraat. However, this building has not yet been formally transferred to the government and, therefore, is still included under this item.

### 3.6 Other fixed assets

These assets consist of computer hardware and software, furniture, and equipment. The estimated life of computer hardware and software is 3 years, that of furniture and motor vehicles 3 years, and equipment 5 years.

### 3.7 Bank notes issued

Bank notes are issued pursuant to article 7, paragraph 1 of the Central Bank Ordinance.

(in thousands of Aruban florin)

Denomination	2004	2003
5	894	904
10	5,327	4,952
25	10,834	13,043
50	13,075	11,990
100	108,769	110,124
500	6,620	8,125
Total	145,519	149,138

### 3.8 Deposits of residents

Deposits of residents comprise the following items:

(in thousands of Aruban florin)

	2004	2003
Government	7,563	38,107
Development funds	41,743	30,468
Banks:		
- current accounts	82,323	61,285
- monetary cash reserve	166,366	158,126
- time deposits	9,681	15,570
- CBA certificates	19,850	19,772
Other	4,142	3,874
Total	331,668	327,202

#### Government

This item contains the accounts of the government of Aruba held at the Bank.

#### Development funds

Money granted by the Aruban and Dutch governments in the framework of the development cooperation with the Netherlands.

#### Banks

Current accounts of the commercial banks are held primarily for transaction purposes.

Monetary cash reserves are mandatory deposits held by the commercial banks in accordance with the monetary policy requirement of the Bank.

The maturity of time deposits may range from 7 days to 24 months.

As of July 7, 2003, the Bank began issuing six-month CBA certificates on a monthly basis to gradually build up a stock of money market paper so that, in due course, it can apply more market-oriented monetary policy instruments. In August 2004, the Bank issued Afl. 20 million at an average rate of 1.51 percent per annum. These certificates matured on February 28, 2005.

#### Other

This mainly includes accounts of official and semi-official entities.

### 3.9 Deposits of nonresidents

This item consists of Aruban florin accounts of nonresident banks.

### 3.10 Money in custody

This item consists largely of funds confiscated by official authorities.

### 3.11 Payables and accrued expenses

The payables and accrued expenses comprise foreign exchange tax due to the government, checks outstanding, pension reserve, interest payable, CBA certificates, accrual management fees, and an accrual for the e-banking project.

### 3.12 Revaluation account

Pursuant to article 31, paragraph 2 of the Central Bank Ordinance, revaluation differences of gold, foreign currency, and security holdings are included in the revaluation account.

### 3.13 General reserve

(in thousands of Aruban florin)

	2004
Beginning balance	68,186
Additional profit distribution	-
Balance at the end of the year 2004	68,186

### 3.14 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 interest revenues

(in thousands of Aruban florin)

	2004	2003
Interest revenues	12,158	19,563
Interest expenses	372	768
Net interest revenues	11,786	18,795

### 4.2 Foreign exchange

This item consists of net transaction profits.

### 4.3 Coins

Pursuant to article 12, paragraph 1 of the State Ordinance governing the monetary system, coins are minted exclusively for the account of the government of Aruba, whereas, in conformity with article 7 of the Central Bank Ordinance, the Bank is

entrusted with the issuing of coins. Furthermore, in accordance with article 12, paragraph 2 of the former ordinance, the difference between the face value and the cost of minting of the coins (seignorage) is included in the Bank's profit. Unlike bank notes, coins issued are not included in the Bank's liabilities.

### 4.4 Various

These are mainly fees for using the Bank's automated clearing system and the proceeds of sale of a depreciated vehicle.

### 4.5 Personnel expenses

These expenses include salaries, social security, and various personnel-related expenses. At the balance sheet date, the Bank employed 62 persons full-time (2003: 57 persons).

### 4.6 Operating expenses

These consist mainly of expenses on utilities, cleaning and maintenance, office supplies, courses, seminars and meetings, telephone, consultancy, property tax, external auditors, bank charges, and other fees.

### 4.7 Profit distribution

In accordance with article 33 paragraph 1 of the Central Bank Ordinance, the Board of Supervisory Directors has decided to allocate the profit over 2004 amounting to Afl. 1.031 million to the Treasury. Subsequently, this amount will be retained for the third annual payment for the sale of the former bank building to the government.

## Report of auditors

We have audited the abbreviated financial statements of the Centrale Bank van Aruba in Oranjestad, Aruba, for the year 2004 (as set out on pages 33 to 41). These abbreviated financial statements have been derived from the financial statements of the Centrale Bank van Aruba for the year 2004. In our auditors' report dated June 7, 2005 we expressed an unqualified opinion on these financial statements. These abbreviated financial statements are the responsibility of the management of the Centrale Bank van Aruba. Our responsibility is to express an opinion on these abbreviated financial statements.

In our opinion, these abbreviated financial statements are consistent, in all material respects, with the financial statements from which they have been derived.

For an understanding of the financial position and results of the Centrale Bank van Aruba and for an adequate understanding of the scope of our audit, the abbreviated financial statements should be read in conjunction with the financial statements from which the abbreviated financial statements have been derived and our unqualified auditors' report thereon issued on June 7, 2005.

Aruba, June 7, 2005

*PricewaterhouseCoopers Aruba*

PricewaterhouseCoopers Aruba





