A REFLECTION OF PERSEVERANCE AND RESILIENCE

Address by Drs. R. Henriquez, President of the Centrale Bank van Aruba, on the occasion of the official opening of Aruba Bank's new head office November 20, 2004

The Honorable Governor of Aruba, Mr. Refunjol; Prime Minister Mr. Oduber; Chairman of Parliament, Mr. Werleman; Board and management of Aruba Bank, ladies and gentlemen.

I am very pleased to have the opportunity to address you on this joyous occasion of the official opening of the new head office of Aruba Bank here at Camacuri.

Aruba Bank N.V. was founded in 1925 as the first bank on the island. During the 79 years since than, Aruba Bank has demonstrated endurance and professionalism, and confidence in the economy of Aruba. It showed its support when Aruba went through periods of recession and strong economic growth and when Aruba entered a new and uncertain constitutional phase, the Status Aparte. Management and staff persevered during trying times to remain one of the larger commercial banks on our island.

Since its establishment, Aruba Bank has shown resilience in facing challenges and overcoming hardships. It made a significant contribution to the economic development of the island by among other things, providing the financial means for investments in both large and small projects, financing housing mortgages for Aruban families, and keeping up with the modernization process in the banking sector, thereby improving its efficiency and service to its clients.

We are now standing at this building and looking towards the future for Aruba Bank. This bright future is also our scope of reflection on the Aruban economy. An economy that during 2001 and 2002 endured a recession with a gross domestic product shrinking by an estimated 3 percent on a cumulative basis. However, stimulated by a more favorable external environment, the economy started to show signs of a recovery in 2003. Its production volume rebounded by 1.5 percent spurred by the positive development in tourism, as well as in investments. Estimates indicate that our economy is expected to grow further by 3 percent in 2004, and 3 to 3.5 percent growth is expected for the next year.

In particular, the tourism sector, the mainstay of our economy, has shown a remarkable rebound. During the first nine months of 2004, tourism picked up considerably. Nights spent by stay-over visitors went up by 11 percent more than the corresponding period a year earlier, and surpassed the level reached in 2000. The average hotel occupancy rate grew by 7 percentage points to 81 percent. Cruise tourism also improved. Passenger arrivals rose by almost 2 percent compared to a decline of 9 percent during the corresponding period a year earlier. The improvement in the tourism sector was also reflected in higher receipts. During the first six months of 2004, these receipts rose by 23 percent, compared to a decrease of almost 2 percent during the same period in 2003.

Entrepreneurs have a renewed optimism about short-term economic prospects. This optimism is reflected in the notable rise in private sector investments, particularly in the tourism sector, which include expansions of existing hotels and construction of new hotels and other tourist facilities. In addition, the public sector implemented several projects, including some infrastructural works, either financed with budgetary funds or through the Fondo Desaroyo Aruba.

Inflationary pressures are currently rather subdued. At the end of September 2004, inflation measured 2.3 percent, down from 4.1 percent at the end of September 2003. Consequently, the price differential with the United States, Aruba's main trading partner, shrank to zero, thus improving Aruba's competitive position. Estimates indicate that the rate of inflation in 2004 is expected to be lower than in 2003, but may rekindle again in 2005, depending on developments in the international oil market and the emerging economic recovery, which could trigger an increasing scarcity of labor, thus leading to higher wage costs.

One major concern of the Centrale Bank van Aruba (the Bank) is the continued pressure being exerted on the foreign exchange reserves. As the guardian of the value of the Aruban florin, the Bank implements its monetary policy with the aim of safeguarding financial stability and maintaining confidence in the currency peg of the florin with the U.S. dollar. To achieve this goal, a comfortable level of foreign exchange reserves should be maintained. Having a coverage ratio of international reserves of over 6 months of merchandise imports would seem quite comfortable. However, these reserves are under increasing pressure because of a persisting and widening deficit on the current account (excluding the oil and free-zone sectors) of the balance of payments. This deficit is caused mainly by increasingly higher imports of goods, largely reflecting an excessive liquidity creation and lending within the banking sector. In 2003, the mentioned deficit amounted to Afl. 330 million.

This continued current account deficit is unsustainable for a small and open economy like Aruba's. To reduce the pressure on the foreign exchange reserves, the Bank resorted to a tighter monetary policy at the beginning of 2004. This policy is geared towards containing the excessive growth in bank lending, which is induced by the consumptive urge of the public and the excess liquidity within the banking sector. This policy seems to be bearing some fruits. During the first nine months of 2004, banking sector credit grew by almost 6 percent, about half of the credit expansion experienced in 2003. Still, it is troublesome that consumer credit has maintained the strong growth rate of a year earlier.

Another concern of the Bank is the structural weakness in public finances. The excessive consumptive spending of the government is largely the result of the large wage bill, the budgetary contributions to the civil servants' pension fund, and the general health insurance. These spending categories absorb a notable 92 percent of total tax revenue, leaving little room for investments and repaying debt. Consequently, to cover its budgetary deficits and to refinance maturing debt, the government resorts regularly to commercial borrowings on the domestic as well as the international capital market, thereby pushing up its outstanding debt. As of the end of September 2004, total government debt reached Afl. 1.7 billion, equivalent to 47 percent of the GDP of 2003.

The expansionary debt policy of the government also exerts a temporary upward effect on the level of foreign exchange reserves. However, this effect is not a real improvement because the increase was brought about by borrowed reserves and not as a result of the actual production process. In this context, I should mention that during the first nine months of 2004, net foreign assets increased by Afl. 39 million to Afl. 683 million. Yet, this rise was caused mainly by a substantial Afl. 119 million increase in the government's foreign commercial loans. The other foreign economic transactions, on the other hand, led to an Afl. 80 million decline in net foreign assets during the indicated period, with the current account (excluding oil and free-zone sectors) showing a deficit of Afl. 99 million.

In the past, the Bank has issued recommendations to the government to solve its structural problems with respect to the size and quality of the public service apparatus, the pension system for civil servants, and the general health insurance. Given the effect of budgetary and debt policy on the level of foreign exchange reserves and, thus, ultimately on financial stability, it is of utmost importance for the government to re-evaluate its policy and seriously consider the implementation of these recommendations without further delay. It is worth mentioning the importance of periodic consultation visits of an independent institution like the International Monetary Fund. During these visits, this distinguished institution assesses recent economic, financial, fiscal, and monetary developments. In this context, the delegation also evaluates the effects of the relevant policies on the economy. Their next visit will take place from January 12 to 19, 2005. Many of you here present will have the opportunity to meet the delegation and discuss these matters with them. Afterwards they will issue their findings and recommendations in a report. It is very important that we all take note of these recommendations and implement them as much as possible for the benefit of Aruba.

In conclusion, I can say that after years of building up the economy, we are now facing economic challenges more related to the consolidation of the economy. Even though the future looks bright, measures must still be taken. But I am confident that with both the private and public sectors doing their part and cooperating with each other, the resilience of the Aruban economy will once more be demonstrated. I again congratulate the Board, management, and staff of Aruba Bank upon the opening of their new head office. May the future be even more exciting and fruitful than the past years. "Masha pabien y hopi exito."

Thank you for your attention.