Centrale Bank van Aruba

Annual Report and Financial Statements for the Year

2006

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Mission Statement

Working towards Financial Stability
for the Benefit of the People

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(as of June 12, 2007)

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The Unsustainability of Sustainable Tourism

It is a truism that tourism is experiencing a paradigmatic transformation. As Aruba ventures into the new reality of the 21st century, it faces strategic challenges that will require nothing less than a tectonic shift in rethinking and redesigning its socioeconomic foundations and philosophies. While traditional strategies and policies may have worked in the past, and growth was almost a given, today we dance to a different beat, and it's no English Waltz.

The classical approaches to policy and planning will no longer suffice if we are unable to innovate and break free from the chains that have shackled our minds and spirits. Sustainable tourism is a wicked oxymoron – basically a contradiction in terms that is misleading and deceptive in its execution. Sustainability refers to an ability to maintain a system in a status quo, based on principles of balance, durability, and continuity, in which stability is essential for maintaining a system – in this case, a tourism destination.

This perspective and praxis leads, however, to inertia and stagnation, due to its 'introverted, divide and conquer' design. By analogy, this approach would imply driving a car by merely looking at the speed dial, rather than looking ahead and using the rear-view mirror as appropriate. While the former strategy may suffice for a couple of minutes or miles on an empty road, as soon as heavy traffic emerges, its sustainability becomes questionable.

In an age of discontinuity, agility, flexibility, and nimbleness become sine qua non for sustained success. Not only must we improve our responsiveness and adaptability, but moreover we must be intelligent, inventive, and innovative in our decisions, and how we manage our valuable resources. More important, we need to start taking some Latin Tango lessons.

Sustainable tourism is a living part of a society that has come to flourish, grow, and progress because of its dynamic and diverse social fabric. In this year's annual report, the Central Bank of Aruba pays homage to the Aruban history and heritage as an integral part of our tourism economy and community. In the spirit of an old African proverb, if you want to know where you are going, you need to understand where you are coming from....

Dr. Ryan R. Peterson
Dean of Hospitality & Tourism Management Studies
University of Aruba

The invention of the jet engine and introduction of the jet airplane ushered a new era of tourism and travel during the 1960s. Airports were constructed and visitors traveled far and away, in search of the exotic unknown. Today, traditional airports have become centers of travel, trade and commerce, as they welcome a new era of tourism and travel. (Source 2007 photograph: Alrric Kock; Source black & white photograph: Archivo Nacional Aruba)

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Preliminary estimations show that the Aruban economy grew in 2006 at virtually the same pace as in 2005. Fitch Ratings estimates an expansion in real GDP of 2.5 percent (2005: 2.4 percent). Economic expansion was spurred by increased construction and investment activities, mainly in the hotel and real estate sectors, as well as higher levels of domestic consumption. However, these effects were partially offset by a weak performance in the tourism sector.

Analysis of economic developments is seriously hampered by a lack of statistical information particularly in the labor market. Signs of labor shortages are becoming more apparent, triggered by the government's implementation of a more stringent immigration policy. This situation is further aggravated by the continued issuance of concessions for the construction of resorts and residential projects (i.e., condominiums), which will require even more labor in the near future.

The inflation rate accelerated further in 2006, fueled by a continued rise in the prices of water, electricity, and gasoline, a reflection of higher oil prices on the international markets. The 12-month average inflation rate rose to 3.6 percent in 2006, up from 3.4 percent in 2005. The inflation rate differential with the United States, Aruba's main trading partner, widened to 0.4 percentage point, slightly worsening Aruba's competitive position.

After a subdued performance in 2005, activities in the tourism sector turned negative in 2006, as both stay-over visitors and their nights spent on Aruba fell by 5 percent and 4 percent, respectively, compared to a slight 1 percent rise in 2005. The Aruba Tourism Authority attributes this contraction to increased hotel rates in combination with a decline in room availability during 2006, due to renovations and upgradings. Higher airfares caused by a rise in fuel costs also had a negative impact. The performance in the cruise tourism industry was more upbeat. Cruise passenger arrivals and port calls rose by 7 percent and 1 percent in 2006, respectively, following a decline of 4 percent and 2 percent in 2005. In total, almost 1.3 million stay-over and cruise tourists visited Aruba in 2006. Fortunately, the period December 2006 through February 2007 showed a recovery in stay-over arrivals.

The sluggish performance in the tourism sector was also reflected in a 2 percent decline in registered gross tourism receipts, compared to 2005, when a 4 percent increase was registered. Consequently, the contribution of tourism receipts to the current account income of the balance of payments of the rest of the economy (excluding the oil and free-zone sectors) declined to 74 percent, 4 percentage points lower than in 2005. Therefore, the partial offsetting effect of the tourism sector income vis-à-vis the large other current account outflows of the rest of the economy (excluding the oil and free-zone sectors) became smaller and, thus, contributed to a further deterioration of the current account balance of the rest of the economy.

The current account deficit of the rest of the economy almost doubled -- from Afl. 309 million in 2005 to Afl. 587 million in 2006. However, the capital and financial account of the rest of the economy (excluding the oil and free-zone sectors) recorded a notable Afl. 515 million surplus in 2006 (2005: Afl. 184 million), largely counterbalancing the earlier described current account deficit of the rest of the economy. The surplus on the capital and financial account was triggered predominantly by higher foreign direct investments, reflecting a prevailing foreign interest in investing in Aruba, particularly in the tourism and real estate sectors.

The main factors influencing the deterioration of the current account deficit of the rest of the economy were the aforementioned decline in tourism receipts and higher transfers abroad for dividend and interest payments as well as workers' remittances to families abroad. Also, the increased payments abroad for merchandise imports and services influenced this outcome. Moreover, the direct investment inflows related to investment and construction activities also led to current account outflows because of a rise in the import of construction-related materials and payments of fees related to construction and business services. In addition, a significant increase should be factored in on transfers abroad related to dividends and loan repayments later on, thereby intensifying the drawdown on foreign exchange reserves in the future.

As a result of the current and capital and financial accounts transactions of the rest of the economy, the balance of payments of the rest of the economy recorded an Afl. 72 million net outflow of funds abroad in 2006. In contrast, the external transactions of the oil and free-zone sectors led to a net inflow of foreign funds amounting to Afl. 125 million. All in all, Aruba's overall balance of payments recorded an Afl. 53 million surplus, raising the level of international reserves to Afl. 651 million (2005: Afl. 598 million). Still, the 12-month average coverage of merchandise imports by international reserves declined further to 5.2 months (2005: 5.5 months), while the 12-month average coverage of all current account payments (i.e., payments for merchandise imports, services, income, and current transfers) shrank to 2.7 months in 2006 (2005: 3.0 months).

The factors inducing the large current account deficit of the rest of the economy in 2006 -- higher imports of goods, increased outflows of funds related to dividend and interest payments and workers' remittances -- are related mainly to the economic structure and development of Aruba. The outward bound payments related to these factors are the result of high economic growth based mainly on foreign capital and foreign human resources, and are generally irreversible in the short or medium term. However, the Bank is mainly concerned about the persistent high current account deficits of the rest of the economy resulting from excessive consumptive spending, as this causes undue pressure on the foreign exchange reserves. This pressure becomes much more evident when the export sector, particularly tourism, is performing below par.

Monetary policy is needed to modify and counter excessive credit creation by the financial system, induced partly by excessive liquidity creation by government due to ongoing high expenditure levels that lead to heightened domestic consumption. Such policy would partly reduce the pressure on the foreign exchange reserves. Through a quantitative credit restriction on the banking sector, the Bank subdues excessive domestic consumption and its direct negative effects on the foreign exchange reserves caused by increased imports of goods and services. The more common and market-oriented interest rate mechanism is not operative in our economy, given the small size of the money and capital markets.

In 2006, the Bank further tightened its monetary policy by lowering overall credit growth by one percentage point to 5 percent, introducing at the same time a separate growth limit of 5 percent on consumer credit and raising the penalty fee for excess lending by 2 percentage points to 8 percent. The Bank also raised the monetary cash reserve requirement from 8 percent to 9.5 percent in October 2006 to neutralize part of the excess liquidity within the banking system. In addition, the Bank took measures to restrict credit allocation by the banklike financial institutions to maintain a level playing field within the financial sector. As a result of these measures, overall banking sector credit grew by 4 percent in 2006, thus remaining within the Bank's guideline.

For 2007, the Bank's preliminary estimates show a slowdown in economic growth in real terms to about 1 percent, while inflation is expected to accelerate to about 7.5 percent. On the one hand, investments in the tourism and real estate sectors will remain buoyant, and tourist arrivals are expected to recover and reach the 2005 levels. On the other hand, inflationary pressures are rising, spurred by, among other things, the introduction of a turnover tax ("Belasting op Bedrijfsomzetten" or BBO) by the government in January 2007, high wage costs resulting from increasing labor shortages induced partially by the government's more restrictive immigration policy, and additional construction projects currently in the pipeline. A further rise in the price of oil on the international market and other commodity prices will also push up domestic prices.

Given these conditions, the Bank decided to maintain the credit growth limitation for 2007 at 5 percent. Additionally, the credit development of the banklike financial institutions is monitored closely. Moreover, the Bank will evaluate a further rise in the monetary cash reserve requirement if called upon by macroeconomic conditions, such as the level of foreign exchange reserves, the balance of payments' current account deficit of the rest of the economy, the inflation rate, and/or the excess liquidity within the banking system.

Curtailing the excessive liquidity creation by the government requires a radical change in fiscal management and discipline. The vicious circle of structurally spending more than the government receives from taxes and other income, and financing the resulting deficit by contracting new loans should be broken. The government should diligently and in a transparent manner strive for financial surpluses to be able to soundly repay its maturing debt and increase its investments. Given its acute liquidity constraints, the government's attention is focused largely on dealing with its cash problems at hand. Moreover, its goal to reach a balanced budget has been predominantly geared towards revenue-generating measures without sufficiently lowering its expenditures.

Fiscal policy is still unstable, which makes conducting business and planning investments quite a challenge. This notion is enforced by a delayed presentation of the budget to Parliament. The 2006 budget was presented to Parliament in May of that year, while the 2007 budget was presented to Parliament in March 2007, but was still not approved by the end of May 2007. Accountability also is deficient. The governments in the past and present have not included the presentation of annual financial statements as an instrument to improve accountability. Indeed, no financial statement was ever approved by Parliament.

In addition, the government raised import duty tariffs in June 2006 to generate additional revenues to finance government operations. These tariffs were partly scaled down again as of January 1, 2007, to compensate for the introduction of the BBO. The latter was introduced as of January 1, 2007, after an intense but short information campaign by the Tax Department. Consequently, there was limited time for stakeholders and the general public to reflect and give their feedback on the proposed changes in tax structure, as well as to adequately prepare for its introduction. With this tax the government intends to bring about a shift in the tax structure from direct to indirect taxes. In normal circumstances, the BBO will have a neutral effect on the profit and loss account of companies. The cascading feature of this tax, however, will generate inflationary repercussions. To compensate for consumers' ensuing loss of purchasing power, the government adjusted the wage and income taxes downward, and raised the minimum wage level.

In 2006, the financial operations of the government resulted in an Afl. 62 million deficit (including the change in unmet financing requirements), lower than the Afl. 152 million deficit registered in 2005. This decline was largely the result of a rise in tax revenues and a decline in payment arrears. Noticeably, government expenditures on a cash basis rose at almost the same pace as its revenues attributable largely to a surge in payments for goods and services, higher wage-related outlays, and increased interest expenses. Again, the government had to resort to local financiers and the international capital market to cover part of its financial needs and to repay maturing debt. This borrowing raised its total outstanding debt by Afl. 124 million to Afl. 1,996 million and the debt-to-GDP ratio by 0.2 percentage point to 47 percent at end 2006.

Throughout 2005 and 2006, the Bank emphasized the importance of introducing adequate legislation with regard to government fiscal policy, the so-called Fiscal Responsibility Law (FRL). This legislation will strengthen fiscal discipline and promote transparency and accountability by improving the current budgetary procedures, including public finance management within a multi-year budgeting framework. Such legislation will also stipulate a maximum on government expenditures and debt, including mandatory balanced budgets. The Bank recommends that amendments to such legislation require a two-third majority vote in Parliament to ensure a sound and stable budgetary process.

The Bank fully supported the initiative of the Minister of Finance and Economic Affairs to institute a National Commission on Public Finance (the Commission) to evaluate, among other things, the development of a set of fiscal responsibility rules to ensure accountability, transparency, and public availability of information within a multi-year budgeting framework. The result would be a set of criteria to regularly monitor the development of the financial position of the government and to enable the achievement of a balanced budget and a debt-to-GDP ratio of 40 percent on the short term. In its report "Sound Public Finance and Public Accountability in Aruba" of February 2007, the Commission presented several recommendations that, if fully implemented, will enable government to reach and maintain a sound financial position in the future.

Over the years, the Bank has considerably expanded and strengthened the supervisory framework regarding the financial sector. Also in view of the international standards for financial sector regulation and supervision and the combating of money laundering and terrorist financing, it is important to broaden in the short term its supervisory scope to company service providers and stock exchanges. However, the legislative processes take time. The draft State Ordinance on the Supervision of Trust Companies is still in the legislative process stage, while a proposal is currently being drafted to bring stock exchanges under the Bank's supervision. With the technical assistance of De Nederlandsche Bank N.V., the Bank is currently working on proposals to strengthen the supervisory ordinances for the banking and insurance industry. These proposals will mainly address the legislative shortcomings identified by the International Monetary Fund and provide the Bank with a more solid legal basis to enforce compliance through supervisory laws and regulations governing this industry.

In August 2006, the Bank issued a revised policy rule for the admission and licensing of banks and insurance companies, to be able to better protect the interests of Aruban depositors and policyholders. Under the revised policy rule, a foreign bank or insurer is only allowed to operate via a branch office (or an agency in the case of an insurer) if it is an international bank or insurer with a balance sheet total of at least US$ 10 billion and an "A" rating issued by Standard & Poor or a comparable rating agency. Foreign banks or insurers that already operate in the Aruban market via a branch office or agency and do not meet the aforementioned conditions are required to establish a separate legal entity in Aruba before July 1, 2007, through which they can continue their banking or insurance activities on this market.

In 2006, the operations of the Bank again produced favorable results. The Bank's profits rose by Afl. 7 million to Afl. 11 million, largely induced by increased net interest revenues following higher yields on the Bank's foreign investments and its efforts in cost control. The Bank continuously strives to strengthen its operations. In 2006, the Bank focused on further improving IT security and data integrity, given the technology-based environment of the Bank and its associated risks. Several assessments were conducted by third parties on the Bank's network architecture and applications.


The business of the Bank

2.1 Core functions

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The Bank, instituted on January 1, 1986 through the enactment of the Central Bank Ordinance, is the public institution responsible for safeguarding financial stability in Aruba. Its principal 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 institutions.

In line with its policy objectives, the Bank performs the following tasks and related activities.

Tasks	Related activities
a. Issue bank notes, as well as coins on behalf of the government.	Bring safe and secure bank notes and coins into circulation to meet the needs of businesses and the public in general.
b. Promote efficiency in settling domestic payments.	Operate an automated clearing system between the commercial banks and a number of government-related institutions.
c. Act as the banker for the government.	Execute payment orders and intermediate in the issuance of government debt paper. No credit is granted to the government.
d. Regulate the flow of international payments.	Facilitate and regulate payments between residents and nonresidents and collect foreign exchange tax.
e. Manage Aruba's official reserves, consisting of gold and foreign exchange holdings.	Invest the Bank's foreign exchange holdings in accordance with cautious guidelines aimed at protecting the country's liquidity and solvency position.
f. Advise the Minister of Finance on financial matters.	Produce relevant information and submit expert advice.
g. Monitor economic and financial developments.	Collect and analyze financial and economic data, published in monthly, quarterly, and annual reports.
h. Conduct monetary policy.	Formulate and implement measures to, inter alia, regulate bank credit and liquidity, thereby contributing to financial stability for the well-being of the people of Aruba.
i. Supervise the financial system.	Perform risk-based supervision on a number of financial institutions to protect the interests of 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

At the end of December 31, 2006, the value of total currency in circulation reached Afl. 201.7 million. Bank notes in circulation accounted for Afl. 180.1 million or 89 percent of the total, while coins in circulation amounted to Afl. 21.6 million. Compared to 2005, total currency in circulation went up by 10.2 percent or Afl. 18.7 million. This growth rate exceeded the 6.1 percent

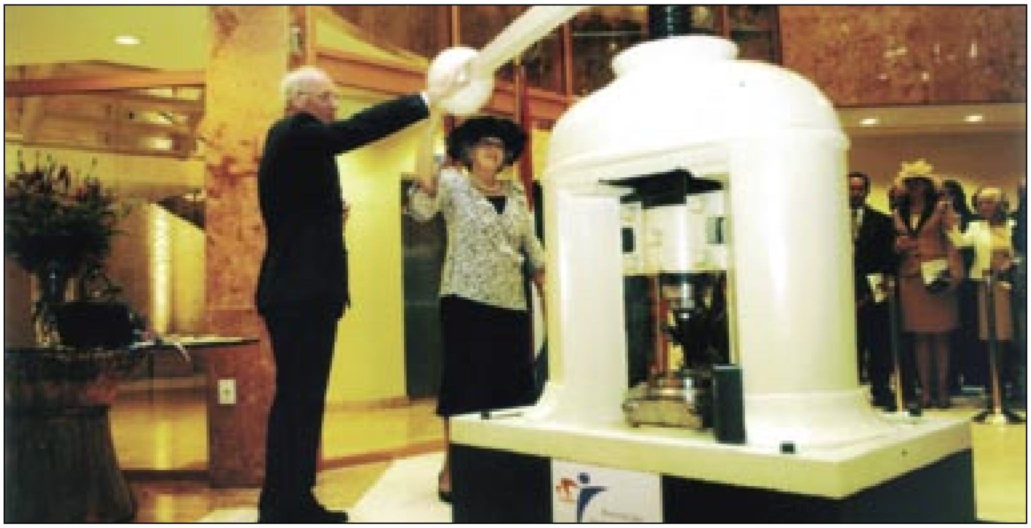
In the hectic world of today with depleting social capital, overcrowding and congestion, families and friends seek those special intimate moments to relax, rejoice and reconnect with loved ones. For decades, our natural heritage has been the cradle of success....
(Source 2007 photograph: Alrric Kock; Source black & white photograph: Archivo Nacional Aruba)

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 4.7 percent (2005: 4.5 percent). 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.

According to article 7 of the Central Bank Ordinance and article 3 of the State Ordinance Governing the Monetary System, florin bank notes are issued in denominations of Afl. 10, Afl. 25, Afl. 50, Afl. 100, and Afl. 500. At end 2006, total florin bank notes in circulation rose by Afl. 17.4 million or 10.7 percent compared to end 2005. Approximately 45 percent of the notes in circulation were Afl. 100 denominations, maintaining the largest share in total number of notes issued, while the Afl. 500 denominations kept the smallest portion at about 0.4 percent.

Article 7 of the Central Bank Ordinance and article 6 of the State Ordinance Governing the Monetary System condition that the Bank issues coins on behalf of the government, denominated in 5 cents, 10 cents, 25 cents, 50 cents, 1 florin, 2½ florin, and 5 florin. In 2006, the total value of coins in circulation, excluding commemorative coins, grew by Afl. 1.3 million or 6.4 percent when compared to 2005. This growth was again attributed to a 10.2 percent increase in circulation of the 5 florin coin. In September 2005, the square 5 florin coin was replaced by a round one. The last day to exchange the square 5 florin coin for other florin currency was August 31, 2006. However, as of that date, 51.3 percent of these square 5 florin coins remained in the hands of the public.

In 2006, the Bank issued a silver and a gold commemorative coin with nominal values of 10 florin and 25 florin, respectively, on the occasions of the 20th anniversary of Aruba's obtaining its Status Aparte within the Dutch Kingdom and the 30th anniversary of introducing its own flag and national anthem. Only 4,000 silver coins and 1,500 gold coins were issued. HM Queen Beatrix of the Kingdom of the Netherlands struck the first silver coin to commemorate this occasion, and the Bank had the honor of hosting this historical event.



(Photograph by Janine Vonk-Flanegin)

2.2.2 Clearing system

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

For the sixth consecutive year, the volume of checks processed through the clearing system declined. In 2006, the drop was 16.9 percent to 502,000 checks compared to the 604,000 checks processed in 2005. However, in contrast to the previous year, the total value processed through the clearing system in 2006 showed a 4.6 percent decrease to Afl. 2.07 billion, compared to Afl. 2.17 billion in 2005. A further growth in the use of direct debit cards as a means of payment contributed to the decline in the volume of checks processed. The volume and value of funds transferred through the clearing system continued to increase in 2006 by 13 percent to 735,880 transactions, and by 7.1 percent to Afl. 4.5 billion, respectively.

2.2.3 Interest payments

The Bank's interest rates are linked to the corresponding interest rate quotations by the Federal Reserve Bank. It pays interest remuneration 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 2006, total interest payments of the Bank increased by 28 percent or Afl. 98,466 to Afl. 449,536, as a result of a rise in the interest rates offered by the Bank. Most deposits were opened for a 7-day period. The corresponding interest rate increased from 1.05 percent per annum at the beginning of 2006 to 2.65 percent at the end of 2006.

2.2.4 Banking for the government

The Bank does not charge any fee on the domestic and foreign payments carried out on behalf of the government, in conformity with article 14 of the Central Bank Ordinance. These payments are cleared through the Treasury's current account held with the Bank, which balance amounted to Afl. 24.5 million at the end of 2006. The government deposits held in earmarked accounts rose by Afl. 10.6 million to Afl. 12.7 million. The development funds account managed by Fondo Desaroyo Aruba (FDA) increased by Afl. 2.3 million to Afl. 2.4 million at end 2006.

In 2006, the Bank assisted on a recurrent basis 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 loan certificates. The yields on the treasury bills moved between 3.47 percent and 5.39 percent and were significantly higher than the yields in 2005. Illustrative is that the average yield on these treasury bills amounted to 4.27 percent in 2006 compared to 2.48 percent in 2005. The yields on the renewal of the two cash loan certificates were 4.41 percent and 2.56 percent, respectively.

2.3 International payment system

2.3.1 Daily exchange rate fixing

The official buying and selling rates for the U.S. dollar from and to the commercial banks remained fixed at Afl. 1.7895 and Afl. 1.7905, respectively. 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 in June 2005, these rates also are published on the website of the Bank. The selling rate of the euro varied between Afl. 2.13 and Afl. 2.40, while the buying rate for this currency fluctuated between Afl. 2.09 and Afl. 2.35. At end 2006, the euro appreciated against the Aruban florin by 11.6 percent or Afl. 0.25 compared to end 2005.

2.3.2 International payments

Based on balance of payments' data, total payments to nonresidents surged by 18.5 percent to Afl. 13 billion at the end of 2006. The payments in U.S. dollars continued to be the largest component of this total, even though its 2006 share went down from 91.2 percent in 2005 to 86.9 percent. The share of settlements in euros increased somewhat to 4 percent, while that of payments to nonresidents settled in an exchange rate other than the U.S. dollar or euro went up by 3.3 percentage points to 9.1 percent in 2006.

2.3.3 Foreign exchange license policy

Foreign exchange payments on current transactions are not subject to any administrative restrictions. The annual upper limits for executing capital transactions without any administrative restrictions were kept at Afl. 300,000 for natural persons and Afl. 750,000 for legal entities (excluding commercial banks). Furthermore, institutional investors should also comply with the 40-60 percent investment rule, which requires that part of the investments, based on the total liabilities, be invested locally. In general, the Bank issues special foreign exchange licenses for amounts exceeding the aforementioned limits quite liberally when they concern regular transactions.

Pursuant to the Notice concerning Foreign Exchange Transactions AW 2005/1, commercial banks also require a foreign exchange license of the Bank for loans granted to nonresidents exceeding the amount of Afl. 1,000,000 per annum and per individual or group of nonresident borrowers, as well as for certain transfers or sales of financial instruments, such as bonds and notes to nonresidents.

Foreign exchange licenses granted

	2004	2005	2006
In numbers	103	138	617
Total amount (in Afl. million)	471.9	655.7	2,646.7

The Bank issued 617 special foreign exchange licenses in 2006, considerably more than the previous year. The total amount of the transactions for which licenses were granted grew by Afl. 2 billion to Afl. 2.6 billion compared to 2005. This enormous increase is mainly because in 2006 the Bank also issued licenses to businesses for transfers to or from their accounts held abroad. Furthermore, a large number of the licenses related to loans were granted retroactively. In addition, a few large loans related to hotel projects were given a license. Licenses granted for loans related to infrastructure remained at zero.

2.3.4 Foreign exchange commission

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

However, certain transactions are exempted from payment of the foreign exchange commission. Exemptions include transactions in the Netherlands Antillean guilder (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 Exemption 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.

Due to the amendment in the tax regime of the Aruba Exempt Corporations, the so-called AVVs, both the State Ordinance on Foreign Exchange Transactions and the State Ordinance on Foreign Exchange Commission were revised by AB 2005 No. 76. The AVVs incorporated before January 1, 2006, are by virtue of law nonresidents and, therefore, are not subject to foreign exchange commission. However, AVVs incorporated after January 1, 2006 are considered residents and should pay the foreign exchange commission. Pursuant to article 19 of the State Ordinance on Foreign Exchange Transactions, an AVV not engaged in economic activities in Aruba can equally, as can all other offshore companies, file a petition at the Bank to obtain a nonresident status.

The government is responsible for determining the policy concerning the foreign exchange commission, while the Bank is entrusted with the collection hereof. In 2006, the Bank raised Afl. 57.3 million in foreign exchange commission, i.e., Afl. 28.2 million more than a year earlier. This increase was attributed mainly to incidental items. As a result of transitorial items, Afl. 62 million was transferred to the Treasury during 2006.

2.4 Managing the official foreign exchange reserves

The Bank manages Aruba's official foreign exchange reserves as laid down in article 12, sub 1 of the Central Bank Ordinance. To this end, it applies, among others, the B-9 rule for commercial banks and the 40-60 percent investment rule for institutional investors. The Bank's foreign exchange reserves are invested in U.S. government and government-guaranteed papers, bonds issued by qualifying supranational financial institutions, and money-market instruments of double A-rated credit institutions. The proceeds from these investments form part of the Bank's income.

Guidelines have been established to manage the various risks inherent in holding these investments. These guidelines 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 2007, the Bank sees no immediate need for further tightening of its monetary policy. This position implies that the overall banking sector credit growth limitation will be kept at 5 percent on an aggregated basis for 2007 and will be calculated based on the outstanding loan portfolio balance as of end 2006 or the limit determined by the Bank at the beginning of 2006. As in 2006, there will be two separate credit growth ceilings: one for the category of consumer credit and one for the remaining credit categories, both of 5 percent. The penalty fee will remain unchanged at 8 percent and will be levied on the individual commercial banks that exceed either one of their lending growth limits.

In October 2006, the Bank raised the monetary cash reserve requirement to 9.5 percent. In the course of 2007, the Bank will evaluate if a further raise is necessary. There is no change in the present arrangements concerning the banks' so-called B-9 position and compensating fee for any deficiency in the monetary cash reserve requirement.

2.6 Prudential supervision

Prudential supervision is aimed primarily at maintaining the stability and integrity of the financial system. To this end, offsite 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 representative organizations.

In conformity with IMF recommendations and also with a view to protecting the reputation of Aruba as a premier location for conducting international financial activities, the supervisory scope should be extended to other currently unregulated parts of the financial sector. A law regulating company service providers has been drafted and is expected to be submitted soon to Parliament for its approval. In 2006 an electronic stock exchange was established in Aruba and a proposal is also currently being formulated to bring these activities under the Bank's supervision. Additionally, with technical assistance from De Nederlandsche Bank N.V., proposals are being drawn up to strengthen the current supervisory laws regulating the banking and insurance industry.

To increase its ability to protect the interests of depositors and policyholders, in August 2006 the Bank issued revised policy rules regarding the admission and licensing of banks and insurance companies. Under the revised policy rules, only international banks and insurers that meet the criteria laid down in said policy rules are allowed to continue their activities via a branch office or agency on the Aruban market after July 1, 2007. Banks or insurers already active via a branch office or agency but not meeting these criteria are required to set up a separate Aruban legal entity before said date through which they can continue their domestic activities.

2.7 Financial highlights

- At the end of 2006, the Bank's total assets rose by Afl. 137.3 million or 22.3 percent to Afl. 752 million compared to 2005. This growth was due largely to an Afl. 115.1 million increase in the foreign currency assets of the Bank.

- Total income (net of interest expenses) went up by Afl. 6.7 million or 38.6 percent to Afl. 24.2 million compared to 2005, mainly because of an increase in net interest revenues as a result of higher yields on U.S. dollar investments.

- Total expenses fell by Afl. 0.2 million or 1.7 percent to Afl. 12.9 million. This decrease was related to a decline in salaries and social security expenses and depreciation charges.

- For 2006, net profit reached Afl. 11.3 million, i.e., Afl. 7 million more than in 2005. In accordance with article 33, paragraph 1 of the Central Bank Ordinance, the total net profit of Afl. 11.3 million was allocated to the Treasury.

2.8 Organizational affairs

2.8.1 Risk management

The Bank engaged in a variety of activities geared at ensuring the mitigation of the different risks to which it is exposed. Given the high technology-based environment and the associated risks to the institution, in 2006 the Bank focused on further improving IT security and data integrity. Therefore, in September 2006, an IT security audit was conducted by a third party. The audit consisted of a technical assessment and review of the Bank's network architecture. In addition, a system penetration test was carried out.

As a technology-dependent organization, the Bank also began the first phase of updating its Disaster Recovery Plan. In 2006, a Recovery Health Check assessment was performed on the different systems and applications of the Bank and was primarily focused on the current disaster readiness of the Bank's technology.

At the end of the year, an extensive review of the administrative organization and internal control of the Operation and Accounting departments of the Bank was initiated. The project entails not only a reassessment of the processes and procedures within these two departments, but also the identification of the different risks associated with these processes and the appropriate controls needed to mitigate these risks.

2.8.2 Training, courses, and seminars

As part of the Bank's policy to provide training opportunities to its employees and to keep them abreast of the latest developments in their fields of expertise, the Bank's staff participated in a number of courses, seminars, and conferences during the year. In 2006, the Bank also hosted two conferences. From May 4-6, 2006, the Bank hosted the XXIV (24th) Annual Conference of the Caribbean Group of Banking Supervisors. This conference has firmly established itself as an important event for the senior regional members, to explore the implications to bank supervision of developments in regional and international markets and to strengthen co-operative efforts to implement international best practices and procedures. The 2006 conference theme was "The Paradigm Shift of Regulation in the Caribbean Region."

During June 5-9, 2006, the Bank accommodated the XVII (17th) Annual Conference of Regional Central Banks' Information Systems Specialists. The theme of the conference was "The Next Era of Information Technology." It focused on the alignment of IT strategies to business strategies by making effective use of the new data center technologies. The conference ended with a one-day workshop on "Strategic Alignment of IT with Business."

2.8.3 Staffing

At the end of December 2006, the Bank employed 64 persons full-time compared to 62 persons in 2005. Two persons terminated their employment with the Bank, and four persons were hired. The Bank's policy is to contain its expenses; therefore only key vacancies were filled during 2006.

The Executive Committee wants to present its thanks and appreciation to all members of the staff for their dedication and valuable contribution that made it possible for the Bank to meet its obligation to the Aruban Community.

Members of the Board of Supervisory Directors, l.-r.:
T.R.L. Vingal, M.R. Croes, A.J. Swaen, H.O. van Trikt, G.G. Oduber

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

(Photographs by Alrric Kock)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Economic and financial developments

3

3.1 The international environment

For the fourth consecutive year, the world economy produced a robust growth --an estimated 5 percent in 2006-- as a result of a strong performance in all major regions. This growth was anticipated by a rapid expansion in world trade, triggered by higher import demand in the Euro area and the Asian countries. Primary commodity prices rose markedly in the first half of 2006, but leveled off in the second half of the year following sharp declines in oil prices as of August 2006. Despite the strong growth and the respective sustained pressure on commodity prices, inflation remained fairly subdued, influenced by, among other things, credible monetary policies, the abundant supply of labor-intensive goods and services provided by the emerging economies, and sharper international competition. The strong growth performance of the world economy also contributed to improving labor market conditions in a large number of countries. However, the employment growth was not strong enough to reduce unemployment rates substantially.

The U.S. economy expanded by an estimated 3.3 percent in 2006, despite a slowdown in growth during the year, following a contraction in investments in the housing market and a decline in production in the car industry due to increased international competition. Private consumption growth was more restrained compared to a year earlier, but government consumption growth was more pronounced. The labor market experienced little effect from the aforementioned slowdown in growth during the year as the unemployment rate contracted further. The financial deficit of the U.S. government decreased to its lowest point since 2001, stimulated by higher revenues associated with the positive business cycle. The U.S. current account deficit was marginally wider than in 2005. Consumer prices grew by 3.2 percent, slightly less than in 2005.

The Japanese economy grew by 2.2 percent in 2006, compared to 1.9 percent in 2005. This expansion was brought about mainly by increasing exports and investments, while both government and private consumption grew meagerly, despite improved labor market conditions. On average, consumer prices rose again for the first time since 1998. The Chinese economy, on the other hand, grew even stronger in 2006, i.e., by 10.7 percent (2005: 10.4 percent), thus recording for the third year in a row a 10-plus percent growth rate. This remarkable expansion was attributed mainly to staggering growth rates in exports and investments, despite measures taken by the Chinese authorities to limit these expansions.

In the Euro area, growth in 2006 nearly doubled that of 2005: 2.6 percent in 2006 versus 1.4 percent in 2005. This improvement was attributed mainly to higher growth rates in consumption, investments, and exports. The unemployment rate contracted by nearly one percentage point to 7.8 percent as a result of rising employment opportunities.

Dancing in the wind to the rhythm of the waves, the harbor is a lively community and village of trade and commerce, where seafaring business flourished through fish and fruit. It brought together different walks and talks of life, and played a pivotal role in our diverse and dynamic multi-cultural society.
(Source 2007 photograph: Alrric Kock; Source black & white photograph: Biblioteca Nacional Aruba)

The Latin American and Caribbean economies grew by 5.5 percent and 8.3 percent, respectively. These outcomes reflected mainly a sustained strong external demand for the region's commodities, complemented by high international prices for these products. In addition, domestic demand was boosted by a strong expansion of private credit, together with continued low interest rates and improved labor market conditions. Inflation in Latin America and the Caribbean region averaged 6.5 percent and 5.6 percent, respectively.

3.2 The domestic real sector

Preliminary information indicates that in 2006 the Aruban economy expanded at about the same pace as in the previous year. Fitch Ratings estimates a growth in real terms of 2.5 percent, compared to 2.4 percent in 2005, mainly affected by the positive performance in the sectors of "construction" , "financial intermediation" and "real estate and other business services."

In 2006, both the number of stay-over visitors and their nights spent on the island decreased by, respectively, 5 percent and 4 percent, compared to a 1 percent increase for both in 2005. According to the Aruba Tourism Authority, this drop in tourism growth was related largely to the higher energy prices affecting airline fares, and, domestically, limited hotel room inventory due to ongoing renovations, and high hotel room rates. In contrast, stay-over visitors in the Caribbean rose by an estimated 3 percent. Cruise tourism in Aruba, however, showed a 7 percent expansion in the number of passengers, compared to a 1 percent increase in the Caribbean region as a whole. Nevertheless, gross tourism receipts, as registered in the balance of payments, fell by 2 percent to Afl. 1,917 million in 2006. This amount accounted for 74 percent of total current account receipts (excluding the oil and free-zone sectors), 4 percentage points less than in 2005.

Compared to 2005, the 12-month average growth in the consumer price index accelerated slightly by 0.2 percentage point to 3.6 percent at end 2006. This acceleration was caused mainly by further increases in the energy-related components of inflation, i.e., water, electricity, and gasoline, induced by higher oil prices on the international markets, which remained higher than a year earlier, despite the sharp declines as of August 2006. The inflation rate was 0.4 percentage point above that of the United States, Aruba's major trading partner, thus resulting in an increase in the real exchange rate index of the Aruban florin vis-à-vis the U.S. dollar from 105.0 in 2005 to 105.4 in 2006. When adjusted for the energy-related components, the inflation rate accelerated to 1.9 percent in 2006, up from 1.7 percent in 2005.

Table 1 Main economic indicators

	2004	2005	2006
1. Gross domestic product			
a. Nominal GDP (in Afl. million) 1)	3,819	4,041	4,288
b. Population (period average)	97,658	100,629	102,817
c. Nominal GDP per capita (in Afl.)	39,106	40,152	41,705
d. Real GDP growth (in percent)	3.5	2.4	2.5
2. Labor market 2)			
a. Unemployment rate (in percent)	7.3	6.9	n.a.
b. Participation rate (in percent)	63.6	63.2	n.a.
c. Productivity growth (in percent)	-0.2	-1.2	n.a.
3. Tourism			
a. Tourism receipts (in Afl. million) 3)	1,883.6	1,953.0	1,917.0
b. Stay-over visitors (x 1,000)	728.2	732.5	694.4
c. Visitor nights (x 1,000)	5,639.9	5,694.5	5,470.5
d. Average hotel occupancy rate (Aruba) 4)	80.7	81.7	76.9
e. Average hotel occupancy rate (Caribbean)	68.4	68.6	n.a.
f. Average daily rate hotels (US$) (Aruba) 4)	145	174	177
g. Revenue per available room (US$) (Aruba) 4)	82	94	83
h. Revenue per available room (US$) (Caribbean)	94	102	n.a.
i. Cruise visitors (x 1,000)	576.3	552.8	591.5
j. Aruba's market share in the Caribbean (in percent)			
- stay-over visitors	3.8	3.7	3.5
- cruise tourism	2.9	2.9	3.0
4. Price developments			
a. Inflation (end of period, in percent)	2.8	3.8	2.5
b. Inflation (period average, in percent)	2.5	3.4	3.6
c. Real exchange rate index (1995 = 100) 5)	105.0	105.0	105.4

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

1) Figure for 2004 is an estimate by IMF. Figure for 2005 is an estimate by CBA. Figure for 2006 is based on the Fitch Ratings estimate June 2006.
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, 38.0 percent in 2004, 42.1 percent in 2005, and 44.8 percent in 2006.
5) Relative to the U.S.A. Based on CPI period-average.

3.3 The financial sector

In 2006, money supply expanded by Afl. 66 million, down from an expansion of Afl. 142 million a year earlier. Domestic money creation amounted to only Afl. 12 million, compared to Afl. 201 million in 2005. Commercial bank lending rose by 4 percent and remained below the credit growth guideline of 5 percent set by the Bank at the beginning of that year. Both credit to enterprises and housing mortgages went up by 6 percent, while consumer credit rose slightly by 1 percent. Transactions of the government with the monetary system contributed, on balance, with Afl. 48 million negatively to the increase in the money supply.

Net foreign assets of the monetary system grew notably by Afl. 53 million or 9 percent to Afl. 651 million. This increase was attributed in part to the receipt of the proceeds of a private placement on the international capital market by the government amounting to Afl. 91 million (US$ 51 million) and an Afl. 29 million (EUR 13 million) transfer of development funds from the Dutch government. Still the rest of the economy (excluding the oil and free-zone sectors) bought on balance Afl. 72 million in foreign exchange from the banking system to finance its foreign transactions. In contrast, the oil and free-zone sectors sold on balance Afl. 125 million in foreign exchange to the commercial banks during 2006.

On balance, monetary growth amounted to 3 percent in 2006 compared to 6 percent a year earlier. Quasi-money fell by 2 percent, while narrowly defined money rose by 9 percent. The reserve to monetary base ratio increased to 150 percent, up from 142 percent in 2005. The ratio of money supply to GDP decreased by two percentage points to 58 percent.

In 2006, the assets of the nonmonetary financial institutions rose further. Claims on the government grew by 8 percent, reflecting the participation in private placements of the government on the local capital market. Claims on the private sector increased by 5 percent, attributed largely to an increase in housing mortgages. The housing mortgage portfolio of the nonmonetary financial institutions went up by 6 percent in 2006 compared to an 11 percent

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

	2004	2005	2006
1. Net domestic money creation	51.3	201.4	12.1
a. Net domestic credit	117.1	217.6	48.8
1. Public sector	21.3	22.8	-48.1
2. Private sector	95.8	194.8	96.9
b. Other domestic factors	-65.8	-16.2	-36.8
2. Inflow of foreign funds 1)	19.9	-59.8	53.4
a. Current account (net)	6.9	-363.0	382.7
b. Capital and financial account (net) 2)	13.0	303.2	-329.3
3. Broad money creation	71.1	141.6	65.5
a. Money	27.6	4.1	90.5
b. Quasi-money	43.5	137.4	-25.0
4. Key indicators (in percent)			
a. 12-month change in money supply	3.2	6.2	2.7
b. Broad money coverage 3)	28.8	24.6	26.1
c. Money supply to GDP	59.8	60.1	58.1
d. Reserve to monetary base 4)	145	142	150

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 (in percentages) of net foreign assets of the monetary system to broad money.
4) Ratio (in percentages) of official reserves to the monetary base (i.e., total bank notes issued and outstanding liabilities to the banking system).

decrease a year earlier. However, their share in the total housing mortgage market remained unchanged at 37 percent. Net foreign assets of the nonmonetary financial institutions surged by 18 percent to Afl. 663 million, which is fifteen times more than the net foreign assets of the commercial banks.

On the liability side, pension fund provisions and the insurance reserve fund went up by 10 percent and 6 percent, respectively. Borrowings and deposits remained virtually unchanged.

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

	2004	2005	2006
1. Net foreign assets	489.8	562.3	662.6
2. Domestic claims	1,340.3	1,429.2	1,519.6
a. Government	551.1	633.1	684.8
b. Private sector, of which:	789.2	796.0	834.8
housing mortgages	469.3	418.2	442.3
3. Total assets = total liabilities	1,830.2	1,991.5	2,182.2
4. Borrowings and deposits	64.0	38.9	38.5
a. Government	36.7	36.6	36.6
b. Other residents	27.3	2.2	1.8
5. Pension fund provisions	1,379.1	1,495.4	1,640.1
6. Insurance reserve fund	288.4	305.4	322.5
7. Other items (net)	98.7	151.8	181.1
8. Key indicators			
a. Net foreign assets in % nominal GDP 2)	12.8	13.9	15.5
b. Total assets in % nominal GDP 3)	75.2	73.9	74.0
c. Share in total housing mortgages market	44.4	37.1	37.0

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 2006, total government revenue on a cash basis rose by a marked Afl. 75 million or 8 percent to Afl. 983 million, reflecting largely an Afl. 71 million or 9 percent increase in tax revenue to Afl. 850 million. The latter was brought about mainly by an Afl. 32 million rise in revenue from taxes on income and profit, in particular the wage tax. In addition, revenues from the foreign exchange tax surged by Afl. 25 million, following the levy on a large dividend payment to abroad. Moreover, taxes on commodities and on property went up by, respectively, Afl. 11 million and Afl. 3 million.

Total government spending on a cash basis (including net lending) rose further by Afl. 68 million (7 percent) compared to 2005, bringing the amount to Afl. 1,102.8 million. Payments for goods and services, salary-related expenses, and interest payments expanded by Afl. 50 million (33 percent), Afl. 37 million (7 percent), and Afl. 13 million (15 percent), respectively. In contrast, other items not included elsewhere shrank by Afl. 28 million (29 percent). Moreover, transfers by the government to the General Health Insurance (AZV) (comprising the government's annual contribution and advances to cover deficits of the AZV) declined by Afl. 11 million (8 percent), attributed in part to the increase in the AZV premium from 8 percent to 9.5 percent at the beginning of 2006. Net lending rose from Afl. 1 million in 2005 to Afl. 7 million in 2006 because a rise in lending (mainly reflecting outlays for student loans) was partly offset by the receipt of repayments on debt extended by the government to Utilities N.V. Investment outlays (which include development fund spending) rose by Afl. 1 million.

As a result of the earlier mentioned transactions, an Afl. 120 million financial deficit was posted in 2006, slightly lower than the deficit recorded in 2005. Unmet financing requirements contracted by Afl. 57 million to Afl. 126 million, reflecting declines in payment arrears to suppliers, government institutions (including the AZV), and the civil servants pension fund (APFA). Consequently, the financial deficit including the change in unmet financing requirements reached Afl. 62 million in 2006 compared to Afl. 152 million a year earlier.

Total financing needs of the government went down notably, from Afl. 314 million in 2005 to Afl. 183 million in 2006. To cover these financing needs, the government took out two private loans amounting to Afl. 24 million and Afl. 34 million, and issued Afl. 75 million in bonds on the local capital market, in addition to a private placement of Afl. 93 million on the international capital market. On balance, bank deposits of the government rose by Afl. 39 million at end-2006.

Outstanding public debt went up by Afl. 124 million or 7 percent to Afl. 1,996 million in 2006, a level equal to 47 percent of nominal GDP. This expansion was brought about by increases in both foreign and domestic debt of Afl. 75 million (9 percent) and Afl. 50 million (5 percent), respectively. The increase in foreign debt was attributed mainly to an Afl. 93 million (US$ 52 million) private placement on the international capital market, which was in part offset by an Afl. 17 million (US$ 9 million) annual repayment on a government bond issued in September 2005 and an Afl. 18 million (EUR 7 million) repayment on loans to the Dutch government in the framework of development aid. The increase in domestic debt was influenced by the acquisition of two private placements totaling Afl. 59 million and an Afl. 75 million bond issue.

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

	2004	2005	2006
1. Revenue and grants	835.9	908.9	983.4
a. Tax revenue	707.1	779.4	850.2
b. Nontax revenue	128.8	129.5	133.2
- grants	31.1	28.4	30.9
- other nontax revenue	97.7	101.0	102.3
2. Expenditures and items n.i.e. 2)	1,180.2	1,033.8	1,095.7
a. Personnel-related outlays 3)	566.3	505.2	542.2
b. Goods and services	191.1	152.9	203.1
c. Interest payments 4)	85.9	84.4	97.4
d. Investments	66.8	64.1	64.7
e. Transfer to the General Health Insurance (AZV)	130.8	130.4	119.7
f. Items n.i.e., of which: 5)	139.3	96.7	68.9
- transfers	38.7	60.4	55.4
- subsidies	24.2	22.7	26.3
- other	76.4	13.6	-12.8
3. Lending minus repayments	9.3	0.7	7.1
4. Financial deficit (-)	-353.6	-125.6	-119.5
5. Net foreign capital	95.6	47.1	58.2
6. Net domestic capital 6)	236.7	55.7	109.4
7. Net recourse to the monetary sector	-21.3	-22.8	48.1
8. Memorandum items			
a. Unmet financing requirements 7)	156.7	183.2	126.1
b. Financial deficit 8)	-224.7	-152.1	-62.4
c. Total government debt 9), of which:	1,706.5	1,871.6	1,995.6
- domestic debt	870.2	1,014.7	1,064.2
- foreign debt 10)	836.3	856.9	931.4
9. Key indicators			
a. Total debt in % nominal GDP	44.7	46.3	46.5
b. Foreign debt in % exports 11)	35.9	35.2	37.5
c. Debt service in % exports 12)	2.9	10.9	4.0

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 APFA debt conversion. Includes transactions related to foreign development cooperation.
2) 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.
3) Excluding the imputed amount related to the APFA debt conversion, the personnel-related outlays were Afl. 478.7 million in 2004.
4) Excluding the imputed amount related to the APFA debt conversion, the interest payments were Afl. 62.2 million in 2004.
5) 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.
6) 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.
7) Comprising all reported unsettled payment obligations to other sectors irrespective of the timeframe in which they mature.
8) Including the change in unmet financing requirements.
9) Preliminary (end-of-period) figures, excluding government guarantees.
10) At year-end exchange rates.
11) Exports of goods and services, excluding the oil sector.
12) Related to foreign debt. Exports exclude the oil sector.

3.5 Balance of payments

In 2006, the balance of payments registered an Afl. 53 million overall surplus, in contrast to an Afl. 60 million deficit in 2005. Consequently, net international reserves of the monetary system (including revaluation differences of gold and official foreign exchange holdings) strengthened significantly and reached Afl. 757 million at the end of 2006, up from Afl. 677 million a year earlier. Nonetheless, the 12-month merchandise import coverage ratio shrank from 5.5 months in 2005 to 5.2 months in 2006, and the 12-month average coverage ratio of all current account payments shrank to 2.7 months in 2006, down from 3.0 months in 2005. In 2006, the reserves of the Bank, including gold, surged by Afl. 125 million to Afl. 714 million compared to 2005. The remainder of the monetary sector's net foreign assets, held by the commercial banks, declined by Afl. 45 million to Afl. 43 million.

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

	2004	2005	2006
1. Current account (net)	6.9	-363.0	382.7
a. Oil sector	251.1	-58.6	960.3
b. Free zone	12.0	4.1	9.3
c. Rest of economy	- 256.3	-308.5	-587.0
1. Goods	-1,244.1	-1,330.2	-1,406.4
2. Services	1,245.4	1,304.0	1,169.1
3. Income	-116.4	-118.3	-185.5
4. Current transfers	-141.2	-164.0	-164.2
2. Capital and financial account (net)	3.5	288.3	-332.4
a. Oil sector	-181.9	110.3	-842.4
b. Free zone	-2.4	8.9	-1.9
c. Rest of economy	187.7	169.1	512.0
1. Capital account transactions	33.8	32.9	37.5
2. Direct investment	196.3	227.7	584.9
3. Portfolio investment	72.1	-6.4	-64.0
4. Financial derivates	0.0	1.5	-3.6
5. Other investment	-114.5	-86.6	-42.9
- loans	-61.5	-53.8	-86.6
- other financial transactions	-53.0	-32.8	43.7
3. Items not yet classified 2)	9.5	14.9	3.1
4. Overall balance (= 1 + 2 + 3)	19.9	-59.8	53.4
5. Total reserves of the monetary sector 3)	722.9	677.1	757.2
of which: official reserves	614.4	588.6	713.9
6. Import coverage in months of merchandise imports 4)			
a. End-of-period	5.5	4.7	5.2
b. 12-month average	6.2	5.5	5.2
7. Import coverage in months of current account payments 5)			
a. End-of-period	3.0	2.6	2.6
b. 12-month average	3.4	3.0	2.7

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 merchandise imports by total reserves of the monetary system. Imports of the oil sector are excluded.
5) Coverage of total payments for merchandise imports, services, income, and current transfers (excluding the oil sector) by total reserves of the monetary system.

The current account of the balance of payments showed an Afl. 383 million surplus in 2006, following an Afl. 363 million deficit in 2005, caused mainly by the external transactions of the oil sector. In 2005, this sector paid Afl. 706 million in dividends abroad, while no dividends were paid in 2006. Moreover, the surplus on the merchandise trade account of this sector widened further by Afl. 292 million or 22 percent in 2006.

However, the current account of the rest of the economy remains an issue of concern, as its deficit widened remarkably to Afl. 587 million or by Afl. 279 million compared to the deficit registered in 2005. This deficit is equivalent to 14 percent of GDP. This deterioration was caused primarily by a lower surplus on the services account associated in part with a decline in tourism receipts and a rise in payments for transportation, travel, and other services. In addition, both the deficits on the merchandise trade account and the income account widened further because of an increase in goods import payments and larger outflows related to dividend and interest payments. The deficit on the current transfers account remained virtually unchanged.

The Afl. 288 million surplus on the capital and financial account in 2005 turned into an Afl. 332 million deficit in 2006, due mainly to an increase in the oil sector's foreign bank deposits. This effect was countered in part by an Afl. 343 million widening capital and financial account surplus of the rest of the economy to Afl. 512 million. The latter resulted largely from a notable Afl. 357 million rise in the direct investment surplus, reflecting increased investment activities in the tourism and real estate sectors in Aruba. This improvement was offset in part by an Afl. 58 million larger portfolio investment deficit reflecting in part a rise in portfolio investment assets as more foreign securities were purchased. The deficit on the other investment account narrowed by more than half, primarily reflecting a decrease in foreign account balances of various local enterprises.

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 Company Pension Funds (AB 1998, GT 17), and the State Ordinance on the Supervision of Money Transfer Companies (AB 2003, No. 60). In addition, the Bank is entrusted with overseeing compliance with the stipulations of the State Ordinance on the Identification for Rendering Financial Services (AB 1995, No. 86), insofar as it concerns the financial institutions under its supervision.

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, it holds regular bilateral meetings with the institutions concerned and with their representative organizations.

The Bank undertakes periodic on-site examinations to assess key risk areas, such as financial condition, asset quality, corporate governance, and anti-money laundering and terrorist financing procedures. During 2006, three commercial banks, two bank-like institutions, four insurance companies, one company pension fund, and three money transfer companies were examined on-site. Based upon the findings, some of the examined institutions were required to take corrective action.

4.2 Major policy issues and developments

4.2.1 Legislative framework

Much improvement has been made over the years in expanding the supervisory framework to other parts of the financial sector. However, it remains important, also in view of the international standards for financial sector regulation and supervision and the combating of money laundering and terrorist financing, to expand on short term the supervisory scope to company service providers and -- in view of the more recently established electronic stock exchange in Aruba -- stock exchanges. Note that the draft State Ordinance on the Supervision of Trust Companies is in the legislative process, while a proposal currently is being drafted to bring stock exchanges under the Bank's supervision.

Furthermore, with technical assistance from De Nederlandsche Bank N.V., proposals currently are being drafted to strengthen the supervisory ordinances for the banking and insurance industry. The aforementioned is being done mainly to address the legislative shortcomings

If streets could talk, what a story they would tell, of man and machine, awestruck by architecture. The capital of nation resides not in economy or geography, but in the mentality, mobility and morphing of a nation...
(Source 2007 photograph: Alrric Kock; Source black & white photograph: Archivo Nacional Aruba)

identified by the International Monetary Fund (IMF) and to provide the Bank with a more solid legal basis to enforce compliance with the supervisory laws and regulations governing the banking and insurance industry. The Bank strives to submit final proposals before the end of June 2007 to the Minister of Finance and Economic Affairs for his approval, after which the legislative process can commence.

A follow-up Offshore Financial Center Sector assessment is planned by the IMF in the last quarter of 2007. The revised and extended core principles for effective banking and insurance supervision will be used as a benchmark by the IMF for this assessment. The almost continuous changes in the international supervisory landscape make it necessary to regularly revise the supervisory laws and regulations, which is quite a challenge for smaller jurisdictions like ours with limited resources.

In view of the continuous expansion and strengthening of the supervisory framework and the increasing associated costs, it is inevitable to charge (part of) the supervision costs to the sectors supervised. This practice is common in most countries. At present, only the insurance sector is charged on the basis of a State Decree on the charging of supervision costs to the insurance sector (AB 2006, No. 3), which came into effect on February 3, 2006. On February 28, 2007, a State Decree on the charging of supervision costs to the money transfer sector (AB 2007, No. 18) came into effect, allowing the Bank also to charge (part of) the costs connected with the execution of the State Ordinance on the Supervision of Money Transfer Companies to this sector as of March 2007. Similar decrees will likely be implemented soon for the banking sector and the company pension funds.

4.2.2 Revised policy rule for admission and licensing of banks and insurance companies

In August 2006, the Bank issued a revised policy rule for the admission and licensing of banks and insurance companies. This in order to be able to better protect the interests of Aruban depositors and policyholders. The main developments that led to this decision can be summarized as follows:

1. Over the past years, some large international banks and insurance companies have exited the local market and sold their operations to regional financial institutions or private shareholders, increasing the risk profiles of these institutions.
2. Supervisory legislation in some jurisdictions in the region does not (yet) permit the home country supervisor to exercise consolidated supervision, while in some cases the gathering of group-level information has proven very difficult, impairing the Bank's ability to conduct effective oversight.

Under the revised policy rule, a foreign bank or insurer is only allowed to operate via a branch office (or an agency in the case of an insurer) if it is an international bank or insurer with a balance sheet total of at least US$ 10 billion and an "A" rating issued by Standard & Poor or a comparable rating agency. Foreign banks or insurers that already operate in the Aruban market via a branch office or agency and do not meet the aforementioned conditions are required to establish a separate legal entity in Aruba before July 1, 2007, through which they can continue their banking or insurance activities on this market.

4.2.3 Issuance of new and revised directives

4.2.3.1 Banking sector

Risk-weighted capital assets ratio

The potential risks for banks operating in a small and undiversified economy are quite high. Therefore, they must maintain sufficient reserves to absorb possible losses stemming from economic downturns. For that reason, the Bank decided to increase the minimum risk-weighted capital assets ratio for banks from 10 to 12 percent, effective January 1, 2007. Branches or subsidiaries of international banks that fall under consolidated supervision are allowed to maintain a minimum risk-weighted assets ratio of 8 percent.

Internal audit

In October 2006, the Bank issued a directive on internal audit in banks, which became effective as of May 1, 2007. This directive is based largely on the paper "Internal audit in banks and the supervisory relationship with auditors" issued by the Basel Committee on Banking Supervision in August 2001. The internal audit directive contains high level principles, which banks should follow when setting up their internal audit. Within the meaning of this directive, internal audit is defined as an independent, objective assurance and consulting activity designed to add value and improve the effectiveness of risk management, control, and governance processes.

Management and reporting of incidents

In December 2006, the Bank issued a directive on the management and reporting of incidents for banks, effective January 1, 2007. Incident management is essential for safeguarding the integrity of a bank. According to this directive, incidents are defined as events that constitute a serious risk to the integrity of a bank, if they concern the conduct of an officer or a person who determines the day-to-day policy of the bank, or a holder of a qualifying shareholding in the bank or a natural person or legal entity that performs activities for the bank.

4.2.3.2 Insurance sector

Combating money laundering and terrorist financing

In October 2006, the Bank issued a revised directive on anti-money laundering and the combating of terrorism for insurance companies. The directive is derived primarily from the guidance paper on anti-money laundering and combating terrorism issued by the International Association of Insurance Supervisors in October 2004, and contains minimum standards in the areas of customer acceptance, customer identification, accounts and transaction monitoring, and risk management. All insurance companies are required to comply with this revised directive before July 1, 2007.

4.2.4 Pawn shops

In general, the activities of pawn shops fall under the scope of section 48, paragraph 1, of the State Ordinance on the Supervision of the Credit System (SOSCS), as most of these shops offer their clients an option to repurchase their goods within a certain period of time against a fee (read: interest). Such pawn contracts are considered loan agreements and, subsequently, fall under the scope of the noted section. Based on information obtained from the companies register of the Chamber of Commerce, it can be concluded that the number of pawn shops, also known as "compra y venta companies", operating in Aruba over the past few years has increased considerably. Section 48, paragraph 1 of the SOSCS prohibits approaching the public for the granting of loans without an exemption from the Bank. Based upon section 48, paragraph 3 of the SOSCS, the Bank recently issued an exemption policy for pawn shops. All pawn shops registered at the Chamber of Commerce or identified via other open information sources have been notified by the Bank that if they do not apply soon for an exemption, they will have to cease their pawn activities. One request for an exemption was denied and currently is being disputed in court.

4.3 Changes in the registers of supervised institutions and changes in shareholding

4.3.1 Banking sector

On January 10, 2006, the Bank granted AIB Bank N.V. permission to acquire a qualified holding in Stichting Onroerend Goed Aruba.

On January 30, 2006, the Bank granted Parman International B.V., a private equity company, permission to acquire the majority of shares of Banco di Caribe N.V.

On May 26, 2006, the Bank granted Orco Bank International Bank N.V. permission to acquire all shares of Aruba Bank N.V. through Orco Aruba Holding N.V.

On October 25, 2006, the Bank approved the acquisition of the issued and outstanding capital stock of Island Finance Aruba N.V. by CFG Aruba Holding N.V., a company ultimately owned by Bear Stearns Merchant Banking Partners III, L.P. and BSC Employee Fund VIII, L.P.

4.3.2 Money transfer companies

In early 2006, De Palm Financial Services N.V. decided to cease its money transfer activities. The Bank cancelled its registration as a money transfer company as of March 1, 2006, reducing the number of registered money transfer companies to three.

4.3.3 Insurance sector

On January 30, 2006, the Bank granted Parman International B.V. approval to purchase the majority of the shares of Ennia Caribe Holding N.V.

On January 31, 2006, the Bank granted British United Provident Association Iberia, S.L. permission to acquire all outstanding shares in Amedex Insurance Company.

On May 19, 2006, the Bank granted Mondis Manufacturing Insurance Company N.V. a license to conduct non-life captive insurance business in the category "pure captive".

Note also that the Stichting Pensioenfonds N.V. Aruba Bank is in liquidation. The employer has decided to insure its pension obligations directly at one of the local insurance companies. The liquidation process is expected to be finalized shortly. Until then, the subject fund remains under the Bank's supervision.

4.4 Integrity of the financial system

The Financial Action Task Force (FATF) is planning a mutual evaluation of the Aruban framework for combating money laundering and terrorist financing in 2008. Aruba, as part of the Kingdom of the Netherlands, is a member of this internationally recognized standard-setter in the area of anti-money laundering and combating terrorist financing and has committed itself to implement the 40+9 FATF recommendations in the area of combating money laundering and terrorist financing. The objective of the upcoming mutual evaluation is to review Aruba's adherence to the 40+9 FATF recommendations. Although some important progress has been made over the years in implementing the FATF recommendations, including the recent enactment of the revised Sanction Ordinance, room remains for further improvement. For example, it is important that the draft State Ordinance on the Supervision of Trust Companies is enacted soon and that the scope of the unusual transaction reporting obligation is extended to other sectors and financial service providers.

At present, only 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 FATF recommendations, 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).

To maintain Aruba's reputation as a premier location for international financial services, it is of utmost importance to bring Aruba's recently started electronic stock exchange under some form of supervision. The reputational risks are too high, if left unsupervised. Thus, the Bank has advised the Minister of Finance and Economic Affairs to implement a law regulating stock exchange activities quickly. The Minister of Finance and Economic Affairs has followed-up on the Bank's advice and has requested that the Bank draft a proposal.

4.5 Supervisory forums and cross-border cooperation

The Bank actively monitors global developments in the supervisory arena, inter alia, by attending meetings of regional and international supervisory groups of which it is a member or an observer, and by participating in seminars and courses.

In May 2006, the Bank also hosted the XXIV (24th) Annual Conference of the Caribbean Group of Banking Supervisors, which had as a central theme "The Paradigm Shift of Regulation in the Caribbean Region." Important topics discussed during this meeting were the use and misuse of corporate vehicles, the emerging role of stress testing, and the implications of mergers and acquisitions in the context of conglomerate and consolidated supervision.

The Bank was represented at the bi-annual International Conference of Banking Supervisors (Merida, Mexico, October 2006), at which meeting also the revised Basel Core Principles for Effective Banking Supervision were endorsed, and at the Annual Conference of the International Association of Insurance Supervisors (Beijing, China, October 2006). Some of the topics discussed during these meetings were the revised Basel Capital Accord for banks, the development of global solvency standards for insurers, corporate governance and disclosure, and cross-border cooperation and information exchange.

In August 2006, the Bank also became party to a Multilateral Memorandum of Understanding (MMOU) on cross-border cooperation and information exchange between several supervisory authorities within the Caribbean region. Note that the increasing cross-border activities of regional financial groups have increased the need for enhanced regional cooperation and information exchange with respect to these financial groups and were the driving force for establishing this MMOU.

4.6 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 2006.

4.6.1 Banking sector

Commercial banks

The aggregated balance sheet total of the four commercial banks increased by Afl. 173 million or 5 percent to Afl. 3,514 million at the end of 2006, equivalent to 82 percent of the estimated GDP for 2006. The banks' aggregated risk-weighted capital asset ratio rose by 1 percentage point to 13 percent, well above the required minimum of 10 percent. As of 2007 a minimum of 12 percent is required. The banks' aggregated prudential liquidity ratio rose by 2 percentage points to 28 percent, significantly above the required minimum of 20 percent. Net income before taxes rose sharply by Afl. 17 million or 19 percent to a record-high of Afl. 104 million, mainly the result of increases in both the interest and noninterest income.

Offshore banks

The number of offshore banks registered in Aruba has remained for many years at two. These two banks are affiliated with Citibank and, thus, fall under the consolidated supervision of the U.S. authorities. The offshore banks' aggregated balance sheet total was Afl. 518 million at the end of 2006, a further decrease of Afl. 55 million or 10 percent compared to 2005. The sharp decrease is mainly the result of the decision of Citibank N.A. to reorganize its Aruban offshore activities and to remain with only one offshore entity in Aruba, namely, Citibank Aruba N.V. The aggregated risk-weighted capital ratio of the two offshore banks increased further from 50 to 62 percent, far above the minimum of 8 percent applicable to offshore branches or subsidiaries of internationally active banks. The two offshore banks operated with a profit (before taxes) of Afl. 39 million, an increase of Afl. 21 million compared to 2005. This notable growth was mainly the result of a rise in the net interest margin due to a recovery on interest already written off on a nonperforming loan as well as an increase in the release of loan loss provisions.

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. Their aggregated balance sheet total amounted to Afl. 603 million at the end of 2006 and, thus, remained virtually unchanged compared to 2005. Their combined loan portfolio was Afl. 420 million at the end of 2006 (2005: Afl. 413 million), equivalent to 10 percent of the estimated GDP for 2006. The aggregated risk-weighted capital ratio of the bank-like institutions increased from 45 percent to 47 percent, significantly exceeding the minimum requirement of 10 percent. Their net income (before taxes) decreased slightly by Afl. 1 million to Afl. 16 million in 2006.

Money transfer companies

In 2006, approximately 243,000 outgoing transfers were executed by the three registered money transfer companies and via the two companies with an exemption as meant in section 10 of the State Ordinance on the Supervision of the Money Transfer Companies (SOSMTC), comprising a total amount of Afl. 112 million (2005: 275,000 outgoing transfers for a total of Afl. 106 million). As in 2005, approximately 15,000 incoming transfers in the amount of Afl. 12 million were recorded. Also in 2006, Colombia remained the major destination of the funds transferred abroad via this sector, accounting for 57 percent of all outgoing money transfers.

4.6.2 Insurance sector

Nonlife insurance companies

At the end of December 2005, the aggregated balance sheet total of the thirteen nonlife insurance companies amounted to Afl. 167 million (equivalent to 4 percent of the GDP for 2005), i.e., a 4 percent increase compared to 2004. Investments rose by Afl. 4 million to Afl. 96 million, mainly the result of an increase in time deposit holdings. At the end of 2005, only 2 percent of the investment portfolio consisted of foreign investments (2004: 3 percent). On the liability side, the technical provisions declined by Afl. 11 million or 19 percent to Afl. 47 million, mainly due to a release in the provision for accident and health insurance by one of the local insurance companies in connection with a favorable outcome of a court case. The capital and reserves of the nonlife insurers went up by Afl. 8 million to Afl. 61 million, while their net income (before taxes) rose by Afl. 13 million to Afl. 17 million. The aggregated coverage ratio of the nonlife insurers grew substantially by 63 percentage points to 306 percent, far above the minimum requirement of 100 percent.

Life insurance companies

At the end of 2005, the aggregated balance sheet total of the eight life insurance companies amounted to Afl. 452 million (equivalent to 11 percent of the GDP for 2005), a significant increase of Afl. 53 million or 13 percent compared to 2004. Their investments rose by Afl. 64 million or 21 percent. This increase was attributable mainly to a rise in government bond holdings of Afl. 58 million. About Afl. 50 million or 13 percent of their investment portfolio consisted of foreign investments, compared to Afl. 42 million or 13 percent in 2004. On the liability side, the technical provisions and capital and reserves rose by Afl. 39 million or 12 percent and Afl. 9 million or 19 percent, respectively. Net income (before taxes) decreased sharply by Afl. 10 million to Afl. 5 million, mainly the result of increases in net claims, additions to the technical provisions, and management expenses. The coverage ratio remained unchanged at 118 percent at the end of 2005 and is well above the minimum solvency requirement of 100 percent.

Company pension funds

The aggregated balance sheet total of the ten company pension funds (excluding the figures of Lago Annuity Foundation, whose pension obligations are covered by a guarantee from ExxonMobil) amounted to Afl. 213 million at the end of 2005 (equivalent to 5 percent of the GDP for 2005), i.e., a 6 percent increase compared to 2004. On the assets side, investments grew by Afl. 10 million to Afl. 192 million. The foreign investments were Afl. 95 million or 49 percent of the total investment portfolio. On the liability side, technical provisions rose by Afl. 10 million to Afl. 182 million. Capital and reserves increased by 18 percent to Afl. 29 million at the end of 2005. The aggregated coverage ratio has continued to rise after a sharp decline of this ratio in 2002. Nonetheless, two company pension funds still do not comply with the minimum coverage ratio requirement of 100 percent. In 2006, the Bank continued to closely monitor the developments at these two pension funds.

4.6.3 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 (APFA), the Social Security Bank (SVB), and the General Health Insurance (AZV). In view of their importance to the Aruban economy the (financial) developments at these institutions are briefly discussed.

The Civil Servants Pension Fund (APFA)

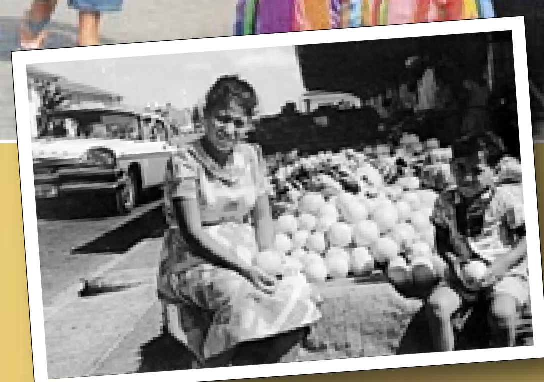
In January 2005, the State Ordinance on the Privatization of the Civil Servants Pension Fund (AB 2005, No. 2) was enacted. This ordinance became effective as of May 1, 2005. As part of the privatization process, APFA was converted into a foundation on April 29, 2005. In addition, a new pension scheme based on the average income was introduced in May 2005 for new participants. However, to date the unsustainable pension scheme for participants that joined APFA prior to May 2005 has not been amended. Note that APFA will fall under the Bank's supervision as soon as the pension scheme for the latter group has been amended and, subsequently, the Pension Ordinance Civil Servants has been revoked. Until then, APFA will remain under the supervision of the Minister of Finance and Economic Affairs. Although in 2005 APFA's coverage ratio improved slightly by 1 percentage point to 80 percent, it remained far below the minimum coverage ratio of 100 percent applicable to company pension funds. Therefore, it is imperative that a more sustainable pension scheme is introduced for participants who joined the APFA prior to May 2005.

The Social Security Bank (SVB)

The SVB is responsible for the execution of various social security funds, including the general old age pension fund (AOV fund). SVB's preliminary figures indicate a financial deterioration in 2005. These figures show a net loss of Afl. 11 million for 2005 (2004: net profit of Afl. 21 million), mainly the result of a decrease of Afl. 10 million in premium income and an Afl. 17 million increase in claims. The aggregated capital and reserves amounted to Afl. 271 million at the end of 2005 (2004: Afl. 282 million). Due to the absence of audited financial figures, no in-depth analysis of SVB could be undertaken.

The General Health Insurance (AZV)

In 2005, the AZV incurred a net loss of Afl. 34 million or 1 percent of estimated GDP for 2005, Afl. 5 million higher than the loss incurred in 2004. The deficits of AZV are by law covered by the government. To reduce the unsustainable deficits, the AZV premium was increased from 7.5 percent to 9.5 percent on January 1, 2006. The result will be a significant deficit reduction.


ARUBA


Financial statements

5

The Caribbean flaunts its colors and flavors in the market place, while jolly-go-happy locals and visitors enjoy the daily gossips. Today, the Caribbean flaunts its colors and flavors in a virtual market space, where visitors tour and share their travel experiences.
(Source 2007 photograph: Alrric Kock; Source black & white photograph: Biblioteca Nacional Aruba)

Balance sheet as of December 31, 2006 1), after profit distribution

(in thousands of Aruban florin)

	2006	2005
Assets		
Gold	126,424	102,022
Foreign currency assets	604,698	489,590
Receivables	7,330	8,184
Printing cost of bank notes	508	1,000
Premises	10,699	11,341
Other fixed assets	2,687	2,860
	752,346	614,997
Liabilities		
Bank notes issued	180,097	162,680
Deposits of residents	361,896	279,034
Deposits of nonresidents	17,172	2,969
Money in custody	778	612
Payables and accrued expenses	8,310	12,332
Revaluation account	105,907	79,184
General reserve	68,186	68,186
Capital	10,000	10,000
	752,346	614,997

1) Abbreviated

Profit and loss account for the year 2006 2)

(in thousands of Aruban florin)

	2006	2005
Net interest revenues	21,066	14,714
Foreign exchange	1,843	1,260
Coins	939	1,100
Various revenues	382	411
Total income	24,230	17,485
Printing cost of bank notes	494	491
Personnel expenses	8,047	8,092
Operating expenses	2,555	2,320
Depreciation	1,829	2,251
Total expenses	12,925	13,154
Profit	11,305	4,331
Profit distribution		
Allocated to the Treasury	11,305	4,331
General reserve	-	-

2) Abbreviated

Explanatory notes to the balance sheet and the profit and loss account 2006

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 for 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 2006.

2.2 Accounting policies

The Bank adheres to the accounting policies 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 an 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 of 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 in the profit and loss account, 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 29, 2006, the market price for gold was US$ 635.70 or Afl. 1,137.90 (2005: US$ 513 or Afl. 918.27) 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.	
	2006	2005	**2006**	2005
	111,103	111,103	**126,424**	102,022

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 29, 2006 amounted to Afl. 55,236,935 negative (2005: Afl. 33,907,743 negative) based on the market price of gold as of December 29, 2006. This market-to-market value was 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 papers 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 receivables, such as prepaid expenses and checks in transit.

3.4 Printing cost of bank notes

In December 2003, a revised series of Aruban florin bank notes was printed, containing additional security features. One-fifth of the total printing costs was charged to the profit and loss account. On February 1, 2004, these notes were brought into circulation, replacing 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. At the end of 2006, the Bank began construction of a new public entrance to the Cash and Vault Department, which will be finished in 2007. Also, in 2007 a security booth will be constructed at the gate entrance of the Bank's building. Therefore, at the end of 2006, an amount of Afl. 353,000 had been accrued for the construction works.

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	2006	2005
5	885	890
10	6,114	5,868
25	13,523	12,429
50	16,392	15,003
100	136,539	121,456
500	6,644	7,034
Total	180,097	162,680

3.8 Deposits of residents

Deposits of residents comprise the following items:

(in thousands of Aruban florin)

	2006	2005
Government	35,817	11,091
Development funds	2,452	151
Banks:		
- current accounts	46,302	63,491
- monetary cash reserve	226,539	183,287
- time deposits	35,503	7,732
Other	15,283	13,282
Total	361,896	279,034

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.

Other

This includes mainly 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, interest payable on government securities, checks outstanding, pension reserve, an accrual for foreign asset management and custodian fees, and for several construction works that will be completed in 2007.

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)

	2006
Beginning balance	68,186
Additional profit distribution	-
Balance at the end of the year 2006	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)

	2006	2005
Interest revenues	21,516	15,065
Interest expenses	450	351
Net interest revenues	21,066	14,714

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 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 the supervisory expenses charged to insurance companies and fees charged, among others, to the commercial banks 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 64 persons full-time (2005: 62 persons).

4.6 Operating expenses

These consist mainly of expenses for 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 Board of Supervisory Directors decided to allocate the 2006 profit of Afl. 11.3 million to the Treasury.


BOTTOM FISHING
OLYMPIC TOURS

Report of auditors

We have audited the abbreviated financial statements of the Centrale Bank van Aruba in Oranjestad, Aruba, for the year 2006 (as set out on pages 37 to 45). These abbreviated financial statements have been derived from the financial statements of the Centrale Bank van Aruba for the year 2006. In our auditors' report dated June 12, 2007 we expressed an unqualified opinion on these financial statements. These abbreviated financial statements are the responsibility of the management of the Centrale Bank van Aruba. Our responsibility is to express an opinion on these abbreviated financial statements.

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

For an understanding of the financial position and results of the Centrale Bank van Aruba and for an adequate understanding of the scope of our audit, the abbreviated financial statements should be read in conjunction with the financial statements from which the abbreviated financial statements have been derived and our unqualified auditors' report thereon issued on June 12, 2007.

Aruba, June 12, 2007

PricewaterhouseCoopers Aruba

Edsel N. Lopez

While we reminisce on restaurants that once were our playground, playing skippy on the pier, or frolicking during our first date, they are a gentle albeit nostalgic reminder that nothing lasts forever, except for change....
(Source 2007 photograph: Alrric Kock; Source black & white photograph: Biblioteca Nacional Aruba)