



CENTRALE BANK VAN ARUBA

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

2005

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MISSION STATEMENT

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FOR THE BENEFIT OF THE PEOPLE

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(as of June 20, 2006)

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CHAMPIONS IN SPORT, CHAMPIONS IN LIFE

Each year the Centrale Bank van Aruba (the Bank) selects a special theme for the presentation of its Annual Report. This year's theme is Champions in Sport, Champions in Life. The theme refers to outstanding young Aruban athletes, extraordinary both in their accomplishments and in their attitude towards life, who have chosen to dedicate an important part of their lives to sport, challenging their own boundaries every day.

Sport is a highly popular activity that has great physical, psychological, personal, and social development benefits for those involved. Participating in sport can improve a person's health and well-being and build character in a way that few other activities can. United Nations' Secretary General, Kofi Annan, underscores this point: "Sport is a universal language that can bring people together, no matter what their origin, background, religious beliefs or economic status. It cuts across barriers that divide societies, making it a powerful tool to support working with young people."

Today's youth face particularly difficult issues that threaten their happiness and sometimes their very existence. Peer pressure and unstable family situations create a negative social framework from which many cannot escape. Add an absence of positive role models, and it becomes clear how difficult it is for today's adolescents to find inspiration and face the demands of the highly competitive world. Unfortunately, many settle for mediocrity instead of discovering the joy of self-development.

In exploring new and creative solutions for these challenges, the Bank recognizes and celebrates some of Aruba's most outstanding young athletes. Each of the profiled athletes has, despite a young age, already achieved national and international success in their respective sport, and they look forward to an even more exciting future. The recognized athletes are Micky van der Vaart and Adrienne Fräser (swimming); Devah Leenheer (synchronized swimming); Zoe Kröhn (tennis); Brian Elisabeth (cycling – BMX); Ramphis Murray and Eugene Simmons (tae kwondo). All have represented Aruba internationally on numerous occasions and made us all proud with their outstanding performances.

These youth are clear examples of how, through hard work and dedication, discipline and determination, and only by revealing true character, their constant quest for excellence leads them to achieve success in everything they do. It is our firm belief that these youngsters will not only become champions in sport, but also champions in life. They are an example to others and create great optimism for the future of our country.

I am particularly pleased that the Bank is paying tribute to these outstanding young "Ambassadors" of our young country, and I hope they will inspire others to follow their vivid example of discipline, determination, excellence, and success.



Nicole Hovertsz
Member
International Olympic Committee

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STATEMENT BY THE PRESIDENT

In 2005, the growth performance of the world economy remained strong at 4.8 percent, although somewhat less robust than in 2004 (5.3 percent). The United States and China were again the main countries driving the world economy through their vigorous demand. Despite soaring oil prices, inflation remained generally moderate, partly because of a decrease in the oil-intensity of economic activity compared to the 1970s, particularly in the industrialized countries. International trade remained upbeat. Economic activities in the Caribbean region were once again buoyant, growing by 4.1 percent, due in part to an estimated 4 percent rise in stay-over tourists in that region. In contrast, cruise tourism contracted by 2 percent.

According to the Bank, the Aruban economy expanded for the third consecutive year in 2005, albeit at a slower pace than in the previous year. Its preliminary estimates based on currently available economic indicators point to a growth in real GDP of 2.4 percent, down from 3.5 percent in 2004, due mainly to a contraction in the growth of tourism spending. On the other hand, domestic demand remained strong, spurred by a notable upturn in gross investments and buoyant private consumption. The labor market showed some improvement in 2005. The unemployment rate fell to 6.9 percent, down from 7.3 percent in 2004. Labor productivity weakened somewhat, continuing its declining trend for the fifth consecutive year.

The 12-month average inflation rate accelerated further to 3.4 percent, up from 2.5 percent a year earlier, spurred by increases in the tariffs of water and electricity, the price of gasoline, and the prices of imported goods, all reflecting higher oil prices on the international markets. In the United States, Aruba's main trading partner, the 12-month inflation rate rose to 3.4 percent in 2005, up from 2.7 percent in 2004. Thus, despite the inflationary tendencies, Aruba managed to preserve its competitive position against the United States during 2005. Maintaining this position will be more difficult in the future given the persisting low productivity.

Following a very strong performance in 2004, developments in the tourism sector were quite subdued in 2005. Particularly in the second half of the year, this sector posted a notable contraction. For the year as a whole, both stay-over visitors and visitor nights rose by merely 1 percent, compared to, respectively, 13 percent and 11 percent in 2004. According to the Aruba Tourism Authority, the main factors leading to a moderate increase in demand were the higher airline fares affected by increased fuel prices, an extremely active hurricane season, and, domestically, a reduced hotel room inventory due to ongoing renovations and probably also the developments surrounding the Holloway case. Cruise tourism performed less favorably than in the previous year. The number of cruise passenger arrivals contracted by 4 percent in 2005, compared to a 6 percent increase a year earlier.

Partly as a result of a decline in hotel room inventory, the average hotel occupancy rate rose further to 81.7 percent (2004: 80.7 percent), pushing up the average daily hotel rate to US\$ 174, up from US\$ 145 in 2004. Registered gross tourism receipts rose by 4 percent to Afl. 1,957 million, compared to 23 percent in 2004. Their contribution to current account

1

receipts (excluding the oil and free-zone sectors) declined to 78 percent (2004: 79 percent).

Despite the contribution of gross tourism receipts to current account receipts and an Afl. 65 million net inflow of foreign funds of the oil and free-zone sectors related to external transactions, the overall balance of payments still recorded an Afl. 61 million deficit in 2005. This outcome was associated mainly with external transactions of the rest of the economy (thus excluding the oil and free-zone sectors), which on balance registered a net outflow of Afl. 126 million, as a result of an Afl. 309 million current account deficit, equivalent to approximately 8 percent of GDP.

Consequently, net international reserves dropped to Afl. 597 million at end December 2005, compared to Afl. 658 million at end 2004. The 12-month average coverage of merchandise imports by international reserves shrank further to 5.5 months, from 6.2 months in 2004 and 6.6 months in 2003. However, when considering all current account payments, thus including payments for services, income, and current transfers, the 12-month average coverage fell to 3.0 months, compared to 3.4 months in 2004 and 3.6 months in 2003.

When analyzing the balance of payments, the Bank separates the transactions of the rest of the economy from the oil and free-zone sectors, because the latter sectors are self-sufficient. The international transactions of the oil sector materialize practically completely outside the scope of the Aruban banking system, with only a net inflow of foreign funds for the financing of local investments and other operational costs. Import payments of the free-zone sector are normally financed by its export receipts. The Bank is particularly concerned about the developments in the current account balance of the rest of the economy (excluding the oil and free-zone sectors) because this account showed a notable deficit in 2005 for the fourth consecutive year. These deficits (2002: Afl. 233 million; 2003: Afl. 346 million; 2004: Afl. 237 million; 2005: Afl. 309 million) are clear signs of an imbalance in the economy with both the private and public sectors persistently spending more on imports than they are generating from exports. Continuous large current account deficits are not sustainable in the long run in any economy. Moreover, the small scale and one-sided economic structure of the Aruban economy add to the risks associated with continuous external deficits.

The 2005 current account deficit of the rest of the economy was in part attributed to excessive liquidity creation resulting from a much larger government financial deficit than initially budgeted and approved by Parliament. The 2005 budget projected a financial deficit of Afl. 81 million (excluding maturing debt). However, during the last part of the year, the government resorted to additional financing because the actual financial deficit at end 2005 stood at approximately Afl. 176 million, more than twice the amount initially budgeted for 2005. This high government spending and borrowing led to additional liquidity creation within the economy. Together with a high demand for bank credit, these actions adversely affected the balance of payments and Aruba's international reserve position.

The larger-than-budgeted financial deficit resulted in part because certain budgeted income revenues were not realized, partly because the necessary legislation had not been introduced (e.g., the environmental levy), and because of a setback in estimating revenues from profit taxes. Moreover, the 2005 budget did not include the transfer to the General Health Insurance (AZV) to cover its operating deficit for the year. The net outcome was worsened because expenditures were not adjusted downward accordingly.

To cover its 2005 financial needs, the government borrowed Afl. 378 million, Afl. 187 million of which was used to refinance maturing debt. Consequently, outstanding government debt rose to Afl. 1,862 million at end 2005, equivalent to approximately 46 percent of estimated GDP for 2005. These borrowings had an expansive effect on the overall domestic liquidity, which combined with the strong credit activities of the banking sector, caused again a large deficit on the current account of the balance of payments.

In 2005, current expenditures of the government (e.g., payroll expenses, financing of health care deficits, government pension fund premiums, interest payments, and goods and services purchases) comprised approximately 94 percent of its total spending. These current expenditures again substantially exceeded total tax revenues. High expenditures and deficit financing of current expenditures hamper the government from initiating so-called public/private sector partnership projects to stimulate a much needed diversification of the economy. The tourism sector is labor-intensive with little room for improvement of the labor productivity level. Economic growth triggered by a further expansion of this sector will conduce to more immigration and exacerbate the burden on the existing infrastructure resulting in progressively higher costs for government as a consequence of a growing population. Moreover, a rise in the demand for social provisions, such as health care and social security, will be evident.

Although the possibilities for a diversification of the economic structure may be limited, this course should be followed, mainly because of the high risks associated with a dependency on only one major economic pillar. Considering the limited human capital resources, diversification should be sought in higher-value-added activities that would yield greater productivity growth in the future (e.g., e-commerce). In addition to fulfilling an important role next to the private sector in exploring opportunities, the government should overhaul and restructure the existing tax system and regulations and bring these up to competitive and transparent standards. The government has been working towards this end. Particularly, the New Fiscal Framework (NFR) was introduced in 2003 to phase out the generous tax-holiday regime and to create new incentives for the international financial sector.

To redress the negative development of the current account of the balance of payments of the rest of the economy, the Bank further tightened its monetary policy at the beginning of 2006 by lowering the allowable banking sector credit growth by one percentage point to 5 percent, including separately monitoring consumer credit as well as raising the penalty fee for excess lending by 2 percentage points to 8 percent. The Bank also will raise the monetary cash reserve requirement if and when the liquidity conditions within the banking system call for this measure.

The Bank is aware that its monetary policy actions alone cannot guarantee an improvement in the level of international reserves as long as the effectiveness of its policy continues to be hampered by an expansionary fiscal policy. In this context, the Bank regularly advises the government on the need for curbing its expenditures in line with its revenues and limiting its borrowings to investment purposes.

Certain steps are being taken to improve government finances. In particular, the AZV lowered its health care expenses per insured person by introducing a benchmark to monitor medical declarations and establishing a limited list of medicines that can be claimed. As of January 1, 2006, the AZV also increased its premium. These measures should further reduce its operational deficit in 2006. In addition, the government has increased and restructured the import duty tariffs of a larger part of import goods as of June 1, 2006, which will generate additional revenues.

The above-mentioned measures will raise the cost of production, which will be passed on to the consumer through price increases. Combined with the low level of productivity, Aruba will have more difficulty remaining competitive in the tourist market of the Caribbean. The overall burden of social charges (including the AZV and social security) is already quite high at 27 percent, of which the tax burden represents 19 percent.

The government should consider adjusting those expenditures, which are focused mainly on consumptive spending and over-employment in the public services sector. In the short term, the government should contain increases in its wage bill, reduce expenditures on goods and services, and pursue its plans of amending the pension scheme for current civil servants. Furthermore, the government should improve fiscal management and discipline. Although the Accountability Act allows for a delayed presentation, the 2006 budget had not yet been presented as of the end of April 2006, due to an ongoing restructuring of certain ministries by the government in its attempt to reduce overall expenditures.

To enhance fiscal discipline and transparency, improved and additional fiscal legislation should be introduced. This legislation, a so-called Fiscal Responsibility Law will stipulate, among other things, a maximum on government expenditures and debt, including mandatory balanced budgets, and procedural objectives with regard to transparency and accountability of the budgetary process. This legislation will promote fiscal discipline, including the possibility of a multi-year budgeting system. The Bank recommends that amendments to this ordinance require two-thirds majority vote in Parliament by embedding this ordinance in the constitution. Contacts with the International Monetary Fund have already been made toward this end, but progress on this important legislation should be pursued with much more diligence to ensure financial and economic stability in the future.

In 2005, the Bank further strengthened its supervision of the banking and insurance sectors, company pension funds, and money transfer companies. Pension fund governance guidelines

for company pension funds and a directive for banks on customer due diligence were issued, while the guidelines for money transfer companies were strengthened. However, decisive actions should be undertaken in the legislative process regarding the extension of the supervisory legislation to other yet unregulated sectors. In particular, the State Ordinance on the Supervision of Trust Companies and the revised Sanction Ordinance should be enacted soon, particularly in view of the planned mutual evaluation of Aruba in 2007 by the Financial Action Task Force.

In 2005, the Bank's profit rose by Afl. 3.3 million to Afl. 4.3 million, reflecting largely an increase in income following a rise in net interest revenues resulting from higher yields on U.S. dollar investments. As of end 2005, the official reserves of the Bank were 141 percent of base money (i.e., total bank notes in circulation and outstanding liabilities to the banking system), thus reflecting a strong position of the Aruban florin. The Bank continuously strives to improve its business procedures and processes to further strengthen its operations and guarantee business continuity to fulfill its policy objectives optimally to benefit 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 the financial sector.

2

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 depositors and policyholders 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

In 2005, total florin currency in circulation surged by 12.5 percent to Afl. 183 million after posting a 1.7 percent decrease in 2004. This year's growth significantly exceeded the 5.8 percent rise in nominal gross domestic product (GDP), resulting in a 0.2 percentage point increase in the ratio of total florin currency in circulation to nominal GDP to 4.5 percent in 2005. Despite the

slight improvement, this ratio remains under that of many countries due to the co-circulation of U.S. dollars in the domestic economy induced mainly by tourism activities, as well as further growth in the use of debit and credit cards for settling transactions.

In conformity with article 7 of the Central Bank Ordinance, florin bank notes are issued in denominations of Afl. 10, Afl. 25, Afl. 50, Afl. 100, and Afl. 500. At end-2005, total florin bank notes in circulation had risen by Afl. 17.2 million or 11.8 percent to Afl. 162.7 million compared to end-2004. Because all denominations increased in circulation, their share in total numbers of notes issued remained practically at the same level as in 2004, with the Afl. 100 banknote maintaining the largest share at 44 percent and the Afl. 500 the smallest share at about one-half percent.

Article 7 of the Central Bank Ordinance stipulates that the Bank issues coins on behalf of the government, which are denominated in 5 cents, 10 cents, 25 cents, 50 cents, 1 florin, 2 1/2 florin, and 5 florin. In 2005, the total value of coins in circulation, excluding commemorative coins, grew by Afl. 3.2 million or 18.7 percent to Afl. 20.3 million, when compared to 2004. This growth was attributed mainly to a 57.4 percent increase in circulation of the 5 florin coin. A significant amount of the square five florin, taken out of circulation, continued to be held by the public, perhaps as a collector's item.

In September 2005, the Bank brought into circulation a new round five florin coin to replace the square five florin coins with issue dates 1995-1999. These coins were withdrawn from circulation as of October 1, 2005, according to article 1 of the State Decree on Withdrawal and Exchange of the Square Five florin coins. The square five florin coins can only be exchanged at the Bank up to and including August 2006. In 2005, the Bank issued a silver and a gold commemorative coin with a nominal value of 5 florin and 10 florin, respectively, on the occasion of the 25th year reigning jubilee of HM Queen Beatrix. For this occasion, the other countries of the Kingdom of the Netherlands, the Netherlands, and the Netherlands Antilles also issued a special coin.

2.2.2 Clearing system

The Bank manages a batch-clearing system based on a secured web-client solution, through which inter-bank check clearing and fund transfers are settled. Institutions using this clearing system include the commercial banks, the Department of Finance, the WEB (water and electricity company), the SETAR (the telecommunications company), and the Bank. In the beginning of 2005, the Civil Servants Pension Fund (APFA) also became a member of the clearing system.

In 2005, the volume of checks processed through the clearing system again declined, i.e., by 5.9 percent to about 604,000 checks (2004: 642,000). However, in contrast to previous years, the total value processed through the clearing system showed a 5.9 percent increase to Afl. 2.17 billion. Further growth in the use of direct debit cards as a means of payment contributed

to the drop in the volume of checks processed, while some incidental large-value transactions in checks took place. In 2005, growth in both the volume and value of funds transferred through the clearing system slowed down somewhat to, respectively, 12.9 percent, amounting to 651,167 transactions, and 5 percent, amounting to Afl. 4.2 billion.

2.2.3 Interest payments

The Bank pays interest, based on corresponding interest quotations by the Federal Reserve Bank of New York, on certain current account balances and on time deposits held by the government and a number of financial institutions. However, no interest is paid on the required monetary cash reserves of the commercial banks. In 2005, total interest payments shrank again, i.e., by 5.6 percent or Afl. 20,808 to Afl. 351,070, despite an increase in the interest rates as a result of a rise in the interest rates offered by the Federal Reserve Bank. The main reason for this decline is that in 2005, the Bank decided to stop issuing six month Central Bank Certificates because of the very low interest of the commercial banks to purchase this monetary instrument. Interest payments to the government on deposits held with the Bank amounted to only Afl. 2,328, which is Afl. 22,939 or 90.8 percent less than in 2004.

2.2.4 Banking for the government

Article 14 of the Central Bank Ordinance stipulates that the government's domestic and foreign payments should be carried out by the Bank free of charge. These payments are cleared through the Treasury's current account held with the Bank, which balance amounted to Afl. 6.8 million at the end of 2005. Government deposits held in earmarked accounts with the Bank rose by Afl. 0.9 million to Afl. 2 million, while the development funds account declined significantly, i.e., by Afl. 41.6 million to Afl. 150,943 at end-2005.

In 2005, the Bank on a recurrent basis assisted in the renewal of two 3-month treasury-bill issues, which summed up to Afl. 40 million, and Afl. 8 million in 6-month cash certificates. The yields on these treasury bills moved between 1.95 percent and 3.15 percent, while those of the cash certificates between 3.21 percent and 3.66 percent. On behalf of the government, the Bank also arranged two bond issues of Afl. 40 million, with a maturity of 4 and 6 years, respectively. The yields for these two issues were 6.0 and 6.5 percent.

2.3 International payment system

2.3.1 Daily exchange rate fixing

The share of payments to nonresidents in U.S. dollars went up from 88.4 percent in 2004 to 91.1 percent in 2005. On the other hand, the payments to nonresidents that were settled in euros dropped by 0.7 percentage point to 3 percent of the total payments to nonresidents at end-2005. 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. Besides the U.S. dollar,

the Bank publishes daily quotations for nine other foreign currencies based on data provided by the European Central Bank. Beginning June 2005, these rates also are published on the website of the Bank. The selling rate of the euro varied between Afl. 2.10 and Afl. 2.43, while the buying rate for this currency fluctuated between Afl. 2.06 and Afl. 2.38. At end-2005, the euro depreciated against the Aruban florin by 13.5 percent or Afl. 0.33 compared to end-2004.

2.3.2 Foreign exchange license policy

There are no restrictions on current foreign exchange payments. During 2005, the annual maxima to execute 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). Transactions exceeding the aforementioned maxima are subject to a special foreign exchange license of the Bank, which in general is granted quite liberally when concerning regular transactions.

On May 1, 2005, the notice concerning Foreign Exchange Transactions AW 1999/1 was replaced by AW 2005/1. Based on the latter notice, commercial banks are required to apply for a special foreign exchange license, inter alia, when transferring or selling local financial instruments, such as bonds, to nonresidents, and for lending and borrowing loans exceeding the amount of Afl. 1,000,000 per annum to and from nonresidents.

In 2005, the Bank granted 138 special foreign exchange licenses, an increase of 34 percent compared to the previous year. The total value of the transactions for these licenses surged by Afl. 183.8 million or 38.9 percent to Afl. 655.7 million compared to 2004. The number of licenses granted for investments abroad increased considerably, while that for loans related to refinancing of existing loans and infrastructure projects remained insignificant.

2.3.3 Foreign exchange tax

The State Ordinance on 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.

Certain transactions are exempted from payment of the foreign exchange tax. These exemptions comprise 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, the so-called AVVs, which were incorporated before January 1, 2006, are by virtue of law nonresidents and, therefore, not subject to foreign exchange tax.

On January 1, 2006, the State Ordinance on Foreign Exchange Transactions and that on Foreign Exchange Commission were revised (AB 2005 No. 76), due to the amendment in the tax regime of the AVVs. This change implies that all AVVs incorporated after January 1, 2006, are considered resident and should pay foreign exchange tax. However, based on article 19 of the State Ordinance on Foreign Exchange Transactions, an AVV can file a petition at the Bank to obtain a nonresident status.

The government is responsible for determining the policy concerning the foreign exchange tax, which the Bank is entrusted with the collection of. In 2005, the Bank raised Afl. 29.1 million in foreign exchange tax, i.e., Afl. 0.8 million more than a year earlier. As a result of transitorial items, Afl. 36.8 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

As stipulated in article 12, sub 1 of the Central Bank Ordinance, the Bank is responsible for managing Aruba's official foreign exchange reserves. The Bank's income stems predominantly from investing its foreign exchange reserve through external asset managers in U.S. government in (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

For 2006, the Bank tightened further its monetary policy to curb consumer credit and to mitigate its negative effect on the current account balance and the international reserves. Illustrative is that in 2005, the credit portfolio of the commercial banks grew by Afl. 177.6 million or 8.2 percent, exceeding the 6 percent target set by the Bank by Afl. 47.4 million. Additionally, real GDP growth for 2006 is expected to decelerate somewhat amid higher inflationary pressure, while the current account balance of the rest of the economy (excluding oil and free zone sectors) would again record a notable deficit.

In light of that expectation, the Bank lowered the allowable credit growth by one percentage

point to 5 percent and introduced two separate credit growth ceilings, comprising a 5 percent growth ceiling for consumer loans and a 5 percent growth maximum for the remaining credit components. Furthermore, the Bank raised the penalty that is levied on those individual commercial banks surpassing the maximum aggregated credit growth, by 2 percentage points to 8 percent as of January 1, 2006.

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 2006. In case of adverse developments, the Bank may alter the monetary cash reserve requirement and thus tighten further monetary policy. The present arrangements concerning the banks' so-called B₉ 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 will be extended to other currently unregulated sectors (e.g., the company service providers and the insurance brokers) in the near future. A law regulating the company service providers is being drafted and will be implemented in due time. Additionally, current laws regulating the banking and insurance sector should be strengthened further to be able to attain a higher degree of compliance with the so-called "Core principles for effective banking supervision" and "Core principles for insurance supervision" issued by the Basel Committee on Banking Supervision and the International Association of Insurance Supervisors, respectively. To this end, the Bank will draft proposals during 2006.

2.7 Financial highlights

- ◆ At the end of 2005, the Bank's total assets have declined by Afl. 29.8 million or 4.6 percent to Afl. 615 million compared to 2004. This was due largely to an Afl. 39.2 million decrease in the foreign currency assets of the Bank.
- ◆ Total income (net of interest expenses) increased by Afl. 3.8 million or 27.7 percent to Afl. 17.5 million compared to 2004, mainly because of an increase in net interest revenues as a result of higher yields on U.S. dollar investments.
- ◆ Total expenses increased by Afl. 0.5 million or 3.9 percent to 13.2 million. This increase was predominantly related to an increase in salaries and social security expenses and depreciation charges.

- ◆ For 2005 net profit reached Afl. 4.3 million, i.e., Afl. 3.3 million more than in 2004. In accordance with article 33, paragraph 1 of the Central Bank Ordinance, Afl. 4.3 million was allocated to the Treasury.

2.8 Organizational affairs

On January 23, 2005, Mrs. E.G.R. Cohen-Henriquez-Jansen, having reached the end of her tenure, resigned as a member of the Board of Supervisory Directors. To fill the vacancies that also arose from the passing away of two board members in 2004, Mr. H.O. van Trikt was appointed as a member of the Board as of April 2005, while Mr. G.G. Oduber and Mr. M.R. Croes were appointed as of September 2005. Their appointment is for a period of 5 years. The Board of Supervisory Directors of the Bank comprises 5 members and is in accordance with article 23 of the Central Bank Ordinance.

In 2005, the Bank introduced an early retirement regulation. Only one employee made use of this opportunity. The Bank's staff remained at 62 at end-2005. Their high professionalism and dedication 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.:
M.R. Croes, H.O. van Trikt, A.J. Swaen, T.R.L. Vingal, G.G. Oduber

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



ECONOMIC AND FINANCIAL DEVELOPMENTS

3.1 The international environment

3

Global economic performance in 2005, though more moderate than in 2004, remained strong despite the further rise in oil prices and the aftermath of natural disasters. Economic growth decelerated from 5.3 percent in 2004 to an estimated 4.8 percent. This expansion was driven mainly by a robust demand in the United States and China. Consumer spending expanded because of improved labor market conditions. In addition, business investment continued its upward trend, encouraged by relatively favorable financing conditions, healthy growth in corporate earnings, and a decrease in the underutilization of production capacity. Overall inflation was pushed up by the surge in energy prices but remained generally contained, in part because of a decrease in the oil-intensity of the economic activity compared to the 1970s, mainly in the industrialized countries.

In the United States, output growth slowed to 3.5 percent, after a 4.2 percent increase in 2004. This development came with gains in both labor productivity and employment, while inflation rose from 2.7 percent a year earlier to 3.4 percent due to higher energy prices. Growth in economic activity was supported largely by the further rise in private consumption and residential investment, notwithstanding a weaker growth in real income. Furthermore, business investments remained vigorous, albeit more restrained than in 2004. The dollar appreciated against most major currencies in 2005 and with domestic demand expanding strongly, the U.S. current account deficit widened more.

The Chinese economy strengthened further in 2005, expanding by 9.9 percent, following a 10.1 percent growth in 2004. The main contributory factors were the buoyant domestic demand and exports. Still, inflationary pressures subsided, principally because of lower food price increases following an increase in production, and decreased prices in the industrial sector because of excess capacity.

Also, the Japanese economy grew by 2.7 percent in 2005 compared to 2.3 percent in 2004. The growth resulted from a pickup in domestic demand, reflecting predominantly increases in household expenditures, attributable to an improvement in employment and the first wage raise since the year 2000, and in business investments. Notwithstanding the sharp rise in oil prices, the general price level fell once again in 2005 by a marginal 0.3 percent.

In the euro area, economic growth in 2005 again was disappointing because of the weakness in domestic spending. Furthermore, export growth decelerated due to a lower growth in international trade and because the appreciation of the euro during the preceding years probably continued to harm the competitiveness of European businesses. Consequently, real GDP growth slowed down from 2.1 percent in 2004 to 1.3 percent in 2005. Nonetheless, labor market conditions improved as employment rose. Inflation increased slightly to 2.2 percent.

Adrienne Fräser, 14 years old, Aruba's first-ever Central American and Caribbean Youth Championships medal winner in swimming. In her favorite stroke, the breaststroke, she is a strong contender for many more international championship titles.

Micky van der Vaart, 17 years old, Aruba's premier athlete, recipient of the coveted title "Aruba's Athlete of the Year 2005" and winner of many international medals for our country, is well on his way to reaching Olympic levels in swimming.

The economies of Latin America and the Caribbean exhibited growth in 2005 for the third consecutive year with GDP rising by 4.3 percent. Export was the main engine of growth in this region, stimulated by the resilient global economy. In addition, the impact of higher remittances, better terms of trade, and higher investments moved economic activity forward. The increase in employment and also the slower growth in the labor supply drove the unemployment rate down. Moreover, inflation declined for the third year in a row to 6.3 percent.

Global output is expected to remain firm, rising by 4.9 percent in 2006. The sustained growth in emerging Asian countries, the continued recovery of the Japanese economy, and solid growth in the United States, the euro area, and Latin America and the Caribbean region are the sources of the expansion of the world economy. Inflationary pressures will remain modest despite a further pickup in oil prices, following increased competition and broad labor markets. However, the optimistic outlook remains subject to downward risks, related mainly to worsening current account imbalances.

3.2 The domestic real sector

According to the Bank, the Aruban economy expanded for the third consecutive year in 2005, albeit at a slower pace than in the previous year. Its preliminary estimates based on currently available economic indicators point to a growth in real GDP of 2.4 percent, down from 3.5 percent in 2004, due mainly to a significant contraction in growth of tourism spending. This slowdown was mitigated by a strong domestic demand, reflecting a notable upturn in gross investments, due partly to the execution of maintenance work at the refinery and a buoyant private consumption. As a result of the strong domestic demand and increased inbound tourism consumption, imports rose further.

The real economic growth in 2005 was led by a hausse in the construction sector. Also, the sectors “hotels and restaurants”, “utilities”, “housing”, and “public administration & education” contributed to this expansion. In contrast, the output of both the “trade” and “transport, storage & communication” sectors contracted in 2005. The economic outlook for 2006 remains positive, though growth in economic activities are expected to subside, in part because of a stagnation in tourism-related activities.

In 2005, both the number of stay-over visitors and their nights spent on the island edged up by 1 percent, compared to 13 percent and 11 percent, respectively, a year earlier. The drop-off in tourism growth was related largely to the effects of a strong hurricane season in the United States, soaring energy prices affecting airline fares, and, domestically, limited hotel room inventory due to renovation. Moreover, the developments surrounding the Holloway case may also have played a role in this context. In comparison, stay-over visitors in the Caribbean rose by an estimated 4 percent. Cruise tourism, however, showed a 4 percent contraction in the number of passengers, compared to a 2 percent decrease in the Caribbean as a whole. Nonetheless, gross tourism receipts, as registered in the balance of payments, went up by

Table 1 Main economic indicators

	2003	2004	2005
1. Gross domestic product			
Nominal GDP (in Afl. million) 1)	3,599	3,819	4,041
Population (period average)	95,076	97,658	100,629
Nominal GDP per capita (in Afl.)	37,856	39,106	40,157
Real GDP growth (in percent)	1.5	3.5	2.4
2. Labor market 2)			
Unemployment rate (in percent)	7.8	7.3	6.9
Participation rate (in percent)	63.9	63.6	63.2
Productivity growth (in percent)	-0.9	-0.2	-1.0
3. Tourism			
Tourism receipts (in Afl. million) 3)	1,521.8	1,875.8	1,956.8
Stay-over visitors (x 1,000)	641.9	728.2	732.5
Visitor nights (x 1,000)	5,097.6	5,639.9	5,694.5
Average hotel occupancy rate (Aruba) 4)	74.4	80.7	81.7
Average hotel occupancy rate (Caribbean)	62.7	68.4	68.6
Average daily rate hotels (US\$) (Aruba) 4)	134	145	174
Revenue per available room (US\$) (Aruba) 4)	69	82	94
Revenue per available room (US\$) (Caribbean)	83	94	102
Cruise visitors (x 1,000)	542.3	576.3	552.8
Aruba's market share in the Caribbean (in percent)			
- stay-over visitors	3.5	3.8	3.7
- cruise tourism	3.1	3.0	2.9
4. Price developments			
Inflation (end of period, in percent)	2.2	2.8	3.8
Inflation (period average, in percent)	3.6	2.5	3.4
Real exchange rate index (1995 = 100) 5)	105.2	105.0	105.0

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

- 1) Figures for 2003 and 2005 are preliminary estimates 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. Time-share rooms as percentage of total rooms were, respectively, 37.6 percent in 2003, 38.0 percent in 2004, and 42.1 percent in 2005.
- 5) Relative to the U.S.A. Based on CPI period-average.

4 percent to Afl. 1,957 million. The latter amount accounted for 78 percent of total current account receipts (excluding the oil and free-zone sectors), one percentage point less than in 2004.

Compared to 2004, the annual average growth in the consumer price index accelerated by 0.9 percentage point to 3.4 percent at end 2005. This acceleration was caused mainly by further increases in the energy-related components of inflation, i.e., water, electricity, and gasoline, reflecting higher oil prices on the international markets. The inflation rate was equal to that of Aruba's major trading partner, the United States, thus resulting in an unchanged real exchange rate index of the Aruban florin vis-à-vis the U.S. dollar, i.e., 105.0. Adjusted for the energy-related components, the inflation rate slowed down by 0.3 percentage point in 2005 to 1.7 percent compared to 2004.

3.3 The financial sector

In 2005, monetary expansion accelerated sharply to Afl. 141 million, up from Afl. 71 million a year earlier. Domestic money creation totaled Afl. 203 million, compared to Afl. 51 million in 2004. This expansion resulted mainly from a further strengthening of the private sector credit demand. Commercial bank lending increased by 8 percent, which exceeded the credit growth guideline (6 percent) set by the Bank for that year. Credit to enterprises, consumer loans, and housing mortgages went up by 2 percent, 10 percent, and 21 percent, respectively. The increase in housing mortgages was influenced largely by the take-over of a mortgage bank by a commercial bank. Transactions of the government with the monetary system contributed, on balance, Afl. 23 million to the increase in the money supply.

In contrast, net foreign assets of the monetary system declined notably by Afl. 61 million or 9 percent to Afl. 597 million. This decline occurred in spite of an Afl. 65 million net sale of foreign exchange by the oil and free-zone sectors to the commercial banks. In contrast, net external transactions of the rest of the economy (excluding the oil and free-zone sectors) led to an Afl. 126 million drop in international reserves. This decline was due largely to higher import payments and the repayments of maturing private placements by the government. This deterioration occurred in spite of increased tourism receipts, the receipt of part of the proceeds of a US\$ 93 million (Afl. 166 million) government bond issue on the international capital market, and grants received from the Dutch government in favour of the Fondo Desaroyo Aruba.

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

	2003	2004	2005
1. Net domestic money creation	241.7	51.3	202.6
a. Net domestic credit	218.5	117.1	214.5
1. Public sector	19.3	21.3	22.8
2. Private sector	199.2	95.8	191.7
b. Other domestic factors	23.2	-65.8	-11.9
2. Inflow of foreign funds 1)	-61.2	19.9	-61.2
a. Current account (net)	-269.0	25.9	-462.9
b. Capital and financial account (net) 2)	207.8	-6.1	401.7
3. Broad money creation	180.5	71.1	141.4
a. Money	88.7	27.6	4.2
b. Quasi-money	91.8	43.5	137.2
4. Key indicators (in percent)			
a. 12-month change in money supply	8.9	3.2	6.2
b. Broad money coverage 3)	28.8	28.8	24.6
c. Money supply to GDP	61.5	59.8	60.1

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.

On balance, monetary growth doubled to 6 percent in 2005 compared to a year earlier. The ratio of money supply to GDP remained virtually unchanged at 60 percent. Quasi-money surged by 10 percent, while narrowly-defined money increased by less than 1 percent.

In 2005, the assets of the nonmonetary financial institutions rose further. Claims on the government soared by 15 percent, reflecting largely the purchase of government bonds by these institutions. Claims on the private sector increased slightly by 1 percent. The latter was influenced by the take-over of a mortgage bank by a commercial bank in January 2005. Excluding this take-over effect, claims on the private sector went up by 11 percent. Net foreign assets rose by 15 percent to Afl. 561 million, more than six times the net foreign assets of the commercial banks.

Following the above-mentioned take-over and the subsequent adjustment in the relevant financial statistics, the housing mortgage portfolio of the nonmonetary financial institutions contracted by 11 percent in 2005. Their share in the total housing mortgage market plummeted by 7 percentage points to 37 percent. On the liability side, pension fund provisions and the insurance reserve fund went up by 8 percent and 6 percent, respectively. On the other hand, borrowings and deposits declined by a notable 39 percent, mainly as a result of the earlier mentioned take-over.

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

	2003	2004	2005
1. Net foreign assets	398.5	489.8	561.1
2. Domestic claims	1,245.9	1,340.3	1,427.7
a. Government	506.9	551.1	632.1
b. Private sector, of which:	739.0	789.2	795.5
housing mortgages	446.8	469.3	418.4
3. Total assets = total liabilities	1,644.4	1,830.2	1,988.8
4. Borrowings and deposits	62.0	64.0	39.1
a. Government	36.8	36.7	36.6
b. Other residents	25.2	27.3	2.4
5. Pension fund provisions	1,218.4	1,379.1	1,494.2
6. Insurance reserve fund	273.3	288.4	305.4
7. Other items (net)	90.7	98.7	150.1
8. Key indicators			
a. Net foreign assets in % nominal GDP 2)	11.1	12.8	13.9
b. Total assets in % nominal GDP 3)	75.5	75.2	73.8
c. Share housing mortgages in total market	44.8	44.4	37.1

Source: CBA.

1) Comprising mortgage banks, pension funds (including 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) The calculation of this ratio cannot be derived from this table because in the "other items (net)" other assets are netted out with other liabilities.

3.4 Government finance

In 2005, total government revenue on a cash basis rose by a marked Afl. 72 million or 9 percent to Afl. 907 million, reflecting largely an Afl. 71 million or 10 percent surge in tax revenue to Afl. 778 million. The latter expansion was brought about mainly by an Afl. 41 million rise in revenue from taxes on income and profit, in particular the wage and profit tax. Moreover, revenues from the foreign exchange tax and revenues from import duties and the land tax went up by, respectively, Afl. 11 million, Afl. 8 million, and Afl. 6 million.

Total expenditures on a cash basis (including net lending) amounted to Afl. 1,034 million in 2005 compared to Afl. 1,190 million in 2004. The 2004 figure included Afl. 176 million in imputed expenditures to reflect the debt conversion in December 2004 between the government and the Civil Servants Pension Fund (APFA) to settle existing arrears of the former with the fund. This fund was privatised in 2005 into a foundation, i.e., Stichting APFA. When excluding this one-off transaction, total government spending on a cash basis (including net lending) rose further by Afl. 20 million (2 percent) compared to 2004. In particular, interest payments, salary-related expenses, and the other items n.i.e. (not included elsewhere) expanded by Afl. 22 million (35 percent), Afl. 27 million (6 percent), and Afl. 21 million (28 percent), respectively. In contrast, expenditures on goods and services and investment outlays shrank by Afl. 38 million (20 percent) and Afl. 3 million (4 percent), respectively. The transfer by the government to the General Health Insurance (AZV), comprising the government's annual contribution and advances to cover deficits of the AZV, remained virtually unchanged at around Afl. 130 million. Net lending declined from Afl. 10 million in 2004 to Afl. 2 million in 2005 because a rise in lending was offset by the sale of government-held shares in a local hotel and the receipt of repayments on debt extended by the government to public nonfinancial corporations.

As a result of the earlier mentioned transactions, an Afl. 127 million financial deficit was posted in 2005, down from Afl. 355 million in 2004. Unmet financing requirements increased by Afl. 27 million to Afl. 183 million, reflecting mainly new payment arrears vis-à-vis suppliers of goods and services. Consequently, the financial deficit including the change in unmet financing requirements reached Afl. 153 million in 2005 compared to Afl. 226 million a year earlier. The narrower financial deficit was attributed mainly to increased revenues. Still, government expenditures remained excessive.

Total financing needs of the government went down from Afl. 475 million in 2004 to Afl. 314 million in 2005. This decline reflected the debt conversion with the APFA, which was included in the 2004 figure. To cover these financing needs, the government placed two bond issues and took out three private loans on the local market totaling Afl. 169 million, and it issued an Afl. 166 million (US\$ 93 million) bond on the foreign capital market. On balance, bank deposits of the government rose by Afl. 36 million.

Table 4 Government financial operations 1)

(in Afl. million or stated otherwise)

	2003	2004	2005
1. Revenue and grants	987.9	835.2	907.3
a. Tax revenue	687.4	707.1	777.7
b. Nontax revenue	300.6	128.1	129.6
- Grants	30.1	31.1	28.4
- Other nontax revenue 2)	270.5	97.0	101.2
2. Expenditures and items n.i.e. 3)	918.6	1,179.5	1,032.2
a. Personnel-related outlays 4)	437.8	566.3	505.2
b. Goods and services	153.5	191.1	152.9
c. Interest payments 5)	44.9	85.2	83.7
d. Investments	42.6	66.8	64.1
e. Transfer to the General Health Insurance (AZV)	132.7	130.8	130.4
f. Items n.i.e., of which: 6)	107.2	139.3	95.8
- transfers	62.2	38.7	60.4
- subsidies	24.2	24.2	22.7
- other	20.8	76.4	12.7
3. Lending minus repayments	-103.1	10.2	1.7
4. Financial deficit (-)	172.4	-354.5	-126.6
5. Net foreign capital	-200.6	96.5	48.1
6. Net domestic capital 7)	9.0	236.7	55.7
7. Net recourse to the monetary sector	-19.3	-21.3	-22.8
8. Memorandum items			
a. Unmet financing requirements 8)	285.5	156.7	183.2
b. Financial deficit 9)	150.9	-225.7	-153.1
c. Total government debt 10),	1,478.8	1,700.2	1,862.1
of which:			
domestic debt	754.6	864.7	1,012.4
foreign debt 11)	724.2	835.6	849.7
d. Outstanding government guarantees	5.4	0.0	0.0
9. Key indicators			
a. Total debt in % nominal GDP	41.1	44.5	46.1
b. Foreign debt in % exports 12)	36.5	36.0	34.9
c. Debt service in % exports 13)	7.8	2.9	7.2

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

- 1) Preliminary figures on a cash basis, including imputed noncash transactions, such as the transactions related to the hotel guarantee issue and the APFA debt conversion. 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 "other nontax revenue".
- 3) In 2004, an agreement between the government and APFA was reached on a debt conversion pertaining largely to existing arrears in premiums, cost of living allowances, and interest payments. The settlement of these arrears was recorded as imputed expenditures in the categories personnel-related outlays, items n.i.e., and interest payments, respectively.
- 4) Excluding the imputed amount related to the APFA debt conversion, the personnel-related outlays were Afl. 478.7 million in 2004.
- 5) Excluding the imputed amount related to the APFA debt conversion, the interest payments were Afl. 62.2 million in 2004.
- 6) Excluding the imputed amount related to the APFA debt conversion, the items n.i.e. (not included elsewhere) were Afl. 74.6 million in 2004.
- 7) Net long-term capital attracted from nonmonetary sectors mainly by issuing government bonds and private loans.
The commercial banks' part in this is included under item 7, while the nonresidents' part is included under item 5.
- 8) Comprising all reported unsettled payment obligations to other sectors irrespective of the timeframe in which they mature.
- 9) Including the change in unmet financing requirements.
- 10) Preliminary (end-of-period) figures, excluding government guarantees.
- 11) At year-end exchange rates.
- 12) Exports of goods and services, excluding the oil sector.
- 13) Related to foreign debt. Exports excluding the oil sector.

Outstanding public debt went up by Afl. 162 million or 10 percent to Afl. 1,862 million in 2005, a level equal to 46 percent of nominal GDP. This increase was brought about by an Afl. 148 million jump in domestic debt to Afl. 1,012 million, reflecting two bond issues of Afl. 40 million each in February and April 2005 and three private loans totaling Afl. 89 million. Foreign debt increased by Afl. 14 million because the proceeds of bonds issued on the international capital market in September 2005 amounting to Afl. 166 million (US\$ 93 million) were used largely to refinance maturing debt. The latter consisted of the repayment on the development loans received from the Netherlands and the repayment of maturing private placements in September and December 2005 totaling US\$ 60 million (Afl. 107 million). Moreover, an Afl. 16 million financial lease claim of a resident on the government was sold to a nonresident company.

3.5 Balance of payments

In 2005, the balance of payments registered an Afl. 61 million overall deficit, in contrast to an Afl. 20 million surplus in 2004. Consequently, net international reserves of the monetary system (including revaluation differences of gold and official foreign exchange holdings) weakened significantly, reaching Afl. 676 million at end 2005, down from Afl. 723 million a year earlier. For the third consecutive year, the 12-month merchandise import coverage ratio shrank notably, i.e., from 6.2 months in 2004 to 5.5 months in 2005. In 2005, the official gold and foreign exchange reserves of the Bank dropped by Afl. 26 million to Afl. 589 million compared to 2004. The remainder of the monetary sector's net foreign assets held by the commercial banks declined by Afl. 21 million to Afl. 87 million.

The current account of the balance of payments showed an Afl. 463 million deficit in 2005, following an Afl. 26 million surplus recorded in 2004. This change was caused mainly by the external transactions of the oil sector. In 2005, this sector paid Afl. 706 million in dividends abroad. The latter was mitigated in part by a marked improvement in the merchandise trade balance of this sector.

Moreover, the deficit on the current account of the rest of the economy widened by Afl. 71 million or 30 percent to Afl. 309 million and is equivalent to 8 percent of GDP. This outcome was caused primarily by a higher deficit on the merchandise trade account, resulting from a further rise in merchandise imports. Also, the deficit on the current transfers account widened, reflecting increased workers' remittances to abroad and a higher transfer to the Solidarity Fund. In contrast, the surplus on the services account rose by 3 percent, largely associated with a 4 percent increase in tourism receipts (compared to 24 percent in 2004) and a rise in receipts from business services, offset in part by higher outlays by residents related to travel and business services. The income account deficit remained virtually unchanged.

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

	2003	2004	2005
1. Current account (net)	-269.0	25.9	-462.9
a. Oil sector	64.7	251.1	-158.6
b. Free zone	12.5	11.9	4.1
c. Rest of economy	-346.2	-237.1	-308.5
1. Goods	-1,115.3	-1,231.5	-1,316.1
2. Services	957.9	1,237.5	1,271.5
3. Income	-73.7	-107.1	-107.5
4. Current transfers	-115.1	-136.1	-156.4
2. Capital and financial account (net)	174.7	-17.2	365.7
a. Oil sector	79.4	-181.9	210.2
b. Free zone	-1.2	-2.4	9.0
c. Rest of economy	96.6	167.1	146.6
1. Capital account transactions	179.8	33.2	32.8
2. Direct investment	218.3	181.6	211.1
3. Portfolio investment	87.8	72.5	-2.3
4. Financial derivatives	0.0	0.0	0.0
5. Other investment	-389.4	-120.2	-95.0
5.1 Loans	40.2	-66.6	-61.4
5.2 Other financial transactions	-429.6	-53.7	-33.6
3. Items not yet classified 2)	33.1	11.1	36.0
4. Overall balance (= 1 + 2 + 3)	-61.2	19.9	-61.2
5. Total reserves of the monetary sector 3)	700.3	722.9	675.7
of which: official reserves	608.9	614.4	588.6
6. Import coverage in months of merchandise imports 4)			
a. End-of-period	5.8	5.6	4.8
b. 12-month average	6.6	6.2	5.5

Source: CBA.

1) On a cash basis.

2) Including errors and omissions.

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

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

The Afl. 17 million deficit on the capital and financial account in 2004 turned into an Afl. 366 million surplus in 2005, due mainly to a decrease in the oil sector's foreign account balances, resulting from earlier mentioned dividend payments. This effect was offset partly by an Afl. 21 million decline in the surplus on the capital and financial account of the rest of the economy to Afl. 147 million. The latter resulted largely from a turnaround of the portfolio investment account's surplus recorded in 2004 into a small deficit in 2005, reflecting mainly a decline in liabilities as repayments of maturing private placements by the government were made. In contrast, the surplus on the direct investment account widened, due partly to an increase in investments in Aruba related to property sales.



PRUDENTIAL SUPERVISION OF FINANCIAL INSTITUTIONS

4

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 State Ordinance on Company Pension Funds (AB 1998, GT 17), and the State Ordinance on the Supervision of 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, the Bank conducts continuous off-site surveillance, as well as periodic risk-based on-site examinations. Furthermore, the Bank holds regular bilateral meetings 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 audited annual 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.

The Bank undertakes on-site examinations to assess key risk areas, such as the financial condition, asset quality, corporate governance, and the anti-money-laundering and terrorist financing procedures. During 2005, two commercial banks, one bank-like institution, seven insurance companies, three company pension funds, and five money transfer companies were examined on-site. Based upon the findings, some of the institutions examined were required to take corrective measures. Also in 2005, no formal regulatory action was deemed necessary against any of the supervised institutions.

4.2 Major issues and developments

4.2.1 Legislative framework

The Bank advised the government on various occasions to extend the legislative framework for the supervision of the financial sector to other currently unsupervised sectors. Worth noting is that a State Ordinance on the Supervision of the Trust Companies is being drafted. Also, in 2006 the Bank intends to start drafting proposals to expand its supervisory activities to insurance brokers and to strengthen the banking and insurance ordinances.

Eugene Simmons, 16 years of age and outstanding athlete in tae kwondo, made Aruba proud when he won a gold medal during the 2005 Junior Pan American Tae kwondo Championships.

Ramphis Murray, 16 years old and already a true champion in the sport of tae kwondo, was Aruba's gold medal winner in the recent Junior Pan American Tae kwondo Championships held in Aruba.

4.2.2 Banking sector

In 2005 the number of banking institutions under the Bank's supervision declined as OHRA Hypotheekbank N.V. was taken over by Aruba Bank N.V. The license of subject mortgage bank was revoked on October 21, 2005.

On May 23, 2005, the Bank granted RBTT Bank N.V. permission to acquire all shares of RBTT Bank Aruba N.V.

Over the past few years, the number of banks operating in Aruba has decreased significantly because of consolidation in this sector. As a result, the systemic risk in the banking sector, defined as the risk to the banking sector and the economy as a whole resulting from the failure of a bank, has increased considerably. Therefore, the presence of sound corporate governance practices including sophisticated risk management systems and comprehensive internal controls are more critical than ever to ensure that the institutions are properly managed. The Bank will continue to strictly monitor compliance with its corporate governance guidelines for credit institutions. The risks for banks operating in a small and undiversified economy are quite high and, therefore, they must maintain sufficient reserves. The Bank also is contemplating increasing the minimum risk-weighted capital asset ratio for banks from 10 to 12 percent.

In accordance with the Bank's Directive on the publication of the audited annual financial statements, all credit institutions are required, as of the reporting year 2005, to publish their audited annual financial statements (or an extract thereof) within 6 months after the end of each financial year by filing these statements with the Chamber of Commerce and Industry Aruba. Branches should publish the audited annual financial statements of the legal entity of which they form part. Insurance companies already are required since 2003 to publish their audited annual financial statements.

4.2.3 Money transfer companies

During 2005 the number of registered money transfer companies declined from six to four, since Unigiros and American Corporation N.V. ceased their activities. Their registration was cancelled on January 12, 2005, and August 3, 2005, respectively. The declining number of registered money transfer companies is largely the result of the strict enforcement of the prevailing supervisory laws and regulations governing this sector.

On September 7, 2005, Western Union was granted an exemption under section 10 of the State Ordinance on the Supervision of Money Transfer Companies (SOSMTC) to conduct money transfer activities via Banco di Caribe N.V. Furthermore, MoneyGram possesses an exemption under section 10 of the SOSMTC to conduct money transfer activities via Caribbean Mercantile Bank N.V. and Global Access Corporation N.V.

4.2.4 Insurance sector

On December 13, 2005, the Bank granted Elvira Verzekeringen N.V. a license to conduct non-life insurance business in the category “other indemnity business”, while on December 27, 2005, it granted Fides Rae Insurance Company N.V. a license to conduct the non-life captive insurance business in the category “association captive”. In 2005 Elvia Reisverzekering Maatschappij and International Health Insurance danmark a/s decided to cease their activities in Aruba. Their general insurance licenses were revoked on December 31, 2005. Consequently, the number of insurance institutions supervised by the Bank remained at 35 as of the end of 2005.

On July 28, 2005, the Bank approved the transfer of the local portfolio of The National Life Assurance Company of Canada to its parent company, Industrial Alliance Insurance and Financial Services, Inc.

In September 2005, the Bank issued “Pension Fund Governance” guidelines containing minimum requirements in the area of board oversight, administrative organization and internal controls, and disclosure of financial information. These guidelines are based mainly on the pension fund governance guidelines issued by the Organization for Economic Co-operation and Development (OECD) in July 2002. As of January 1, 2007, all company pension funds must comply with these new guidelines.

4.3 Integrity of the financial system

At present, banks, life insurance companies, money transfer companies, free-zone companies, casinos, and the post office are required to report unusual transactions to the Reporting Center for Unusual Transactions (RCUT). In accordance with the revised 40+9 recommendations of the Financial Action Task Force (FATF), the unusual transactions reporting obligation 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 RCUT is entrusted with the execution of the State Ordinances on the Reporting of Unusual Transactions (SORUT) (AB1995, No. 85) and on the State Ordinance on the Identification for Rendering Financial Services (SOIRFS) (AB 1995, No. 86). The Bank also is entrusted by law with overseeing compliance with the stipulations of the SORUT, insofar as it concerns the financial institutions under its supervision. In December 2005 a Memorandum of Understanding was signed between the Bank and the RCUT on the exchange of general information on money laundering and terrorist financing issues.

The State Ordinance on the Supervision of Trust Companies and the revised Sanction Ordinance are still in the legislative process. In accordance with the conclusions of the IMF Article IV Consultation Mission that visited Aruba in January 2005, the legislative process in the area of combating money laundering and terrorist financing should be given a higher priority. This also in view of the planned mutual evaluation of Aruba by the FATF in 2007.

Primarily based on the Customer Due Dilligence guidelines issued by the Basel Committee on Banking Supervision, the Bank issued in December 2005 a directive for banks on Customer Due Diligence. This directive contains minimum standards in the areas of customer acceptance policy, customer identification, on-going monitoring of accounts and transactions, and risk management. All credit institutions are required to comply with these requirements before July 1, 2006.

In February 2005, the Bank issued revised guidelines for the money transfer companies in the area of combating money laundering and terrorist financing. Pursuant to these revised guidelines all money transfer companies are required, among other things, to appoint a compliance officer responsible for overseeing adherence to the laws and regulations governing money transfer companies.

In 2006 the Bank also intends to revise its current anti-money laundering guidelines for insurance companies based on the guidance paper on anti-money laundering and combating the financing of terrorism issued in October 2004 by the International Association of Insurance Supervisors.

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 conferences of the Caribbean Group of Banking Supervisors (Tortola, British Virgin Islands, May 2005), the Association of Supervisors of Banks of the Americas (Oaxaca, Mexico, September 2005), and the International Association of Insurance Supervisors (Vienna, Austria, October 2005). Important topics discussed during these events were the revised Basel Capital Accord for banks, the international financial reporting standards, corporate governance, operational risk, and consolidated 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 2005.

4.5.1 Banking sector

Commercial banks

The aggregated balance sheet of the commercial banks increased by 7 percent to Afl. 3,336 million at the end of 2005, equivalent to 83 percent of estimated nominal GDP. Cash and due from banks rose by 28 percent to Afl. 755 million, while loans grew by 10 percent to Afl. 2,270 million. On the liability side, deposits rose by 8 percent to Afl. 2,854 million. As a consequence,

the loans-to-deposits ratio increased by 1 percentage point to 77 percent, still adequately below the prudential maximum of 80 percent. The banks' aggregated risk-weighted capital asset ratio remained at approximately 12 percent, well above the 10 percent minimum set by the Bank. Over 2005, the commercial banks recorded a profit (before taxes) of Afl. 84 million (2004: Afl. 73 million), while their return on equity declined by 2 percentage points to 26 percent, due mainly to an increase in the average shareholder's equity. Their liquidity ratio decreased slightly to 26 percent, but is still amply above the Bank's minimum prudential liquidity requirement of 20 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. 573 million at the end of 2005, which represents a 43 percent decrease compared to 2004. Mainly due to the significant decline of Afl. 203 million in the risk-weighted assets, their aggregated risk-weighted capital ratio rose from 36 percent to 53 percent, far above the Basel minimum of 8 percent. In 2005, an Afl. 20 million profit (before taxes) was recorded, compared to a profit of Afl. 47 million in 2004. This drop was mainly the result of a decrease in the net interest margin caused by a sharp decline in the size of the loan portfolio and a negative revenue from foreign exchange transactions.

Bank-like institutions

The three bank-like institutions in Aruba are engaged mainly in mortgage lending to individuals, financing of social housing projects, long-term project financing, and/or granting of personal loans for consumptive and home improvement purposes. These activities are financed predominantly by attracting funds from their parent company, other (local) financial institutions, and/or institutional investors. The aggregated balance sheet total of the bank-like institutions declined by Afl. 44 million to Afl. 601 million compared to 2004, mainly as a result of the take-over of OHRA Hypotheekbank N.V. by Aruba Bank N.V. The combined loan portfolio of the bank-like institutions amounted to Afl. 412 million at the end of 2005 (2004: Afl. 443 million), equivalent to 10 percent of estimated nominal GDP. The aggregated risk-weighted capital ratio of the bank-like institutions decreased by 1 percentage point to 46 percent, well above the Bank's minimum requirement of 10 percent. Their net income (before taxes) decreased by Afl. 1 million to Afl. 14 million, while their return on equity increased by 1 percentage point to 6 percent.

Money transfer companies

According to the 2005 preliminary figures, approximately 275,000 outgoing transfers were executed by the money transfer companies registered in Aruba equivalent to Afl. 106 million (2004: 255,000 outgoing transfers amounting to Afl. 100 million), while approximately 15,000 incoming transfers in the amount of Afl. 11 million were recorded, resulting on balance in a significant net outflow of funds. The large number of immigrants from Latin America and the Caribbean region who are 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 2004, the aggregated balance sheet total of the 13 non-life insurance companies amounted to Afl. 166 million (equivalent to 4 percent of nominal GDP), i.e., a 4 percent decrease compared to 2003. Investments and amounts due from affiliated companies increased by Afl. 10 million and Afl. 7 million, respectively, while current assets fell by Afl. 26 million. At end 2004, 3 percent of the investment portfolio of these companies consisted of foreign investments. On the liability side, the amounts due to affiliated companies declined by Afl. 6 million or 15 percent, while the technical provisions rose by 8 percent to Afl. 58 million. Capital and reserves fell by Afl. 12 million or 17 percent to Afl. 56 million, mainly due to the transfer of a part of the solvency surplus of one of the local insurance companies to its head office. Their net income (before taxes) decreased from Afl. 14 million to Afl. 11 million. In 2004, the coverage ratio dropped by 44 percentage points to 259 percent, still far above the minimum of 100 percent. The decrease in the coverage ratio was mainly the result of the aforementioned transfer of a part of the solvency surplus of one of the local non-life insurers to its head office. At the end of 2004, all non-life insurance companies complied with the minimum coverage ratio requirement of 100 percent.

Life insurance companies

At the end of 2004, the aggregated balance sheet total of the eight life insurance companies amounted to Afl. 401 million (equivalent to 10 percent of nominal GDP), which represents a slight decrease of Afl. 2 million compared to 2003. The amounts due from affiliated companies declined by Afl. 42 million, while the investments and current assets rose by Afl. 26 million and Afl. 15 million, respectively. At end 2004, 13 percent of the investment portfolio of these companies consisted of foreign investments. On the liability side, the amounts due to affiliated companies decreased by Afl. 25 million, while the technical provisions rose by 10 percent to Afl. 325 million. Capital and reserves fell by Afl. 9 million to Afl. 52 million, mainly due to the transfers of a part of the solvency surplus of two of the local life insurance companies to their head offices. Net income (before taxes) doubled from Afl. 7 million to Afl. 14 million. In 2004, the coverage ratio fell by 12 percentage points to 118 percent. All life insurance companies complied with the minimum coverage ratio requirement of 100 percent.

Company pension funds

The aggregated balance sheet total of the ten active company pension funds amounted to Afl. 200 million at the end of 2004 (equivalent to 5 percent of nominal GDP). Investment rose by 8 percent to Afl. 182 million, of which 52 percent were foreign assets. On the liability side, technical provisions increased by 8 percent to Afl. 172 million. The net result of the company pension funds grew by 10 percent to Afl. 5 million in 2004. The return on investments ratio declined by 3 percentage points to 7 percent in 2004. In 2004 the coverage ratio rose slightly by 2 percentage points to 107 percent. However, two company pension funds were not in compliance with the minimum coverage ratio requirement of 100 percent. The Bank will continue to strictly monitor the financial developments of these two institutions on the basis of their recovery plans.

4.5.3 Other institutions

Other large financial institutions operating in Aruba, which do not yet 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 these institutions.

The Civil Servants Pension Fund (APFA)

In December 2004, the State Ordinance on the Privatization of the Civil Servants Pension Fund (APFA) was enacted. One of the main objectives of this privatization was to convert APFA into a foundation and to introduce a new and more sustainable pension scheme for current and future members based on the so-called average income scheme. However, the pension scheme for current members has not yet been amended. Once this has taken place, APFA will fall under the Bank's supervision. Until then, it will remain under the supervision of the Minister of Finance and Economic Affairs. Although in 2004 APFA's coverage ratio improved by 2 percentage points to 79 percent, it still remained far below the minimum coverage ratio of 100 percent applicable to company pension funds. In the short term, a more sustainable pension scheme also must be introduced for the current members of the fund to safeguard its long-term viability.

The Social Security Bank (SVB)

Although the financials of SVB are satisfactory on an aggregated basis, the vulnerability of the economy to external shocks and the expected rapid population aging seem to justify a reform of the present universal pension system. The most important measure to consider is an increase in the effective retirement age.

The General Health Insurance (AZV)

The AZV has repeatedly experienced large deficits since its inception in 2001. Therefore, in 2004 the basis for the calculation of the AZV premium was broadened from taxable income to gross income. As a consequence, premium income rose by 16 percent in 2004. Furthermore, the different measures taken, such as the introduction of benchmarking tools to monitor the medical declarations and the establishment of a limited list of medicines that can be claimed at the AZV, resulted in a reduction in health expenses by Afl. 9 million or 4 percent in 2004. On balance, a loss of Afl. 29 million or 1 percent of estimated GDP for 2004 was incurred, substantially lower than the losses incurred in previous years. The more recent AZV premium increase from 7.5 to 9.5 percent will probably lead to a more balanced financial situation for this institution. To prevent future premium increases, further cost-reducing measures may still be necessary. In view of the expected aging of the population, consideration also should be given to the forming of reserves to absorb the expected increase in health costs.



FINANCIAL STATEMENTS

5

BALANCE SHEET AS OF DECEMBER 31, 2005 ¹⁾, AFTER PROFIT DISTRIBUTION

(in thousands of Aruban florin)

	2005	2004
Assets		
Gold	102,022	87,107
Foreign currency assets	489,590	528,808
Receivables	8,184	7,377
Printing cost of bank notes	1,000	1,491
Premises	11,341	15,940
Other fixed assets	2,860	4,105
	<u>614,997</u>	<u>644,828</u>
Liabilities		
Bank notes issued	162,680	145,519
Deposits of residents	279,034	331,668
Deposits of nonresidents	2,969	1,510
Money in custody	612	601
Payables and accrued expenses	12,332	22,119
Revaluation account	79,184	65,225
General reserve	68,186	68,186
Capital	10,000	10,000
	<u>614,997</u>	<u>644,828</u>

1) Abbreviated

PROFIT AND LOSS ACCOUNT FOR THE YEAR 2005 ²⁾

(in thousands of Aruban florin)

	2005	2004
Net interest revenues	14,714	11,786
Foreign exchange	1,260	1,172
Coins	1,100	562
Various	411	176
Total income	17,485	13,696
Printing cost of bank notes	491	491
Personnel expenses	8,092	7,166
Operating expenses	2,320	2,921
Depreciation	2,251	2,087
Total expenses	13,154	12,665
Profit	4,331	1,031
Profit distribution		
Allocated to the Treasury	4,331	1,031
General reserve	-	-

2) Abbreviated

EXPLANATORY NOTES TO THE BALANCE SHEET AND THE PROFIT AND LOSS ACCOUNT 2005

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 2005.

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.

2.3 Premises and other fixed assets

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. The Bank's building is depreciated in 20 years, renovations and landscaping in 10 years.

Other fixed 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.

2.4 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.

2.5 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, 2005, the market price for gold was US\$ 513 or Afl. 918.27 (2004: US\$ 438 or Afl. 784.02) per fine troy ounce. The Bank's gold stock amounted to approximately 111,103 fine troy ounces.

Gold holdings:	Fine troy ounces		Value in thousands Afl.	
	2005	2004	2005	2004
	111,103	111,103	102,022	87,107

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. A net estimated value of this option contract as per December 31, 2005 was Afl. 33,907,743 negative based on the gold market price as of December 30, 2005. This market-to-market value is based upon an estimation of the counter party of the Bank in this option contract.

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. Furthermore, in December 2005, the Bank's building at Havenstraat was formally transferred to the government. It was sold for Afl. 4.3 million in 2002. The government still needs to pay the Bank the amount of Afl. 646,756 for the purchase of this building including additional expenses such as insurance and ground tax. As formally agreed upon, the aforementioned amount should be deducted from the government's share of the profit of 2005.

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. These costs are amortized over a period of 5 years.

3.5 Premises

This item comprises the Bank's building at J.E. Irausquin Boulevard 8 and landscaping. The former office building at Havenstraat 2 was formally transferred to the government on December 22, 2005. Therefore, it is no longer included under this item.

3.6 Other fixed assets

These assets consist of computer hardware and software, furniture, and equipment.

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	2005	2004
5	890	894
10	5,868	5,327
25	12,429	10,834
50	15,003	13,075
100	121,456	108,769
500	7,034	6,620
Total	162,680	145,519

3.8 Deposits of residents

Deposits of residents comprise the following items:

(in thousands of Aruban florin)

	2005	2004
Government	11,091	7,563
Development funds	151	41,743
Banks:		
- current accounts	63,491	82,323
- monetary cash reserve	183,287	166,366
- time deposits	7,732	9,681
- CBA certificates	-	19,850
Other	13,282	4,142
Total	279,034	331,668

Government

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

Development funds

These funds are 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 requirements of the Bank.

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

In 2003, the Bank began issuing six-month 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 instruments. In 2005 the Bank decided to postpone this activity, as the commercial banks' interest to purchase these certificates was very low.

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 of funds received in consignment and 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, an accrual for foreign asset management and custodian fees, expenses for the medical insurance plan, and for several construction works that started in 2005 and will be completed in 2006.

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)

	2005
Beginning balance	68,186
Additional profit distribution	-
Balance at the end of the year 2005	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)

	2005	2004
Interest revenues	15,065	12,158
Interest expenses	351	372
Net interest revenues	14,714	11,786

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 revenues

These are mainly penalty fees charged to the commercial banks for exceeding the credit growth ceiling established by the Bank in 2005 and fees for using the Bank's automated clearing system.

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 (2004: 62 persons).

4.6 Operating expenses

These consist mainly of expenses on utilities, cleaning and maintenance, printing and 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 profit over 2005 amounting to Afl. 4.331 million has been allocated to the Treasury. From this amount, a sum of Afl. 646,756 has been retained as the last payment for the purchase of the former Bank building at Havenstraat by the government.



Report of auditors

Introduction

We have audited the accompanying balance sheet of the Centrale Bank van Aruba in Oranjestad, Aruba as of December 31, 2005 and the related income and statement for the period January 1, 2005 until December 31, 2005. These financial statements set out on pages 33 to 41 are the responsibility of the management of the Centrale Bank van Aruba. Our responsibility is to express an opinion on these financial statements based on our audit.

Scope

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

Opinion

In our opinion the financial statements as set out on pages 33 to 41 present fairly in all material respects the financial position of the Centrale Bank van Aruba as of December 31, 2005 and of the results of its operations for the period January 1, 2005 until December 31, 2005 in accordance with the Central Bank Ordinance and the accounting policies of the European Central Bank (ECB) and the European System of Central Banks (ESCB) as described in Note 2.2 of the financial statements.

Aruba, June 20, 2006

A handwritten signature in blue ink that reads "PricewaterhouseCoopers Aruba". The signature is written in a cursive, flowing style.

PricewaterhouseCoopers Aruba

