



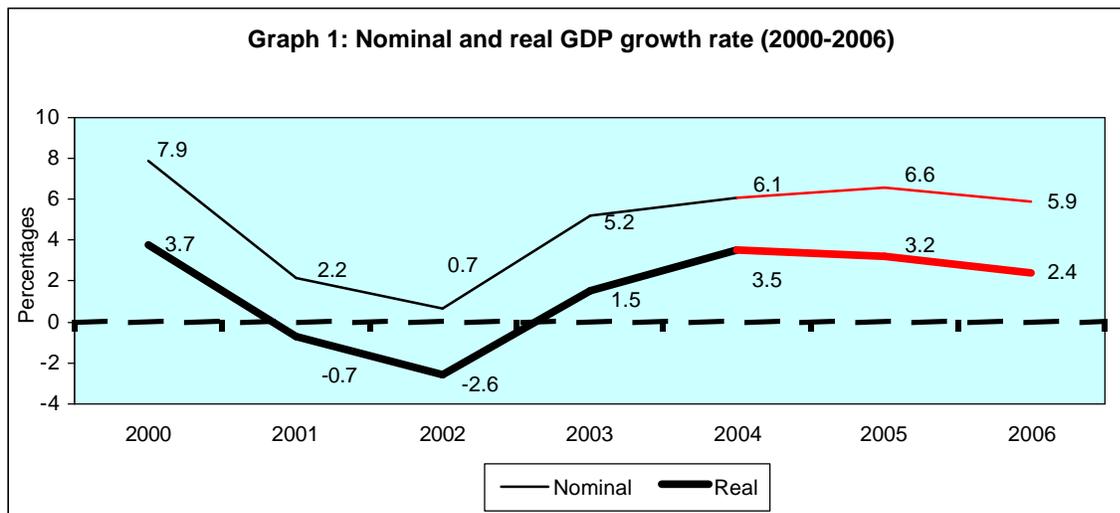
CENTRALE BANK VAN ARUBA

The state of the Aruban economy

*An update prepared for the meeting with the Chamber of Commerce of Aruba
on March 15, 2006.*

1. Economic growth

According to IMF estimates, real GDP growth for 2005 will amount to 3.2 percent (see graph 1). This is a slight contraction of the real economic growth estimated at 3.5 percent in 2004. For 2006 a further contraction is expected, as preliminary estimates of the IMF show a real GDP growth of 2.4 percent.



2. Tourism

The Aruba Tourism Authority is having problems gathering data on tourist arrivals and nights spent on the island. The most updated figures in this area are for the month of November 2005. These figures show that in the first eleven months of 2005, the tourism sector expanded further, albeit at a more moderate pace than in the corresponding period a year earlier. The number of stay-over visitors and their nights spent on the island increased by 1.2 percent and 1.3 percent during the first eleven months of the year, respectively, compared to 13.5 percent and 11 percent in the same period of 2004 (see table 1). Tourism receipts, as registered by the Centrale Bank van Aruba (the Bank) through the balance of payments, rose by 4 percent to Afl. 1,953 million in 2005, compared to a notable 23.4 percent increase a year earlier.

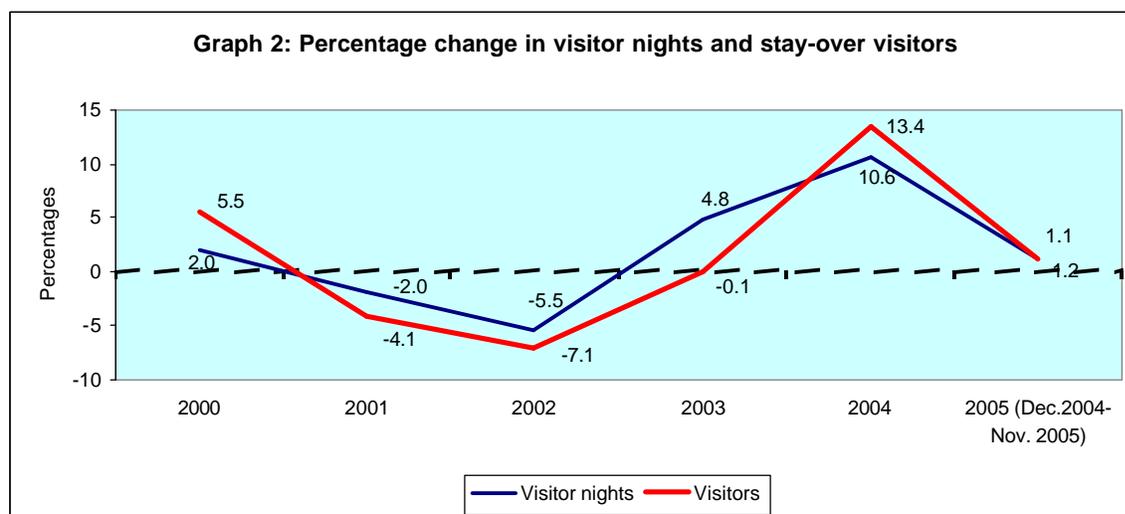
Table 1: Tourism

	2002	2003	2004	2005
Stay-over tourists	642,627	641,906	728,157	675,304 ¹⁾
Nights spent	4,862,548	5,097,571	5,639,869	5,190,129 ¹⁾
Cruise tourists	582,195	542,327	576,320	552,819
Tourism receipts (in Afl. million)	1,473.4	1,521.6	1,877.3	1,953.0
<i>Percentage changes</i>				
Stay-over tourists	-7.1	-0.1	13.4	1.2 ²⁾
Nights spent	-5.5	4.8	10.6	1.3 ²⁾
Cruise tourists	19.5	-6.8	6.3	-4.1
Tourism receipts	0.8	3.3	23.4	4.0

Source: Centrale Bank van Aruba; ATA; Cruise Tourism Authority.

¹⁾ Data refer to the period January-November. The data for December on stay-over tourists and their nights spent on Aruba are not yet available.

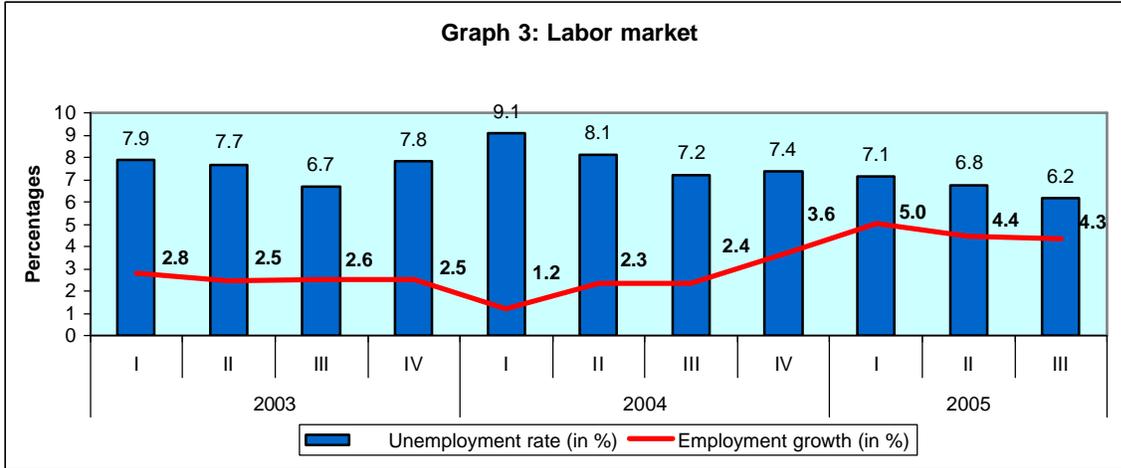
²⁾ Data refer to the percentage change of the period January-November 2005 compared to the corresponding period of 2004.



3. Labor market

Due to the severe lack of information on the development of the labor market, the Bank has been making some rough calculations to assess the situation in this market. According to these calculations, the number of unemployed persons declined by 427 or 12.1 percent to 3,114 at end-September 2005, compared to the corresponding period a year earlier.¹ Consequently, the unemployment rate fell from 7.2 percent in the third quarter of 2004 to 6.2 percent in the corresponding quarter of 2005 (see graph 3).

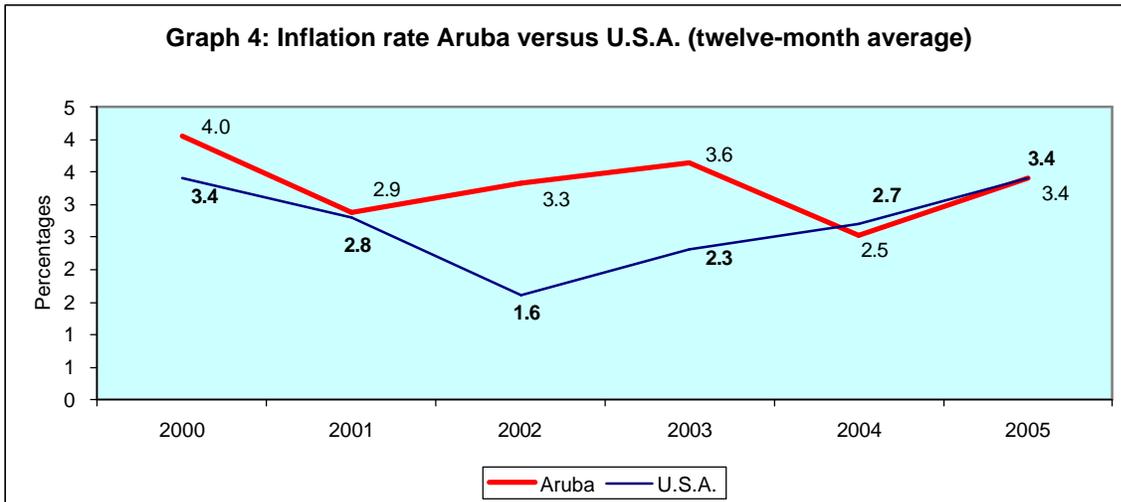
¹⁾ It should be pointed out that this figure also includes the unemployed persons who are working unofficially (or on the black market) and are not registered at any of the sources used by the Bank to calculate the unemployment rate. In the black market of labor (unofficial work) there are no written employment contracts, neither taxes nor social insurance premiums are paid, and safety at work is not guaranteed.



The number of employed persons rose by 1,967 or 4.3 percent to 47,350 (see graph 3). This rise is almost five times larger than the decline in the number of unemployed persons. The increase in employment reflected mainly a rise in the number of employed persons in the private sector of 1,592 or 4 percent to 41,036. In addition, the number of public employees went up by 375 or 6.3 percent to 6,314. The participation rate, being the active part of the working age population, declined slightly to 63.3 percent .

4. Inflation

At end-2005, inflation stood at 3.8 percent, compared to 2.8 percent a year earlier. The inflation rate, measured as a 12-month average percentage change, accelerated by nearly one percentage point to 3.4 percent in 2005, reflecting mainly price increases for water, electricity and gasoline following higher oil prices on the international market. This rate is equal to the annual average inflation rate for the United States in the corresponding period (see graph 4). For 2006, the 12-month average inflation rate is expected to reach 3.5 percent.



5. Government finance

In the first nine months of 2005, total government revenues on a cash basis increased by Afl. 50.7 million or 8.3 percent to Afl. 664 million, compared to the corresponding period of 2004, reflecting largely an increase in tax revenue. Total expenditure on a cash basis declined slightly Afl. 2.2 million to Afl. 768.3 million in the first nine months of 2005 compared to the corresponding period in 2004. Consequently, government financial deficit on a cash basis fell to Afl. 108.9 million, down from Afl. 165.3 million in the first nine months of 2004. When including the change in the unmet financing requirements, a financial deficit of Afl. 85.1 million was registered against an Afl. 171.8 million deficit in the first three quarters of 2004 (see table 2).

Table 2: Government financial operations 1)

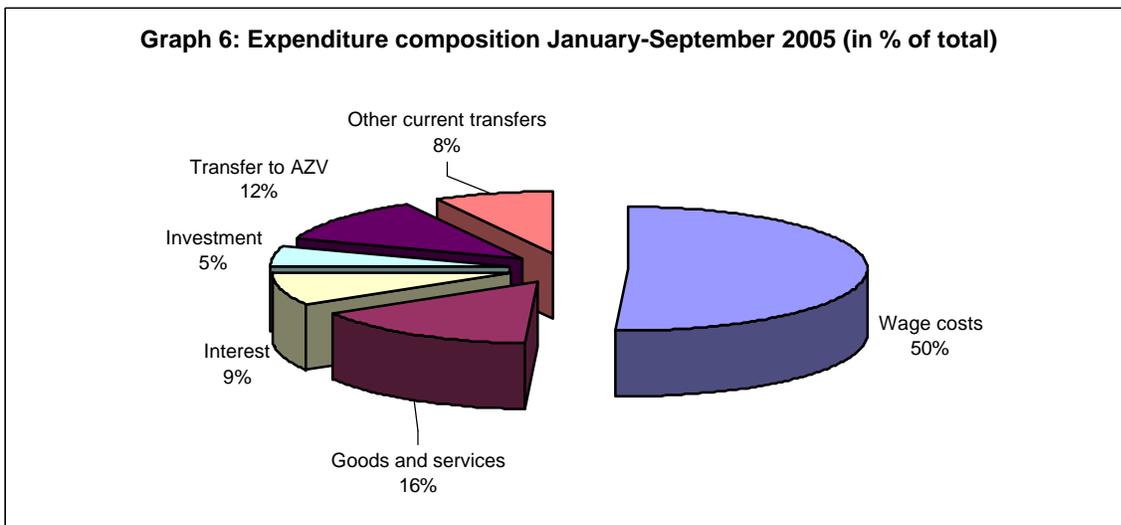
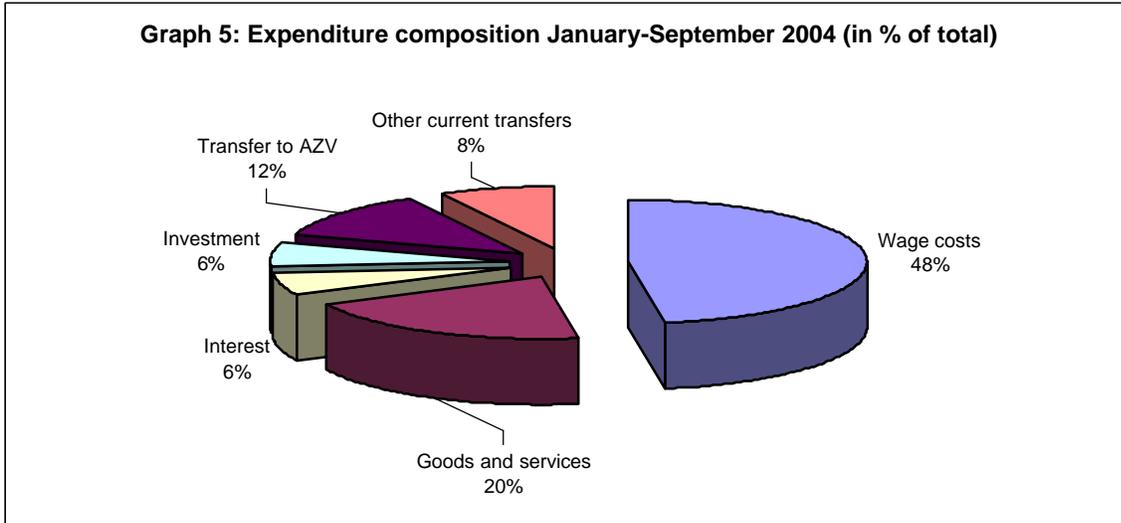
	January-September				
	2002	2003	2004	2004	2005
1. Revenue and grants 2)	754.0	987.9	835.2	612.8	663.5
2. Expenditure	865.3	918.6	1,179.5	771.1	768.3
3. Lending minus repayments 3)	-38.4	-103.1	10.2	6.9	4.1
4. Financial deficit (-)	-72.9	172.4	-354.5	-165.3	-108.9
5. Memorandum item					
a. Unmet financing requirements 4)	260.2	281.7	152.9	288.2	129.3
b. Expenditure 5)	868.4	940.1	1,050.7	777.6	744.7
c. Financial deficit (-) 5)	-76.1	150.9	-225.7	-171.8	-85.1

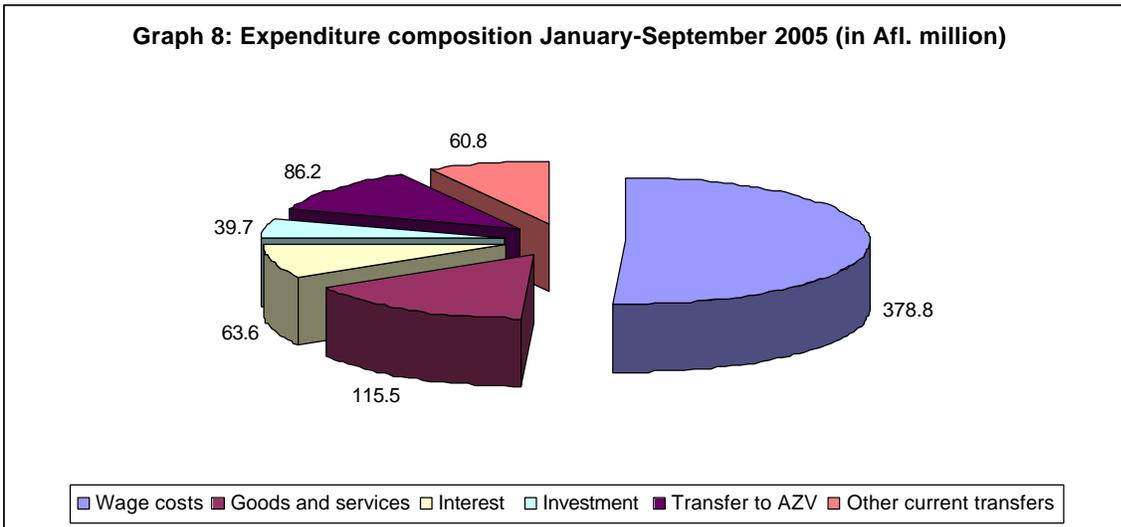
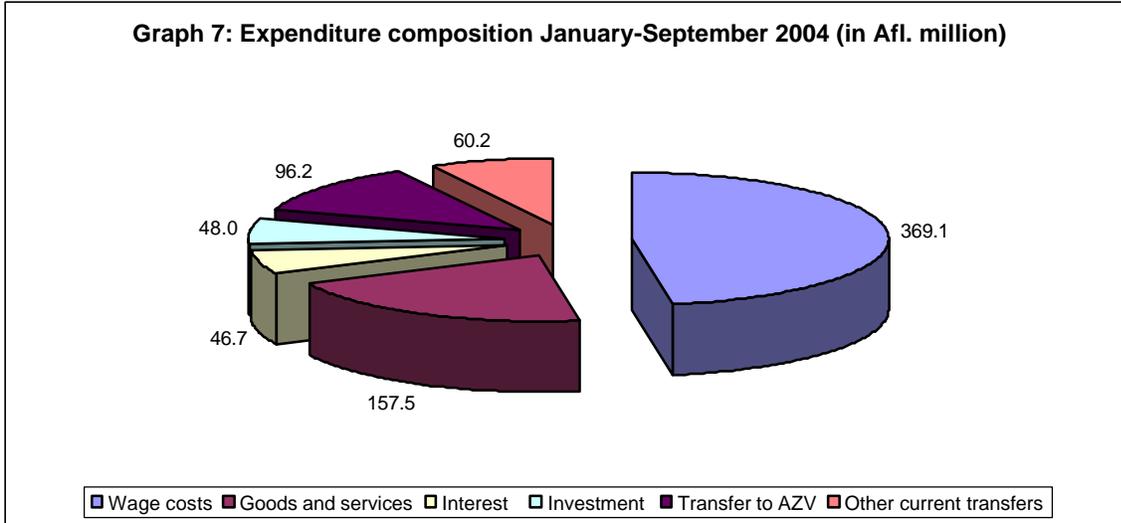
Source: Department of Finance; Tax Collector's Office; APFA; CBA.

- 1) Preliminary figures and estimates on a cash basis, including imputed noncash transactions.
- 2) Including imputed debt forgiveness in 2003.
- 3) Includes payments due to loans made and equities purchased from official entities, minus receipts from repayments and equities sold to these entities. A (-) sign indicates that extended loans were less than the repayments received.
- 4) At the end of the period. The unmet financing requirements comprise all unsettled payment obligations to other sectors, irrespective of the time frame in which they mature, registered by the Department of Finance.
- 5) Including the change in unmet financing requirements.

In graphs 5 through 8, the expenditure composition (including change in unmet financing requirements) for the first nine months of 2004 and 2005 is shown. As can be seen in these graphs, the current expenditures (consisting of wage costs, purchases of goods and services, interest expenses, transfer to the General Health Insurance (AZV), and other current transfers) totaled Afl. 704.9 million and were equal to 95 percent of total expenditures (Afl. 744.7 million) in the first nine months of 2005 (first nine months of 2004: 94 percent). The main components of current expenditures are wage costs, purchases of goods and services, and transfer to AZV, representing 50 percent, 16 percent and 12 percent, respectively, of total expenditures. It is worthwhile to mention that the share of interest expenditures surged notably by 3 percentage points to 9 percent of total expenditures in the first nine months of 2005, following the further rise in outstanding government debt on commercial terms. As a result of the excessive current expenditures by the government, funds for productive expenditures that will eventually contribute to the long-run economic growth of Aruba are crowded out. In the first nine months of 2005, investment expenditures amounted to Afl. 39.7 million, down from Afl. 48 million in the corresponding period of 2004, and were equal to 5 percent of total expenditures. These

expenditures are largely financed by funds coming out of the Fondo Desaroyo Aruba (FDA).





In Annex 1, total revenue, total expenditure and total debt are illustrated for various years. It is obvious that the revenues received by the government were much lower than the total government expenditures in those years, thus reflecting the structural imbalance between government revenues and expenditures. Consequently, the government had to take recourse to debt financing to cover its deficit.

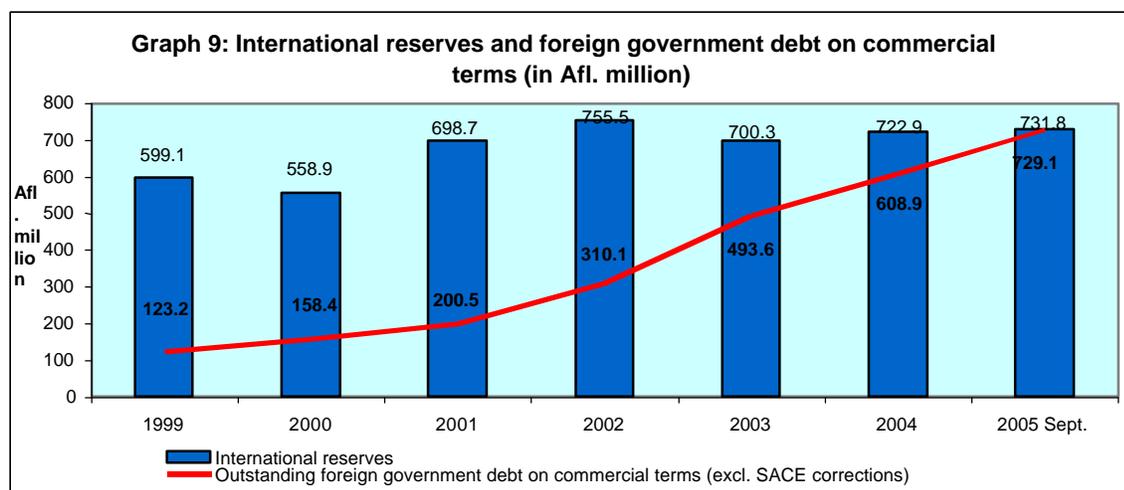
Outstanding government debt rose by Afl. 176.7 million or 10.6 percent to Afl. 1,836.3 million at end-September 2005 (see table 3), compared to end-September 2004. This rise resulted from increases in both the foreign debt component and the domestic debt component of, respectively, Afl. 98.3 million and Afl. 78.4 million.

Table 3: Outstanding government debt (End of period, in Afl. million)

	End-September				
	2002	2003	2004	2004	2005
1. Total debt	1,611.1	1,478.8	1,700.2	1,659.6	1,836.3
2. Domestic debt	717.5	754.6	864.7	825.6	904.0
a. Negotiable	189.1	218.5	320.9	286.9	377.1
b. Nonnegotiable	528.4	536.1	543.8	538.7	526.8
3. Foreign debt 1)	893.7	724.2	835.6	834.0	932.3

1) At end-of-period exchange rates.

At end-September 2005, outstanding foreign government debt on commercial terms amounted to Afl. 729.1 million, i.e., equal to 99.6 percent of the net international reserves. The ratio international reserves vis-à-vis outstanding foreign government debt on commercial terms deteriorated in recent years as a result of the excessive government consumption (see graph 9).



It should be mentioned that the government finance and debt statistics will be revised soon to include the agreement between the government and a private corporation to construct and finance two buildings for the Ministry of Justice, i.e., a prison and a justice centre. This agreement has been classified by the Bank as a financial lease agreement. Consequently, the buildings acquired under this financial lease, are treated by the Bank as if purchased and owned by the government. The acquisition is treated as being financed by a loan.

6. Monetary and balance of payments developments

Money supply rose by Afl. 141.4 million or 6.2 percent to Afl. 2,426.7 million in 2005, caused by an Afl. 202.6 million or 12.4 percent increase in net domestic assets. Net foreign assets, on the other hand, decreased by Afl. 61.2 million or 9.3 percent compared to end-2004. Total credit granted by the local commercial banks rose by Afl. 177.6 million or 8.2 percent, which exceeded

the credit growth guideline of 6 percent set by the Bank for 2005 by Afl. 47.4 million or 2.2 percentage points. Housing mortgages, consumer credit and loans to enterprises rose by Afl. 123.1 million (21.0 percent), Afl. 46.4 million (9.7 percent) and Afl. 14.6 million (1.5 percent), respectively.

It is noteworthy mentioning that in spite of the favorable performance in the tourism sector up to and including November 2005, the net international reserves have not increased. On the contrary, at the end of December 2005 these reserves were Afl. 61.2 million or 9.3 percent lower than in the corresponding period a year earlier (see table 4). This development was in part influenced by persistent deficits on the current account balance of the rest of the economy.

Table 4: Monetary developments

	2002	2003	2004	2005
Net domestic assets (in Afl. million)	1,334.6	1,576.3	1,627.6	1,830.1
Net foreign assets (in Afl. million)	699.0	637.9	657.7	596.5
Money supply (in Afl. million)	2,033.6	2,214.1	2,285.3	2,426.7
<i>Percentage changes</i>				
Net domestic assets	13.1	18.1	3.3	12.4
Net foreign assets	5.9	-8.7	3.1	-9.3
Money supply	10.5	8.9	3.2	6.2

Source: Centrale Bank van Aruba

Available information for 2005 shows that the overall balance of payments of the rest of the economy, i.e. excluding the oil and free-zone sectors, recorded an Afl. 124 million deficit, compared to an Afl. 56.2 million deficit a year earlier. Further analysis shows that the current

Table 5: Balance of payments, excluding oil and free zone sectors (in Afl. million)

	Current account (net)			Capital and financial account (net)		
	Private sector	Public sector 1)	Total	Private sector	Public sector 2)	Total
1996	32.8	-82.5	-49.7	-74.9	-6.5	-81.4
1997	44.3	-89.9	-45.6	-85.8	-3.9	-89.7
1998	34.0	-60.5	-26.5	40.9	66.2	107.1
1999	-91.6	-90.5	-182.1	134.1	24.3	158.4
2000	10.6	-87.5	-76.9	-71.3	35.0	-36.3
2001	49.2	-79.0	-29.8	110.8	38.8	149.6
2002	-108.3	-120.0	-228.3	22.6	106.8	129.4
2003	-220.6	-123.2	-343.8	112.9	-46.5	66.4
2004	-109.9	-124.1	-234.0	38.7	97.1	135.8
2005	-169.6	-124.9	-294.5	77.1	33.7	110.8

Source: Centrale Bank van Aruba.

- 1) Excluding public corporations.
- 2) Excluding public corporations and development funds from the Netherlands.

account deficit of the rest of the economy widened further to Afl. 294.5 million in 2005, up from a deficit of Afl. 234 million a year earlier (see table 5). This pattern of significant deficits on the current account of the rest of the economy has been going on since 2002 and is an issue of concern to the Bank, because it is indicative of a structural imbalance in the Aruban economy.

7. Concluding remarks

The data on tourism signals that up to November 2005 this sector performed favorably, albeit at a slower pace compared to 2004. However, domestic prices were pushed up by the developments on the international oil market. It should be noted, however, that the net international reserve position of Aruba did not benefit from the favorable performance in the overall economy. This can be a sign that the performance in the tourism sector is reaching its peak. Another factor influencing the poor development in the international reserve position is the expansionary budgetary policy of and, consequently, the excess liquidity creation by the government, which affect the current account of the balance of payments negatively. Contrary to the aforementioned declining trend of the international reserves, these reserves should be increasing significantly as the overall economy still shows a growing trend. Given these effects and the surge in inflation during 2005, as well as the still high demand for bank credit, the Bank reached the decision to tight its monetary policy in 2006. However, the Bank is aware that monetary policy on its own cannot guarantee a stable relation of our international reserves vis-à-vis the Aruban florin. This relation is also influenced by the budgetary policy. Therefore, the Bank continues to stress the need for the government to limit its current expenditures in line with its revenues in order to contain its borrowing needs. In this way, a more balanced mix of monetary and budgetary policy can be achieved.

Centrale Bank van Aruba
Economic Policy Department
March 15, 2006.

Annex 1: Government revenue, expenditure and debt (in Afl. million)

