February 2008
IMF Country Report No. 08/78

Kingdom of the Netherlands—Aruba: 2007 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for the Kingdom of the Netherlands—Aruba

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2007 Article IV consultation with the Kingdom of the Netherlands—Aruba, the following documents have been released and are included in this package:

- The staff report for the 2007 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on December 4, 2007, with the officials of the Kingdom of the Netherlands—Aruba on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on January 24, 2008. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its February 8, 2008 discussion of the staff report that concluded the Article IV consultation.

- A statement by the Executive Director for the Kingdom of the Netherlands—Aruba.

The document listed below has been or will be separately released.

Statistical Appendix

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org • Internet: http://www.imf.org

Price: $18.00 a copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

KINGDOM OF THE NETHERLANDS—ARUBA

Staff Report for the 2007 Article IV Consultation Discussions

Prepared by the Staff Representatives for the 2007 Consultation Discussions
with the Kingdom of the Netherlands—Aruba

Approved by Alessandro Leipold and Martin Fetherston

January 24, 2008

Executive Summary

Background. Aruba—pursuing open, market-friendly policies—continues to do well as one of the most developed islands in the Caribbean. Still, it is vulnerable to external shocks owing to its heavy dependence on tourism and a steady increase in public debt from 39 percent of GDP in 2000 to 46 percent of GDP in 2006. The economy's exposure to external shocks was apparent in 2006 when—following a pronounced drop in tourist arrivals—GDP growth virtually stalled and the non-oil current account deficit widened sharply. However, a gradual tightening of macroeconomic policies since 2005 has helped to slow the rise in public debt and maintain a sufficient level of foreign exchange reserves.

The task is now to implement policies to support further fiscal consolidation and boost Aruba's growth potential. Against this background, consultation discussions centered on the following key issues, with broad agreement on the identified priorities:

- **Maintaining macroeconomic stability.** Consolidation of the fiscal accounts has advanced commendably and should continue. Immediate action is needed to address the renewed financial problems of the general health insurance (AZV). Monetary policy is being appropriately kept on hold until there are clear signs that inflationary pressures are abating. The peg of the florin to the U.S. dollar provides an effective nominal anchor, and the current exchange rate is at a competitive level.

- **Ensuring medium-term fiscal sustainability.** The authorities are targeting to balance the budget by 2009 and reduce public debt to less than 40 percent of GDP, but supporting measures have yet to be identified. More emphasis to limiting growth of personnel costs and better control of spending on goods and services would help to achieve the target. Advancing pension reforms, in particular increasing the retirement age from 60 to 62, would help to ensure the pension system remains financially sound in the face of rapid population ageing.

- **Strengthening policy frameworks and public institutions.** Good progress is being made in improving the budget process and work is underway to strengthen fiscal responsibility. At the same time, the central bank's *de facto* independence could be usefully formalized in the central bank law. Improving Aruba's statistical base would help support effective policymaking.

- **Boosting potential growth.** To create an environment that is conducive to investment and diversification, additional tax reforms—with a greater reliance on indirect taxes and a reduction of the high marginal personal income tax rate—would be beneficial. Plans to eliminate the credit ceilings and make greater use of indirect monetary policy instruments are well-placed and should be taken forward to promote more efficient financial intermediation.

Contents Page

Aruba is among the most developed islands in the Caribbean (Figure 1). Its per capita GDP has increased from US$6,662 in 1986, when it gained autonomy from the Kingdom of the Netherlands, to US$23,550 in 2006. This impressive gain has been achieved with the help of market-friendly policies that have fostered a stable macroeconomic environment and a rapid expansion of the tourist sector, now accounting for more than half of GDP. However, the heavy dependence on tourism has rendered the economy vulnerable to external shocks, a situation that has been aggravated by a steady increase in public debt. The Article IV consultation discussions consequently focused on strategies for reducing Aruba's external vulnerability and strengthening institutions and policy frameworks necessary for sustained growth.

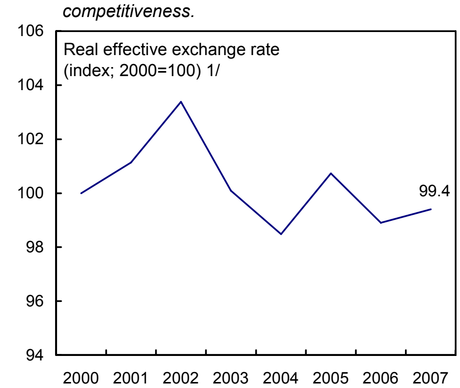
I. A REBOUNDING ECONOMY

1. **Following a sharp deceleration in 2006, real GDP growth has rebounded driven by a recovery in tourism** (Tables 1 and 2; Figure 2). Tourism receipts, which account for 80 percent of export revenues, declined by 2 percent in 2006 as tourist arrivals fell following negative publicity and because of extensive upgrading of hotel rooms. The slowdown was only partially offset by an expansion of construction and investment activities in the hotel and real estate sectors. As a result, real GDP growth decelerated to 0.6 percent in 2006. The deceleration proved to be temporary, however, as tourist arrivals picked up again in the last quarter of 2006. The rebound in the tourist sector continued in 2007, while activity in the construction and utility sectors was also robust.

2. **Inflation has accelerated, but mainly owing to one-off supply shocks.** After several years of broadly following changes in the U.S. CPI, inflation in Aruba almost tripled from 2.5 percent year-on-year in December 2006 to 7.3 percent in October 2007. The acceleration is largely due to the introduction of a turnover tax in January 2007 and to a lesser extent higher utility tariffs. Official estimates suggest that the turnover tax has directly contributed about 3 percentage points to inflation in 2007.

3. **Although there are signs that the labor market has tightened, Aruba has maintained its international competitiveness.** Preliminary estimates by the authorities suggest the unemployment rate has dropped appreciably, from 6.9 percent in 2000 to 3.8 percent at present. However, wage pressures have been contained by a large inflow of low-skilled migrant workers from the region into the tourism and construction sectors. This influx contributed to maintaining Aruba's international competitiveness.

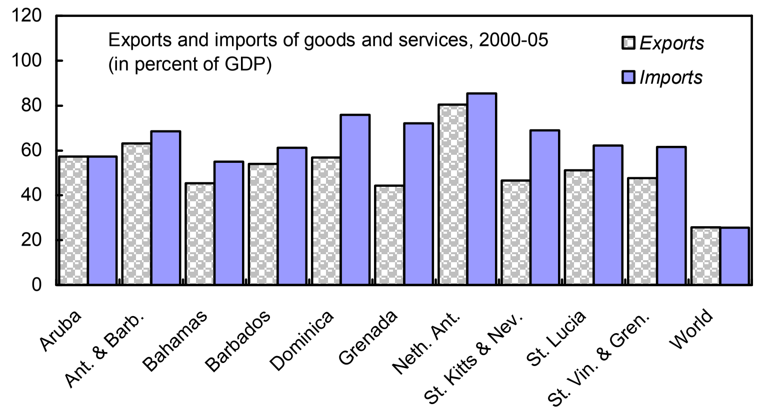
With the REER slightly below its level in 2000, Aruba is maintaining its international competitiveness.



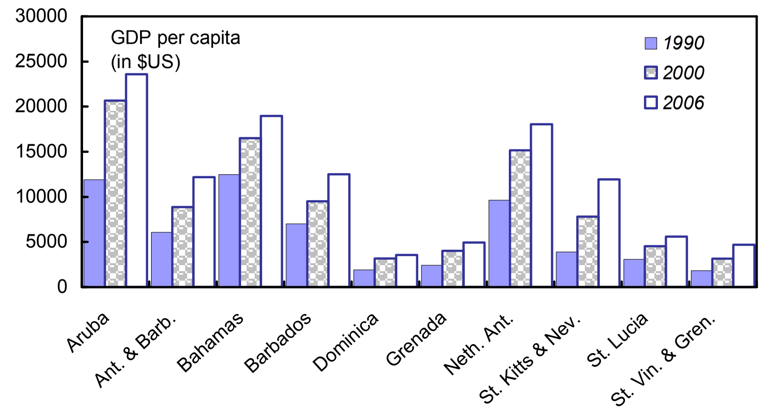
Sources: Aruban authorities; IMF, IFS; and staff estimates.
1/ Trade-weighted, CPI-based.

Figure 1. Aruba: Regional Perspective

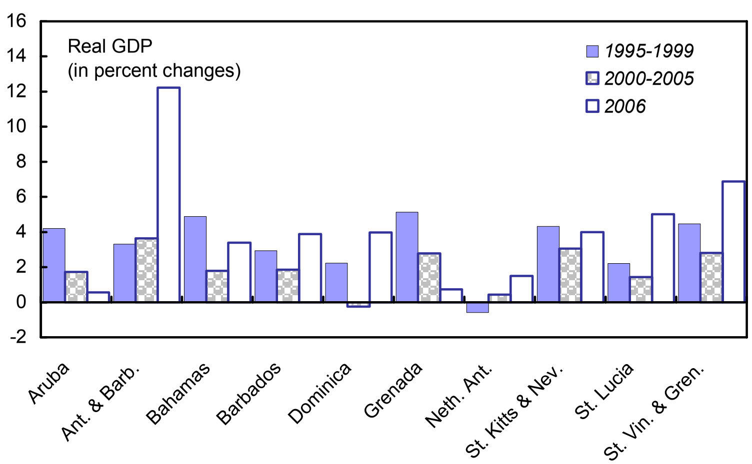
Like all other countries in the Caribbean region, Aruba has a very open economy.



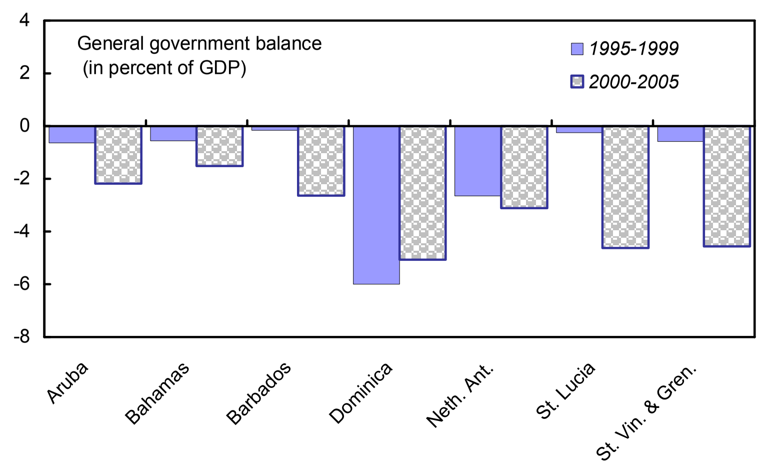
Its per capita GDP has increased rapidly ...



... but other countries are catching up as Aruba's growth has lagged in recent years.



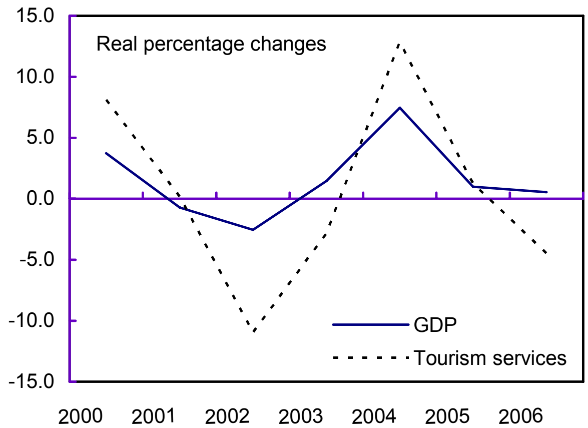
As in many other countries in the region, Aruba's fiscal balance has deteriorated compared to the second half of the 1990s.



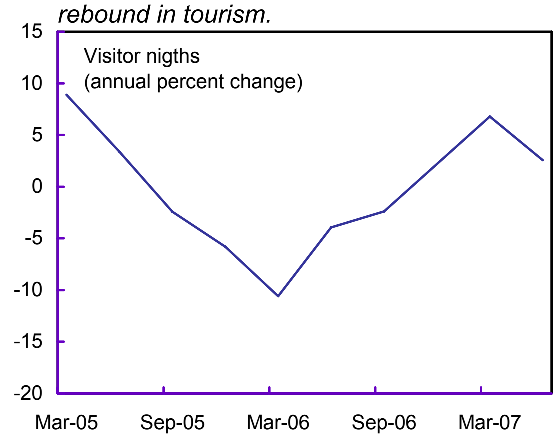
Sources: IMF; WEO and staff calculations.

Figure 2. Aruba: Recent Economic Developments

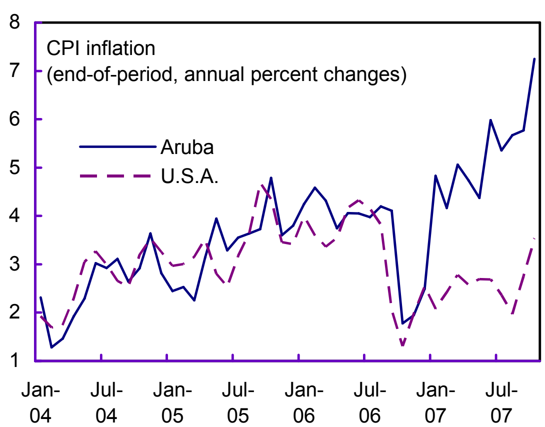
GDP growth dropped sharply in 2006 ...



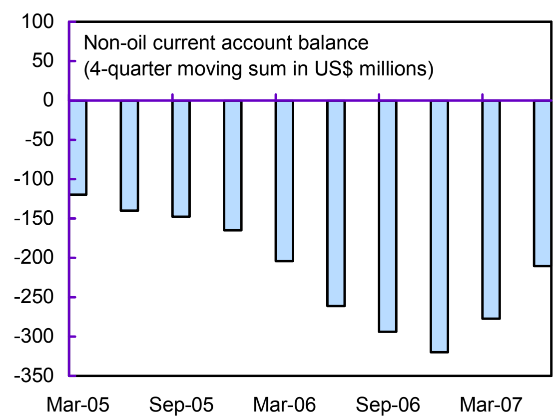
... but is now recovering driven by a rebound in tourism.



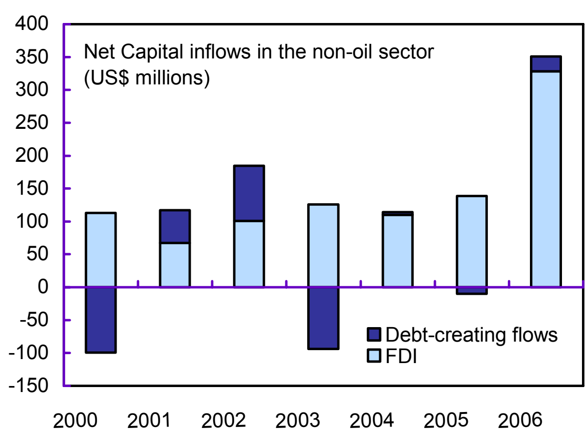
Several supply shocks have lifted inflation.



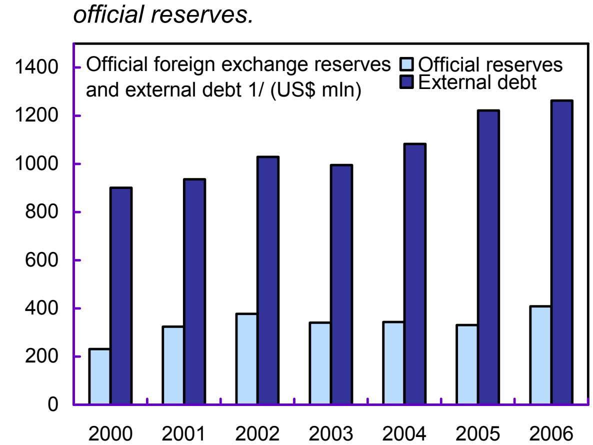
The non-oil current account is recovering.



Capital inflows have increased led by FDI.

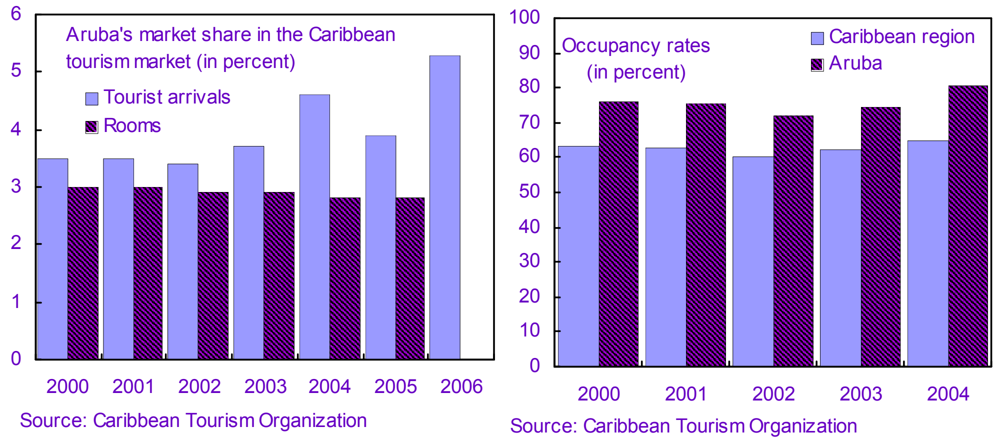


External debt remains high in comparison to official reserves.



Sources: Central Bank of Aruba, and staff estimates.
1/ Includes debt of the oil sector.

The competitiveness of the tourist sector, which accounts for most of Aruba's tradable sector, appears to have strengthened as reflected by high occupancy rates and a rising share in the Caribbean tourism market.



4. **The rebound in tourist arrivals is contributing to a recovery in the non-oil current account** (Table 3).[1] The deficit in the non-oil current account widened sharply from some 7½ percent of GDP in 2005 to over 13 percent of GDP in 2006, mainly as a result of declining tourism revenue, increasing outflows of workers' remittances, and strong growth in merchandise imports driven by robust investment activity. Following the rebound in tourism, the deficit in the non-oil current account has begun to narrow again, coming in at 6 percent of GDP in the year ending in June 2007.

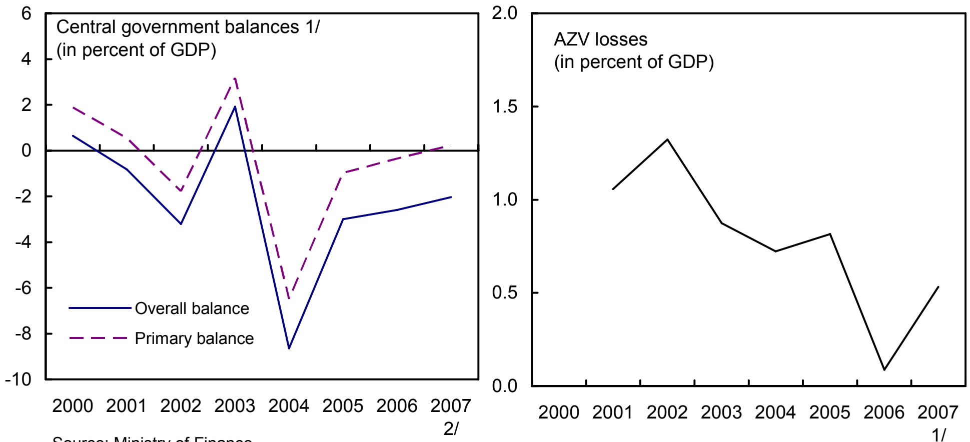
5. **Capital inflows have increased sharply as a result of increased investment activity.** FDI inflows more than doubled in 2006, reaching 13½ percent of GDP, though preliminary estimates indicate a slowdown in inflows in the first half of 2007. Official reserves have increased to US$408 million, equivalent to about three months of imports of goods and services, but the ratio of external debt to official reserves remains high at more than 300 percent (Table 4).

6. **The authorities have tightened macroeconomic policies to stem the rise in public debt and maintain a sufficient level of foreign exchange reserves.**

- After a jump to an unusually large fiscal deficit (including losses of the AZV) of 8½ percent of GDP in 2004, the deficit narrowed to 2½ percent of GDP in 2006. The

[1] The operations of a foreign-owned refinery, which re-exports oil products and accounts for about 5 percent of GDP, create large swings in the current account, but these operations are financed directly by the owners from abroad. The analysis of Aruba's external position is thus based on the non-oil current account, which excludes the activities of the refinery.

Public finances have improved after a jump to an unusually large fiscal deficit, owing to financial problems at the AZV and financial obligations resulting from government guarantees related to the construction of hotels.

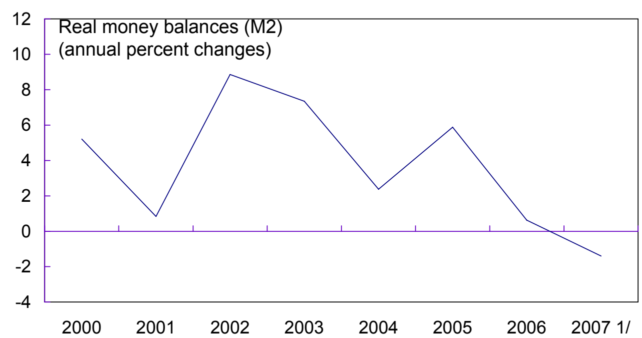


Source: Ministry of Finance.
1/ Including AZV losses.
2/ Estimate.

Source: AZV
1/ Estimate.

2007 budget of the central government envisions a further decline to 1½ percent of GDP (Table 5). However, renewed problems at the AZV owing to large cost overruns andrevenue shortfalls are estimated to increase the fiscal deficit by an additional ½ percent of GDP.[2] Despite this shortfall, the primary balance is projected to record a small surplus.

Monetary tightening has been reflected in a decline in real money balances.



Source: Central Bank of Aruba.
1/ July.

- The Central Bank of Aruba (CBA) tightened credit limits and the reserve requirement of commercial banks in 2006 to reduce pressures on foreign exchange reserves and safeguard the value of the currency following the sharp widening of the current account deficit (Table 6).

II. What Lies Ahead?

7. **The near-term outlook is mostly favorable.** Staff projects real GDP to expand by about 2 percent in 2007 and 2008. The tourist sector is making a strong comeback and will, together with continued robust investment, be a key engine of growth in the near term.

---

[2] Improved cost control and a hike in medical insurance premiums in 2006 had resulted in an almost balanced AZV budget in 2006.

Inflation is projected to ease from slightly over 6 percent in 2007 to just under 4 percent in 2008 as the impact of the one-off supply shocks gradually dissipates. The deficit in the non-oil current account is projected to decline to about 8 percent of GDP in 2007 and 6¾ percent of GDP in 2008. The main risks to the outlook are a more pronounced and protracted slowdown in the U.S. economy and a further increase in oil prices. It is also possible that the full impact on inflation of the turnover tax will take longer to materialize, which, together with further increases in the oil price and signs of tightness in the labor market, could provide additional impetus to inflation.

8. **Despite the tightening of macroeconomic policies and the rebound in growth, Aruba remains vulnerable to external shocks.** The continued vulnerability emanates mainly from the high dependence on the often volatile tourist sector and the state of Aruba's public finances, which, although sustainable, remains fragile. Absent further fiscal consolidation, the room for maneuver of macroeconomic policies in case of unforeseen events remains limited; a negative shock to the economy would almost certainly require the authorities to tighten pro-cyclically to avoid a sharp loss of international reserves and an unsustainable rise in the level of public debt (Table 7; Figure 3). While the large current account deficit does not pose an immediate threat to external stability, it leaves little room for maneuver. It is projected to improve appreciably over the medium term, as export revenues increase following the expansion in room capacity, and import growth slows after the current construction and investment boom in the hotel sector tapers off. However, the improvement in the debt-creating deficit (current account balance plus FDI) will be appreciably smaller, because the moderation in investment activity will also be reflected in lower FDI inflows. As a result, external debt is projected to decline only gradually (Tables 8-9; Figure 4).

III. How Can Aruba Reduce its External Vulnerability?

9. **The task for Aruba is to implement policies that will keep public finances on a sustainable path and boost its economic potential.** Key in this regard are: (i) maintaining macroeconomic stability, (ii) reducing public debt, (iii) strengthening public institutions and policy frameworks, and (iv) creating an economic environment that is conducive to investment and diversification. These goals are broadly shared by the authorities, who intend to achieve a balanced budget by 2009, but their growth strategy remains insufficiently focused on creating conditions for increasing potential.

A. The Near Term: Maintaining Macroeconomic Stability

10. **A key priority of the government is further consolidation of the fiscal accounts, but the renewed problems at the AZV are posing a serious challenge.** The 2008 budget entails a further reduction in the fiscal deficit to 1 percent of GDP. Contrary to previous years, the adjustment in 2008 is to be achieved mainly by containing growth in current expenditures. However, the financial problems at the AZV are casting a cloud over the 2008

budget. Absent corrective measures, staff estimates that the fiscal deficit would exceed the budget target by about ½ percent of GDP.

11. **The authorities have made resolving the losses of the AZV a top policy priority.** They have begun to investigate possible measures, including an increase in premiums, introduction of co-payments, and caps on expenditure. Measures to strengthen financial monitoring of the AZV would also be considered. The authorities indicated they intend to close the deficit of the AZV in 2008, but noted that, given the size of the shortfall, this will be a challenge.

12. **Staff warned that the losses of the AZV should not lead to slippage in the ongoing fiscal consolidation.** It supported a quick resolution of the AZV's financial problems, but stressed that to the extent the situation cannot be remedied in the short run, offsetting savings in current expenditure should be identified in the 2008 budget so as to keep the fiscal deficit on a firm downward trend. Cuts in public investment, which is already at a low level, would best be avoided, while any larger-than-budgeted revenues should be saved.

13. **Monetary policy is set to remain on hold in the near term.** The monetary authorities intend to lower the credit ceilings to 4 percent at the beginning of 2008. The modest tightening is motivated by the uncertain inflation outlook and the challenges facing fiscal policy. The authorities noted, however, that, contrary to previous years when credit ceilings were set for an entire year, they will adopt a more flexible approach in 2008, allowing an increase in the credit ceilings during the year to up to 7 percent if there are clear signs that inflationary pressures are abating and international reserves remain at a comfortable level.[3] The authorities are also planning a gradual increase in the use of indirect monetary instruments in 2008 with the aim of abolishing the credit ceilings by the end of the year.[4] Staff agreed that under the current outlook it was prudent to err on the side of caution and that credit growth of 4-7 percent, depending on the economic situation, was appropriate. It welcomed the planned move to indirect instruments, noting that the CBA should stand ready to increase interest rates and absorb excess liquidity if credit growth accelerated excessively.

14. **There was agreement that the fixed exchange rate regime remained appropriate for Aruba, and that the exchange rate was at a competitive level.** Although the fixed exchange rate policy has limited the flexibility of policymakers to respond to external

[3] The objective of the authorities is to maintain a level of net foreign assets in the banking system (central bank plus commercial banks) that is close to six months of merchandise imports, excluding the oil refinery. Note that staff uses a different definition to calculate import coverage (Table 3b).

[4] See also Box 2 and paragraph 29.

shocks, it has provided an effective nominal anchor that has been instrumental in achieving generally low inflation. With the United States accounting for 70 percent of tourist arrivals and almost 60 percent of imports of goods, the authorities felt that the peg to the U.S. dollar remained appropriate. Staff and the authorities agreed that, assessed against the medium-term balance of payments outlook (paragraph 8), the exchange rate was at an appropriate level. In addition, although Aruba's immigration policy has been tightened recently, it is expected that the continuing inflow of migrant workers will act as a safety valve against wage pressures, thus helping Aruba to maintain its international competitiveness. Staff cautioned, however, there may be a limit to the number of migrant workers the island can accommodate. It also stressed that for the CBA to maintain a sufficient level of foreign exchange reserves to support the current exchange rate peg it is important that fiscal consolidation and structural reforms move forward.

B. The Medium Term: Ensuring Fiscal Sustainability

15. **The authorities are committed to balancing the budget by 2009 and reducing public debt to less than 40 percent of GDP.** The key objectives of this policy are to ensure long-run fiscal sustainability and create room for spending on infrastructure and education by reducing the share of interest payments in the budget. To achieve these objectives the authorities intend to limit annual growth of personnel costs to 3 percent and that of spending on goods and services to 2 percent.

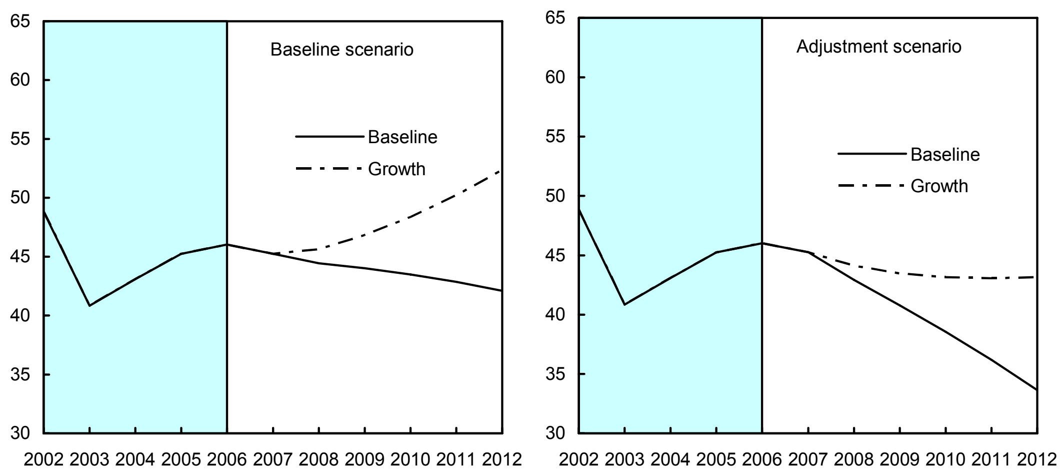
16. **Staff supported the government's goal, but noted that its achievement would require additional measures.** Staff projections, based on the government's medium-term fiscal framework and the projected shortfall in the AZV, indicate that the government will—in the absence of further measures—run a deficit of about 1½ percent of GDP in 2009 and that fiscal balance will not be achieved until after 2012 (Box 1). To achieve a broadly balanced budget from 2009 onward staff suggested a temporary freeze of personnel costs at the level of the 2008 budget and 3 percent annual growth thereafter. Staff argued that to achieve this target the government should consider rationalizing Aruba's relatively large civil service as it will be difficult to restrict wage growth to the rate of inflation over the medium term. Staff also recommended the authorities make a greater effort to limit growth of spending on goods and services as the 2008 budget allows for an expansion of 7-8 percent, well above the government's 2 percent target.

17. **The authorities acknowledged their plan was ambitious and welcomed staff's recommendations.** They recognized that limiting growth in personnel costs will be difficult without a reduction in the size of the civil service, but—2009 being an election year—were reluctant to consider more than a hiring freeze for now. They explained that the large increase in spending on goods and services in 2008 was the result of unanticipated outlays following the completion of public investment projects. They expected to gain better control over these expenses as they moved to a full-fledged medium-term fiscal framework.

Box 1. Aruba: Fiscal Sustainability

While Aruba's present fiscal situation is not unsustainable, it leaves little room for maneuver in the event of an unforeseen shock. Under staff's baseline scenario, which assumes no changes in current policies, the government will not achieve a balanced budget over the medium term. Public debt will, however, continue to decline gradually, although it will not fall below 40 percent of GDP. Under this scenario, an unexpected GDP shock would lead to an unsustainable rise in public debt absent a pro-cyclical tightening of fiscal policy. By contrast, under an adjustment scenario—assuming the government realizes a balanced budget in 2009 and resolves the financial problems of the AZV in 2008—public debt declines to about 35 percent of GDP over the medium term. In this case, public debt would remain below 45 percent of GDP in the event of an unexpected GDP shock.

Aruba: Impact of an Economic Shock on Public Debt
(Public debt in percent of GDP)



Source: Authorities; staff estimates and calculations.

18. **Notable progress has been made in pension reform but additional reforms are needed to support medium-term fiscal sustainability.** The civil service pension fund (APFA) was partially reformed in 2005, which contributed to a considerable, albeit still insufficient, improvement in its coverage ratio. The final stage of the reform is expected to raise the fund's coverage ratio to 100 percent. At that point, it will also come under the supervision of the central bank. Staff called for early completion of the reforms and urged the government to settle its remaining payment arrears with APFA. By contrast, much less has been achieved in the reform of the universal pay-as-you-go pension system (AOV)—an increasingly pressing issue in light of rapid population ageing. Starting in 2012, the AOV will begin to run down its reserve to cover pension obligations. Without adjustment in the AOV's parameters the reserve could be depleted by as early as 2020. Against a background of increased life expectancy and a shortage in the domestic supply of labor, staff recommended a gradual increase in the effective retirement age. It also suggested other

options, including raising the income ceiling, increasing premiums, and lowering the replacement ratio.

19. **The authorities agreed that additional pension reforms are needed.** They were optimistic about the final stage of the reform of APFA and expected that it would be completed in 2008, including the settlement of arrears. As to the reform of the AOV, the authorities' preferred option was to increase the retirement age from 60 to 62, but noted that sufficient public support was still lacking.

C. Strengthening Policy Frameworks and Public Institutions

20. **The authorities have made progress in improving the budget process and work is underway to strengthen fiscal responsibility.** Staff welcomed the timely submission of the 2008 budget to parliament—the first time the budget was submitted on time in several years—and the inclusion of a medium-term fiscal framework in the budget documents, noting these were useful steps toward a more transparent budget process. The authorities are preparing changes to the budget law, to be implemented in 2008, which they expect will provide additional institutional support for fiscal consolidation by imposing greater fiscal discipline, improving fiscal management, and strengthening the fiscal framework.

21. **Little progress has been made in strengthening central bank independence.** Although in practice the CBA enjoys a high degree of operational independence, staff saw a need to formalize this in the central bank law to provide a safeguard against potential government interference. The authorities acknowledged the need for formalizing central bank independence and noted that plans to that extent were being developed. However, the government remains wary of giving the CBA greater budgetary independence. They also noted that the CBA had not provided direct financing to the budget for many years and did not intend to do so in the future.

22. **The authorities have made substantial improvements in Aruba's statistical base, but more work is needed to support effective policymaking.** Great effort has been made to update national accounts and labor market statistics. Staff recommended that, next, attention should be given to national accounts in constant prices and new weights for the consumer price index as the current weights are outdated. The authorities noted that the Central Bureau of Statistics is developing plans to address these issues.

D. Bolstering Long-Run GDP Growth

23. **Aruba's potential GDP growth is driven to a large extent by increases in the labor force.** In particular, the expansion in the tourist sector and the attendant construction activity are labor intensive and rely predominantly on immigrant workers. However, with a population density that is already more than 500 inhabitants per square kilometer, this growth

model is bound to come under pressure at some future point. The discussions thus focused on developing a sustainable growth strategy and creating an environment that is conducive to more investment and diversification. Key in this regard are further tax reform and more efficient financial intermediation.

Reforming the tax system

24. **Aruba's tax system is geared heavily toward direct taxation.** As a small open economy, staff noted that Aruba should avoid levying high taxes on capital and skilled labor, which are mobile and tend to gravitate toward countries with favorable tax regimes. Instead, it will need to rely more on indirect consumption-based taxes.

Summary of Tax Revenues in Aruba and the Caribbean Region, 2004-06
(In percent of GDP)

	Aruba	Caribbean region (average)
Tax revenue	20.1	23.9
Direct taxes	11.8	8.1
Indirect taxes	8.3	15.7
Of which: customs duties	3.8	4.6

Sources: Aruban authorities, and Fund staff estimates.

25. **Recent tax reforms were an important step toward a more investment friendly environment, but more can be done.** There was agreement that the introduction of the turnover tax is an important achievement that will increase the share of indirect taxes in total tax revenue. Aruba being a small island economy, the cascading effect, inherent in turnover taxes, has been limited thus far. In addition, the authorities reduced the number of import duty rates from eight to four in 2006 and cut the corporate income tax rate from 35 percent to 28 percent in combination with a reduction in exemptions and incentives. Staff welcomed these reforms, but suggested the following additional measures.

- Further rationalization of import duties as a number of goods continue to be subject to special duty rates.

- Reduction of the personal income tax. The highest marginal rate is currently 58 percent, compared to an average of 34 percent in the Caribbean region.

- Elimination of the tax on foreign exchange transactions. This tax is a nuisance to foreign investors and constitutes an unapproved exchange restriction under Article VIII of the Fund's Articles of Agreement.

26. **The authorities agreed that there is scope for additional tax reforms to enhance the investment environment.** They stressed, however, that any changes had to be revenue neutral with cuts in direct taxes being offset by an expansion of indirect tax revenue or a broadening of the tax base. The authorities intend to eliminate the foreign exchange tax, but could not commit to a timeframe.

Strengthening financial intermediation

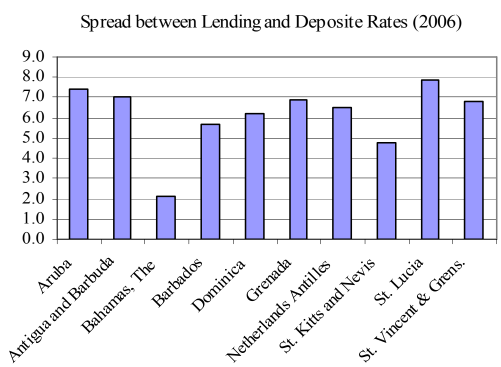
27. **Aruba's banking sector is characterized by a limited degree of financial intermediation and a low level of competition.** Although Aruba's banking sector is large relative to the size of its economy, with banking sector assets close to 100 percent of GDP, domestic financial intermediation is limited, with private sector credit amounting to only 59 percent of GDP. The low level of competition among banks is reflected in very high profitability arising mainly from a wide margin between lending and deposit rates.

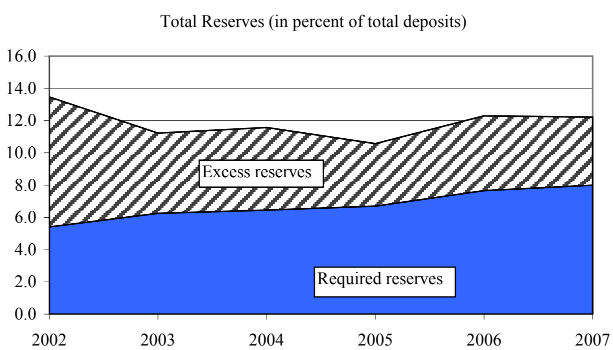
28. **The characteristics of the banking system reflect in part the CBA's reliance on credit ceilings and capital controls** (Box 2). Although these quantitative measures have been effective in containing domestic credit growth, staff noted they have also hindered greater competition between commercial banks and contributed to excess liquidity in the banking system.

Box 2. Aruba: Towards Indirect Monetary Policy Instruments

The CBA has relied mainly on credit ceilings and capital controls in conducting its monetary policy. The ceilings, which were reintroduced in 2003, are announced at the beginning of each year and limit the nominal expansion of gross credit of each individual commercial bank. The capital controls include a cap on banks' net foreign asset positions and a 60-40 rule, which limits the amount that institutional investors can invest abroad. This framework has been effective under the fixed exchange rate regime in maintaining price stability.

However, these direct controls have hindered efficient financial intermediation. The credit ceilings have created a disincentive for banks to compete.[1] This is manifest in the high profits in the banking sector and the large spread between lending and deposit rates, which is among the highest in the region. The combination of credit ceilings and capital controls has also contributed to a considerable amount of unremunerated excess liquidity, thus raising the cost of intermediation.





Source: Central Bank of Aruba

Following the example of several other islands in the region, the CBA plans to make greater use of indirect monetary instruments. This will give the CBA more flexibility in the conduct of its monetary policy and is expected to promote more efficient financial intermediation.

[1] Although foreign banks can set up branches in Aruba, none of the major international banks have a presence in Aruba.

29. **A key step toward the creation of a more competitive and efficient banking sector would be for the CBA to make greater use of indirect monetary instruments.** Staff therefore welcomed the CBA's plan to abolish the credit ceilings by the end of 2008 and to begin issuing central bank certificates to manage liquidity. Staff noted that the CBA would have to issue a significant amount of certificates at commercially attractive rates to mop up the excess liquidity, but that the CBA's financial position is sufficiently sound to carry out this operation. Staff also recommended that the CBA strengthen its liquidity forecasting framework.

30. **The financial system is generally sound, but the large exposure of commercial banks to the tourist sector warrants continued supervisory vigilance.** In this regard, the CBA raised the minimum risk-weighted capital adequacy ratio from 10 to 12 percent in 2007. Staff recommended that banks and the CBA consider employing stress tests to gain additional insight in the banking sector's capacity to withstand large shocks.

IV. Staff Appraisal

31. **Aruba remains one of the most developed islands in the regions.** This success has been the result of market-friendly policies that have fostered a stable macroeconomic environment and a rapid expansion of the tourist sector. Equally important has been the openness of the economy as foreign investment and, in particular, migrant workers have been key contributors to economic growth.

32. **However, heavy dependence on tourism has rendered the economy vulnerable to external shocks.** This vulnerability has been aggravated by a steady increase in public debt, owing to an unfavorable fiscal trend during 2000-04. Against this background, the recent tightening of macroeconomic policies was both welcome and timely.

33. **The task is now to implement policies that will support further fiscal consolidation and boost Aruba's growth potential.** It is important, therefore, that Aruba adopts a strategy for keeping public finances on a sustainable path and bolstering potential growth. Key in this regard are maintaining macroeconomic stability, reducing public debt, strengthening public institutions and policy frameworks, and creating an economic environment that is conducive to investment and diversification.

34. **Maintaining macroeconomic stability in the near term will require further fiscal adjustment and an appropriately tight monetary policy.** Immediate action is needed to address the renewed financial problems of the AZV. To the extent that these problems cannot be resolved in the short run, offsetting savings in current expenditure should be identified. Monetary policy should remain on hold until there are clear signs that inflationary pressures are abating. The peg of the florin to the U.S. dollar should be maintained as it is providing an effective nominal anchor, while the current exchange rate is at a competitive level.

35. **The government's plan to balance the budget by 2009 and reduce public debt to less than 40 percent of GDP needs to be supported by additional measures.** Emphasis should be given to limiting growth of personnel costs, including through rationalizing the civil service. Control of spending on goods and services should be strengthened and additional reforms are needed to ensure the pension system remains financially sound in the face of rapid population ageing.

36. **More needs to be done to strengthen policy frameworks and public institutions.** While good progress is being made in improving the budget process and work is underway to strengthen fiscal responsibility, there is a need for formally strengthening the independence of the central bank. Aruba's statistical base also needs to be improved to support effective policymaking.

37. **Bolstering Aruba's long-run growth potential will require creating the right conditions for private investment and diversification.** Such a strategy will need to be supported by additional tax reform—aimed at further simplification and greater reliance on indirect taxes—and by steps toward more efficient financial intermediation. These steps would need to include elimination of the credit ceilings and greater use of indirect monetary instruments, and plans in this direction are welcome.

38. **The financial system is generally sound, but the large exposure of commercial banks to the tourist sector warrants continued supervisory vigilance.** The CBA should consider employing stress tests to gain additional insight in the banking sector's capacity to withstand large shocks.

39. It is proposed that the next Article IV consultation with Aruba be held on the 24-month cycle.

Table 1. Aruba: Basic Data, 2000-2008

Area	180 square kilometers
Population (2006)	102,816
GDP per capita (2006)	$23,550
Social indicators	
Literacy rate, in percent (2003)	98.00
Life expectancy at birth (2003)	73.06
Infant mortality (percent of live births) (2000)	0.01
Death rate, in percent (2003)	0.52
Percent of population below age 15 (2006)	20.7
Percent of population aged 65+ (2006)	8.8

								Estimates	Staff Proj.
	2000	2001	2002	2003	2004	2005	2006	2007	2008
					(Percent change)				
GDP (in constant prices)									
GDP	3.7	-0.7	-2.5	1.5	7.5	1.0	0.6	2.1	2.1
Final consumption	0.2	4.6	2.1	1.7	1.9	2.1	2.0	1.3	1.3
Fixed gross capital formation	-13.8	-7.5	11.2	7.2	3.9	18.3	6.0	3.7	2.8
Exports	-2.8	-5.6	-9.8	-2.4	10.0	6.9	-4.3	3.8	3.7
Imports	-12.7	-3.4	-0.9	2.5	2.3	14.6	-0.1	1.7	2.4
Inflation and exchange rate									
CPI (period average)	4.1	2.9	3.3	3.7	2.4	3.4	3.6	6.1	3.8
Real effective exchange rate 1/	2.1	1.1	2.2	-3.2	-1.6	2.3	-1.8	0.5	...
					(Percent of GDP)				
Balance of payments									
Current account	11.2	16.7	-17.3	-7.8	2.4	-9.0	-2.7	0.1	1.3
Oil sector	13.9	18.1	-8.6	1.8	8.6	-1.4	10.4	8.1	8.0
Non-oil	-2.7	-1.4	-9.3	-9.6	-6.1	-7.6	-13.1	-8.0	-6.7
Financial and capital account	-12.6	-12.1	18.6	4.8	-2.6	7.7	5.0	-0.7	-0.6
Of which									
Direct Investment	-6.7	-13.8	17.3	7.6	6.8	5.8	25.3	...	...
Portfolio Investment	-0.4	2.2	3.9	2.1	1.5	-0.3	-1.7	...	...
Loans to central government	-2.2	-1.1	-1.1	2.3	-0.6	-0.1	-0.6	...	...
Change in reserves (-=increase) 2/	0.8	-4.3	-2.1	1.8	-0.1	1.0	-2.3	0.0	-1.0
					(Percent change)				
Monetary aggregates									
Net foreign assets	-8.1	24.4	5.9	-8.8	3.1	-9.1	8.9	-3.1	5.4
Net domestic assets	7.7	-2.3	13.1	18.1	3.2	12.4	0.7	7.8	5.8
Domestic credit	8.4	2.1	10.3	12.8	6.1	10.7	2.2	7.9	4.6
To private sector	9.5	3.7	12.4	11.3	4.9	9.5	4.3	4.4	4.3
Money and quasi-money	2.3	5.9	10.5	8.9	3.2	6.2	2.7	4.9	5.7
Money	1.0	17.6	20.5	10.5	3.0	0.4	9.4	4.9	5.7
Quasi-money	3.0	-0.2	4.3	7.7	3.4	10.4	-1.7	4.9	5.7
					(Percent of GDP)				
Public finances central government									
Revenue and grants	22.2	21.4	21.7	27.3	21.0	21.9	22.7	23.4	23.1
Expenditure	21.6	22.2	24.9	25.4	29.6	24.9	25.3	25.4	24.7
Balance incl. AZV 3/	0.6	-0.8	-3.2	1.9	-8.6	-3.0	-2.6	-2.0	-1.6
Balance of AZV 3/	...	-1.1	-1.3	-0.9	-0.7	-0.8	-0.1	-0.5	-0.6
Government debt									
External (millAfl)	724.8	752.9	893.7	724.2	836.3	856.9	933.8	981.4	1020.5
Domestic (mill Afl)	570.7	715.5	720.9	753.5	1026.9	1197.9	1182.7	1318.3	1357.4
External	21.6	21.9	25.7	20.0	21.0	20.6	21.5	20.9	20.5
Domestic	17.0	20.8	20.7	20.8	25.8	28.8	27.3	28.1	27.3
Interest rates, in percent 4/									
Deposit rate	6.20	5.84	5.56	5.33	4.4	4.0	3.9	4.0	...
Lending rate	12.1	12.1	13.1	11.40	11.4	11.4	11.1	11.8	...

Sources: Data provided by the Aruban authorities; and IMF staff estimates.

1/ Trade-weighted, CPI based. End of period.
2/ Including gold, excluding revaluation differences.
3/ The health care fund (AZV) was introduced in 2001.
4/ Data for 2007 refer to the second quarter.

Table 2. Aruba: Estimated GDP and Components, 2000-2012

(In millions of Aruban florins at current prices)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Final consumption expenditure 1/	2,374	2,555	2,695	2,842	2,965	3,130	3,310	3,558	3,742	3,898	4,085	4,286	4,492
Real percentage change	0.2	4.6	2.1	1.7	1.9	2.1	2.0	1.3	1.3	1.1	1.7	1.9	1.7
Household final consumption expenditure	1,656	1,712	1,820	1,947	2,041	2,199	2,322	2,511	2,664	2,809	2,963	3,125	3,296
Real percentage change	-0.7	0.5	2.9	3.2	2.3	4.2	1.9	1.9	2.2	2.4	2.4	2.4	2.4
Government final consumption expenditure	718	843	874	894	925	931	988	1,047	1,078	1,089	1,122	1,161	1,196
Real percentage change	2.4	14.1	0.3	-1.3	0.9	-2.6	2.3	-0.1	-0.8	-1.9	0.0	0.5	0.0
Gross capital formation 1/	855	815	935	1,057	1,129	1,364	1,495	1,582	1,661	1,737	1,805	1,876	1,951
Real percentage change	-13.7	-7.4	11.1	9.0	4.3	16.9	5.7	-0.2	1.1	1.5	0.9	0.9	1.0
Private gross capital formation	827	792	912	1,007	1,069	1,300	1,430	1,519	1,599	1,672	1,731	1,799	1,871
Real percentage change	-12.8	-7.0	11.6	6.4	3.7	17.6	6.1	0.1	1.4	1.5	0.5	0.9	1.0
Public gross capital formation	28	23	23	50	60	64	65	63	62	65	73	77	81
Real percentage change	-34.8	-19.3	-4.7	112.6	16.2	3.9	-2.6	-7.6	-5.6	1.5	9.7	1.9	1.9
Exports of goods and services 1/ 2/	2,495	2,423	2,256	2,283	2,574	2,846	2,824	3,111	3,349	3,609	3,871	4,127	4,399
Real percentage change	-2.8	-5.6	-9.8	-2.4	10.0	6.9	-4.3	3.8	3.7	4.6	4.1	3.5	3.5
Of which: tourism services	1,454	1,497	1,377	1,387	1,603	1,678	1,661	1,852	2,017	2,209	2,401	2,582	2,776
Real percentage change	8.1	0.1	-11.0	-2.8	12.8	1.2	-4.5	5.1	4.9	6.3	5.5	4.4	4.4
Less: imports of goods and services 1/	2,370	2,356	2,411	2,564	2,685	3,181	3,295	3,555	3,777	4,018	4,254	4,494	4,744
Real percentage change	-12.7	-3.4	-0.9	2.5	2.3	14.6	-0.1	1.7	2.4	3.3	2.8	2.6	2.5
Gross domestic product at market prices	3,353	3,437	3,475	3,618	3,983	4,159	4,334	4,696	4,975	5,226	5,506	5,795	6,099
Real percentage change	3.7	-0.7	-2.5	1.5	7.5	1.0	0.6	2.1	2.1	2.0	2.3	2.2	2.2
CPI	4.1	2.9	3.3	3.7	2.4	3.4	3.6	6.1	3.8	3.0	3.0	3.0	3.0

Sources: CBA; and IMF staff projections.

1/ Real percentage changes are computed using consumer price inflation.

2/ Trade data exclude the imports of crude oil and exports of refined petroleum products. However, an estimation of the net value added of the Coastal oil refinery is included in the exports data.

Table 3a. Aruba: Balance of Payments Summary, 2000-2012

								Est.	Staff Projections				
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
	(In millions of U.S. dollars)												
Current Account	210.2	320.3	-335.5	-157.8	54.1	-208.8	-65.0	2.7	36.8	63.0	85.4	112.5	133.5
Merchandise trade balance	-58.4	52.2	-535.8	-347.9	-235.8	-5.6	-172.2	-330.0	-353.5	-404.5	-456.6	-509.7	-563.8
Exports of goods	2,525.1	2,423.0	1,487.8	2,052.1	2,723.5	3,483.0	3,668.4	3,100.9	3,273.5	3,305.9	3,324.7	3,343.6	3,362.8
Imports of goods	2,583.5	2,370.8	2,023.6	2,399.9	2,959.3	3,488.7	3,840.7	3,430.9	3,626.9	3,710.5	3,781.2	3,853.3	3,926.6
Services	364.4	374.2	394.4	317.7	458.2	395.5	333.5	533.8	600.6	685.4	768.2	856.9	940.9
Exports of services	1,008.8	988.4	1,000.7	1,045.3	1,247.9	1,304.0	1,316.7	1,491.2	1,613.9	1,738.1	1,863.3	1,995.6	2,125.4
Imports of services	644.5	614.1	606.3	727.6	789.7	908.5	983.2	931.0	982.4	1,039.6	1,095.5	1,151.6	1,212.3
Of which: Travel and tourism	668.0	687.1	674.8	669.8	837.5	875.9	839.8	976.7	1,068.6	1,176.0	1,282.9	1,384.3	1,492.5
Income and current transfers	-95.8	-106.1	-194.1	-127.7	-168.2	-598.8	-226.3	-201.1	-210.3	-217.8	-226.2	-234.8	-243.6
Income	-20.2	-48.4	-125.1	-42.1	-64.9	-472.7	-105.2	-84.6	-89.6	-94.2	-99.2	-104.4	-109.9
Current Transfers	-75.6	-57.8	-69.0	-85.6	-103.3	-126.1	-121.1	-116.5	-120.6	-123.7	-127.0	-130.3	-133.7
Financial and capital account	-236.0	-231.6	360.8	96.2	-57.3	179.5	120.2	-19.3	-17.9	-26.2	-52.5	-89.1	-112.1
Financial account	-247.3	-230.1	339.5	-4.1	-76.3	160.9	99.1	...	...	...	...	...	...
Direct investment	-125.8	-264.2	336.5	153.4	152.3	134.2	613.2	...	...	...	...	...	...
Portfolio investment	-6.7	42.2	75.5	41.8	32.8	-7.9	-40.2	...	...	...	...	...	...
Loans to central government	-42.0	-21.9	-21.8	45.8	-13.1	-3.2	-13.8	...	...	...	...	...	...
Banking sector (net increase in liabilities)	11.1	10.3	18.4	-2.1	-9.6	11.2	23.9	11.2	9.1	-8.9	-5.0	4.6	6.6
Other	-84.0	3.5	-69.1	-243.0	-238.8	26.6	-484.0	...	...	...	...	...	...
Capital account	11.2	-1.5	21.3	100.3	18.9	18.5	21.1	...	...	...	...	...	...
Errors and omissions	10.8	-5.9	14.9	25.3	4.7	7.2	-0.2	5.4	0.0	0.0	0.0	0.0	0.0
Change in reserves (-=increase) 1/	15.0	-82.8	-40.2	36.3	-1.6	22.2	-55.1	0.0	-27.9	-27.9	-27.9	-27.9	-27.9
	(In percent of GDP)												
Current account	11.2	16.7	-17.3	-7.8	2.4	-9.0	-2.7	0.1	1.3	2.2	2.8	3.5	3.9
Merchandise trade balance	-3.1	2.7	-27.6	-17.2	-10.6	-0.2	-7.1	-12.6	-12.7	-13.9	-14.8	-15.7	-16.5
Exports of goods	134.8	126.2	76.6	101.5	122.4	149.9	151.5	118.2	117.8	113.2	108.1	103.3	98.7
Imports of goods	137.9	123.5	104.3	118.7	133.0	150.2	158.6	130.8	130.5	127.1	122.9	119.0	115.2
Services	19.4	19.5	20.3	15.7	20.6	17.0	13.8	20.3	21.6	23.5	25.0	26.5	27.6
Exports of services	53.8	51.5	51.6	51.7	56.1	56.1	54.4	56.8	58.1	59.5	60.6	61.6	62.4
Imports of services	34.4	32.0	31.2	36.0	35.5	39.1	40.6	35.5	35.3	35.6	35.6	35.6	35.6
Income and current transfers	-5.1	-5.5	-10.0	-6.3	-7.6	-25.8	-9.3	-7.7	-7.6	-7.5	-7.4	-7.3	-7.2
Financial and capital account	-12.6	-12.1	18.6	4.8	-2.6	7.7	5.0	-0.7	-0.6	-0.9	-1.7	-2.8	-3.3
Financial account	-13.2	-12.0	17.5	-0.2	-3.4	6.9	4.1	...	...	...	...	...	...
Direct investment	-6.7	-13.8	17.3	7.6	6.8	5.8	25.3	...	...	...	...	...	...
Portfolio investment	-0.4	2.2	3.9	2.1	1.5	-0.3	-1.7	...	...	...	...	...	...
Loans to central government	-2.2	-1.1	-1.1	2.3	-0.6	-0.1	-0.6	...	...	...	...	...	...
Banking sector (net increase in liabilities)	0.6	0.5	0.9	-0.1	-0.4	0.5	1.0	0.4	0.3	-0.3	-0.2	0.1	0.2
Other	-4.5	0.2	-3.6	-12.0	-10.7	1.1	-20.0	...	...	...	...	...	...
Capital account	0.6	-0.1	1.1	5.0	0.9	0.8	0.9	...	...	...	...	...	...
Errors and omissions	0.6	-0.3	0.8	1.3	0.2	0.3	0.0	0.2	0.0	0.0	0.0	0.0	0.0
Change in reserves (-) 1/	0.8	-4.3	-2.1	1.8	-0.1	1.0	-2.3	0.0	-1.0	-1.0	-0.9	-0.9	-0.8
Memorandum items													
Non-oil current account	-2.7	-1.4	-9.3	-9.6	-6.1	-7.6	-13.1	-8.0	-6.7	-5.5	-4.6	-3.5	-2.8
Oil sector current account	13.9	18.1	-8.6	1.8	8.6	-1.4	10.4	8.1	8.0	7.7	7.3	7.0	6.7

Sources: CBA; and IMF staff estimates.

1/ Including gold, excluding revaluation differences.

Table 3b. Aruba: Non-Oil Balance of Payments Summary, 2000-2012 1/

								Est.	Staff Projections				
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
	(In millions of U.S. dollars)												
Current Account	-50.3	-26.6	-180.7	-193.9	-136.2	-176.0	-316.5	-208.6	-186.3	-162.0	-140.6	-114.5	-94.5
Merchandise trade balance	-563.5	-523.5	-555.6	-617.5	-684.9	-736.5	-776.5	-837.7	-889.3	-945.1	-999.5	-1,055.0	-1,111.4
Exports of goods	102.7	109.1	83.9	63.8	57.7	61.7	78.0	84.5	89.4	93.9	98.7	103.7	108.9
Imports of goods	666.1	632.6	639.5	681.3	742.5	798.2	854.5	922.1	978.7	1,039.0	1,098.2	1,158.7	1,220.3
Services	583.1	582.1	553.7	531.8	692.2	725.0	653.1	802.2	883.9	971.2	1,055.3	1,145.2	1,230.4
Exports of services	1,006.0	983.8	996.6	1,040.8	1,242.4	1,298.9	1,314.2	1,491.2	1,613.9	1,738.1	1,863.3	1,995.6	2,125.4
Imports of services	422.9	401.7	442.9	509.0	550.2	573.9	661.2	689.0	730.1	766.9	808.0	850.4	895.0
Of which: Travel and tourism	668.0	687.1	674.8	669.8	837.5	875.9	839.8	976.7	1,068.6	1,176.0	1,282.9	1,384.3	1,492.5
Income and current transfers	-69.9	-85.3	-178.8	-108.2	-143.5	-164.5	-193.1	-173.2	-180.8	-188.1	-196.3	-204.8	-213.5
Income	-20.2	-48.4	-125.1	-42.1	-64.9	-472.7	-105.2	-84.6	-89.6	-94.2	-99.2	-104.4	-109.9
Current Transfers	-75.6	-57.8	-69.0	-85.6	-103.3	-126.1	-121.1	-116.5	-120.6	-123.7	-127.0	-130.3	-133.7
Financial and capital account	24.5	115.4	206.0	132.2	133.0	146.7	371.7	203.3	214.2	190.0	168.5	142.5	122.4
Financial account	13.2	116.9	184.7	32.0	114.1	128.2	350.6	183.7	194.5	169.8	148.7	122.6	102.5
Direct investment	112.8	67.3	100.7	125.6	110.1	138.4	328.3	139.9	141.7	119.7	101.5	77.7	64.7
Portfolio investment	-6.0	42.2	76.0	42.6	33.2	-7.5	-39.5	-12.7	-12.9	-10.9	-9.2	-7.0	-5.9
Loans to central government	-42.0	-21.9	-21.8	45.8	-13.1	-3.2	-13.8	26.6	21.8	23.3	24.1	22.6	20.6
Banking sector (net increase in liabilities)	32.3	34.5	47.3	78.3	29.2	40.1	89.8	66.5	67.5	50.1	54.2	64.0	66.2
Other	-83.9	-5.3	-17.5	-260.4	-45.3	-39.6	-14.1	-36.6	-23.7	-12.4	-21.9	-34.7	-43.2
Capital account	11.2	-1.5	21.3	100.3	18.9	18.5	21.1	19.5	19.7	20.1	19.8	19.9	19.9
Errors and omissions	10.8	-5.9	14.9	25.3	4.7	7.2	-0.2	5.4	0.0	0.0	0.0	0.0	0.0
Change in reserves (-=increase) 1/	15.0	-82.8	-40.2	36.3	-1.6	22.2	-55.1	0.0	-27.9	-27.9	-27.9	-27.9	-27.9
	(In percent of GDP)												
Current account	-2.7	-1.4	-9.3	-9.6	-6.1	-7.6	-13.1	-8.0	-6.7	-5.5	-4.6	-3.5	-2.8
Merchandise trade balance	-30.1	-27.3	-28.6	-30.5	-30.8	-31.7	-32.1	-31.9	-32.0	-32.4	-32.5	-32.6	-32.6
Exports of goods	5.5	5.7	4.3	3.2	2.6	2.7	3.2	3.2	3.2	3.2	3.2	3.2	3.2
Imports of goods	35.6	32.9	32.9	33.7	33.4	34.4	35.3	35.2	35.2	35.6	35.7	35.8	35.8
Services	31.1	30.3	28.5	26.3	31.1	31.2	27.0	30.6	31.8	33.3	34.3	35.4	36.1
Exports of services	53.7	51.2	51.3	51.5	55.8	55.9	54.3	56.8	58.1	59.5	60.6	61.6	62.4
Imports of services	22.6	20.9	22.8	25.2	24.7	24.7	27.3	26.3	26.3	26.3	26.3	26.3	26.3
Income and current transfers	-3.7	-4.4	-9.2	-5.4	-6.5	-7.1	-8.0	-6.6	-6.5	-6.4	-6.4	-6.3	-6.3
Financial and capital account	1.3	6.0	10.6	6.5	6.0	6.3	15.4	7.7	7.7	6.5	5.5	4.4	3.6
Financial account	0.7	6.1	9.5	1.6	5.1	5.5	14.5	7.0	7.0	5.8	4.8	3.8	3.0
Direct investment	6.0	3.5	5.2	6.2	4.9	6.0	13.6	5.3	5.1	4.1	3.3	2.4	1.9
Portfolio investment	-0.3	2.2	3.9	2.1	1.5	-0.3	-1.6	-0.5	-0.5	-0.4	-0.3	-0.2	-0.2
Loans to central government	-2.2	-1.1	-1.1	2.3	-0.6	-0.1	-0.6	1.0	0.8	0.8	0.8	0.7	0.6
Banking sector (net increase in liabilities)	1.7	1.8	2.4	3.9	1.3	1.7	3.7	2.5	2.4	1.7	1.8	2.0	1.9
Other	-4.5	-0.3	-0.9	-12.9	-2.0	-1.7	-0.6	-1.4	-0.9	-0.4	-0.7	-1.1	-1.3
Capital account	0.6	-0.1	1.1	5.0	0.9	0.8	0.9	0.7	0.7	0.7	0.6	0.6	0.6
Errors and omissions	0.6	-0.3	0.8	1.3	0.2	0.3	0.0	0.2	0.0	0.0	0.0	0.0	0.0
Change in reserves (-) 2/	0.8	-4.3	-2.1	1.8	-0.1	1.0	-2.3	0.0	-1.0	-1.0	-0.9	-0.9	-0.8
Memorandum items													
Import coverage ratio													
(authorities' methodology) (months) 3/	5.3	7.0	7.3	6.3	5.9	5.0	5.1	4.6	4.6	4.7	4.8	4.8	4.8
Import coverage ratio (months) 4/	2.7	3.6	3.8	3.2	3.0	2.6	3.0	2.9	2.9	2.9	2.9	3.0	3.0

Sources: CBA; and IMF staff estimates.

1/ Excluding the oil sector.
2/ Including gold, excluding revaluation differences.
3/ Net foreign assets of the monetary system divided by present-year merchandise imports (excluding the oil sector).
4/ Official reserves of the CBA divided by imports of goods and services of the following year (excluding the oil sector).

Table 4. Aruba: Indicators of External and Financial Vulnerability, 2000-2008

	2000	2001	2002	2003	2004	2005	2006	Staff Projections 2007	2008
External indicators									
Exports goods and services (annual percent change, in U.S. dollars)	46.5	-3.5	-27.1	24.5	28.2	20.5	4.1	-7.9	6.4
Imports goods and services (annual percent change, in U.S. dollars)	18.6	-7.5	-11.9	18.9	19.9	17.3	9.7	-9.6	5.7
Current account balance (percent of GDP)	11.2	16.7	-17.3	-7.8	2.4	-9.0	-2.7	0.1	1.3
Capital and financial account balance (percent of GDP)	-12.6	-12.1	18.6	4.8	-2.6	7.7	5.0	-0.7	-0.6
Inward portfolio investment (percent of GDP)	-0.4	2.2	3.9	2.1	1.5	-0.3	-1.7	...	...
Inward foreign direct investment (percent of GDP)	-6.7	-13.8	17.3	7.6	6.8	5.8	25.3	...	...
Official reserves (in Af., millions)	413.3	580.7	676.3	611.5	615.9	591.6	731.1	731.1	781.1
Official reserves (in U.S. dollars, millions)	230.9	324.4	377.8	341.6	344.1	330.5	408.4	408.4	436.4
Broad money (in Af., millions)	1,738.3	1,840.6	2,033.6	2,214.1	2,285.3	2,426.9	2,492.3	2,615.0	2,763.9
Reserves (in Af., millions)	530.4	660.0	699.0	637.8	657.7	597.9	651.2	631.2	665.0
Broad money to net foreign assets (ratio)	3.3	2.8	2.9	3.5	3.5	4.1	3.8	4.1	4.2
Central bank foreign liabilities (in U.S. dollars, millions)	1.3	1.5	4.7	1.5	2.0	2.6	3.1	3.7	4.2
Import coverage ratio									
(authorities' methodology) (months) 1/ 2/	5.3	7.0	7.3	6.3	5.9	5.0	5.1	4.6	4.6
Import coverage ratio (months) 1/ 3/	2.7	3.6	3.8	3.2	3.0	2.6	3.0	2.9	2.9
Total external debt (in Af., millions)	1,613.7	1,676.5	1,843.7	1,781.2	1,940.0	2,186.8	2,262.3	2,335.3	2,395.0
Total external debt (in percent of GDP)	48.1	48.8	53.1	49.2	48.7	52.6	52.2	49.7	48.1
Total external debt to exports (ratio in percent) 1/	24.8	26.7	40.3	31.3	26.6	24.9	24.7	27.7	26.7
Exchange rate (per U.S. dollar, period average)	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8
Financial Market Indicators									
Public sector debt (percent of GDP)	38.6	42.7	46.5	40.8	43.1	45.2	46.0	44.7	43.8
Public commercial external debt (percent of GDP)	15.2	16.4	19.7	13.7	15.4	16.2	17.4	...	...
Financial Sector Risk Indicators									
Mortgage credit to total assets (in percent)	17.6	18.6	18.5	18.6	19.1	21.6	21.7	...	...
Capital Adequacy									
Risk-weighted capital ratio=regulatory capital ratio	8.2	10.5	9.4	11.4	12.3	11.5	11.5	...	...
Tier 1 capital ratio	3.8	4.0	5.5	5.3	6.8	6.1	7.2	...	...
Asset Quality									
Nonperforming loans (net of provisions) to gross loans	2.6	3.4	2.7	3.3	2.3	0.2	0.0	...	...
Nonperforming loans (net of provisions) to regulatory capital	33.7	34.0	30.7	30.2	19.5	2.2	0.2	...	...
Large loans to regulatory capital	276.3	177.7	197.6	107.5	102.4	121.2	109.2	...	...
Earnings and profitability									
Return on assets (before taxes)	2.0	2.0	1.7	2.5	2.5	2.8	3.1	...	...
Return on assets (after taxes)	1.2	1.6	1.1	2.0	1.9	2.1	2.4	...	...
Return on equity (before taxes)	49.9	42.6	33.6	40.1	35.4	37.8	41.4	...	...
Return on equity (after taxes)	30.1	32.9	22.0	31.9	27.7	28.6	32.1	...	...
Interest margin to gross income	65.9	65.7	62.7	62.2	65.6	65.0	72.3	...	...
Noninterest expenses to gross income	85.1	78.7	83.5	71.7	73.5	73.2	70.1	...	...
Liquidity									
Loan-to-deposit ratio	75.6	73.1	71.9	73.2	75.4	76.7	75.4	...	...
Prudential liquidity ratio	24.4	27.5	28.2	27.8	27.1	26.5	28.0	...	...
Liquidity assets to short-term liabilities	78.0	85.4	77.6	77.2	75.0	78.7	81.1	...	...
Sensitivity to market risk									
Interest rate margin	5.8	6.2	7.3	6.1	7.0	7.4	7.2	...	...
Net foreign assets to regulatory capital	111.0	71.3	105.1	92.0	...	...	...	...	...

Sources: Data provided by the authorities, and IMF, *International Financial Statistics* .

1/ Imports and exports are from the balance of payments.

2/ Net foreign assets of the monetary system divided by present-year merchandise imports (excluding the oil sector).

3/ Official reserves of the CBA divided by imports of goods and services of the following year (excluding the oil sector).

Table 5. Aruba: Central Government Budgetary Operations, 2000-2012
(In percent of GDP)

										Staff Projections			
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Revenue	22.2	21.4	21.7	27.3	21.0	21.9	22.7	23.4	23.1	22.7	22.7	22.7	22.7
Taxes	18.6	17.6	17.5	19.0	17.8	18.7	19.6	20.3	20.4	20.4	20.4	20.4	20.4
Nontax revenue	3.1	3.8	3.1	7.5	2.5	2.4	2.4	2.4	2.2	2.2	2.2	2.2	2.2
Grants	0.5	0.0	1.1	0.8	0.8	0.7	0.8	0.6	0.5	0.0	0.0	0.0	0.0
Expenditure	21.6	22.2	24.9	25.4	29.6	24.9	25.3	25.4	24.7	24.3	24.2	24.0	23.8
Current spending	20.8	21.7	24.4	24.2	28.0	23.3	23.8	24.2	23.7	22.9	22.5	22.4	22.1
Labor costs 1/	11.2	10.8	12.4	12.1	14.2	12.1	12.5	12.2	11.9	11.7	11.4	11.2	10.9
Goods and services 2/	5.7	4.0	4.3	4.2	4.8	3.7	4.7	4.6	4.7	4.5	4.4	4.3	4.1
Interest	1.2	1.4	1.4	1.3	2.2	2.0	2.2	2.3	2.3	2.2	2.2	2.1	2.1
Other current spending 3/	2.6	5.6	6.3	6.6	6.8	5.5	4.3	5.1	4.9	4.5	4.5	4.8	4.9
Capital spending	0.8	0.5	0.5	1.2	1.7	1.5	1.5	1.2	1.0	1.3	1.7	1.7	1.7
Balance 3/	0.6	-0.8	-3.2	1.9	-8.6	-3.0	-2.6	-2.0	-1.6	-1.6	-1.6	-1.4	-1.2
Statistical discrepancy	1.9	3.0	-0.2	-0.5	-4.3	-0.5	1.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing	1.2	3.8	3.0	-2.4	4.3	2.5	3.6	2.0	1.6	1.6	1.6	1.4	1.2
Foreign	0.7	0.8	2.8	-5.5	2.4	1.1	1.3	1.0	0.8	0.8	0.8	0.7	0.6
Domestic	0.5	3.0	0.2	3.2	1.9	1.4	2.3	2.9	0.8	0.8	0.8	0.7	0.6
Monetary system	-0.4	-0.7	-1.0	-0.5	-0.5	-0.5	1.1	2.9	0.8	0.8	0.8	0.7	0.6
Nonmonetary sectors	-0.5	0.4	0.1	0.2	5.9	1.3	2.5	0.0	0.0	0.0	0.1	0.1	0.1
Change in unmet payment obligations	1.9	3.3	0.1	0.6	-3.2	0.6	-1.2	-0.2	-1.1	0.0	0.0	0.0	0.0
Net lending	0.5	0.0	-1.1	-2.8	0.2	0.0	0.2						
Memorandum items:													
Health care fund (AZV) balance 4/	...	-1.1	-1.3	-0.9	-0.7	-0.8	-0.1	-0.5	-0.6	-0.7	-0.8	-0.9	-1.0
Stock of unmet payment obligations 5/	4.4	7.6	7.6	7.9	3.9	4.4	3.0	1.9	1.3	1.2	1.2	1.1	1.1
Central government debt including arrears and AZV	38.6	42.7	46.5	40.8	46.8	49.4	48.8	49.0	47.8	47.1	46.2	45.3	44.2

Sources: Ministry of Finance; CBA; and IMF staff calculations and projections.

1/ Including payments of arrears to APFA.
2/ Including payments of arrears to suppliers.
3/ Including the balance of the AZV.
4/ The health care fund (AZV) was introduced in 2001.
5/ Stock of domestic payment obligations at end of period as a percent of (estimated) annual GDP.

Table 6. Aruba: Monetary Developments, 2000-2008

	2000	2001	2002	2003	2004	2005	2006	Staff Projections 2007	2008
	(In millions of Aruban florins, end of period)								
Net foreign assets	530.4	660.0	699.0	637.8	657.7	597.9	651.2	631.2	665.0
Central bank 1/	391.4	539.5	611.4	546.4	549.2	509.5	608.0	608.0	658.0
Commercial banks	139.0	120.5	87.6	91.4	108.5	88.4	43.2	23.2	7.0
Net domestic assets	1207.8	1180.5	1334.6	1576.4	1627.6	1829.0	1840.9	1983.8	2098.9
Domestic credit	1512.1	1543.9	1702.9	1921.5	2038.5	2256.1	2304.8	2486.0	2601.1
Public sector 1/	-1.1	-25.7	-62.0	-42.6	-21.3	1.4	-46.7	30.0	39.0
Private sector	1513.2	1569.6	1764.9	1964.1	2059.8	2254.7	2351.5	2456.0	2562.1
Enterprises	730.0	739.9	836.2	926.2	952.4	966.5	1026.1	1070.0	1123.5
Consumer credit	357.3	366.7	409.3	434.6	478.8	528.9	534.4	561.1	589.2
Housing mortgages	400.5	444.8	491.1	549.6	586.6	709.8	752.9	790.5	830.1
Other	25.4	18.2	28.3	53.7	42.0	49.5	38.1	34.3	19.3
Other items (net)	-304.3	-363.4	-368.3	-345.1	-410.9	-427.1	-463.9	-502.2	-502.2
Money supply (M2)	1738.3	1840.6	2033.6	2214.1	2285.3	2426.9	2492.3	2615.0	2763.9
Money (M1)	596.3	701.0	844.5	933.2	960.8	965.0	1055.4	1107.4	1170.4
Quasi-money	1142.0	1139.6	1189.1	1280.9	1324.5	1461.9	1436.9	1507.6	1593.5
	(Contribution to change in broad money, in percent)								
Net foreign assets	-2.7	7.5	2.1	-3.0	0.9	-2.6	2.2	-0.8	1.3
Central bank	-1.6	8.5	3.9	-3.2	0.1	-1.7	4.1	0.0	1.9
Commercial banks	-1.2	-1.1	-1.8	0.2	0.8	-0.9	-1.9	-0.8	-0.6
Net domestic assets	5.1	-1.6	8.4	11.9	2.3	8.8	0.5	5.7	4.4
Domestic credit	6.9	1.8	8.6	10.7	5.3	9.5	2.0	7.3	4.4
Public sector	-0.8	-1.4	-2.0	1.0	1.0	1.0	-2.0	3.1	0.3
Private sector	7.7	3.2	10.6	9.8	4.3	8.5	4.0	4.2	4.1
Enterprises	3.5	0.6	5.2	4.4	1.2	0.6	2.5	1.8	2.0
Consumer credit	1.3	0.5	2.3	1.2	2.0	2.2	0.2	1.1	1.1
Housing mortgages	2.9	2.5	2.5	2.9	1.7	5.4	1.8	1.5	1.5
Other	0.0	-0.4	0.5	1.2	-0.5	0.3	-0.5	-0.2	-0.6
Other items (net)	-1.9	-3.4	-0.3	1.1	-3.0	-0.7	-1.5	-1.5	0.0
Money supply (M2)	2.3	5.9	10.5	8.9	3.2	6.2	2.7	4.9	5.7
Money (M1)	0.3	6.0	7.8	4.4	1.2	0.2	3.7	2.1	2.4
Quasi-money	2.0	-0.1	2.7	4.5	2.0	6.0	-1.0	2.8	3.3
Memorandum items:									
Velocity of money	1.9	1.9	1.7	1.6	1.7	1.7	1.7	1.8	1.8
Official reserves of the central bank (in millions of U.S. dollars)	230.9	324.4	377.8	341.6	344.1	330.5	408.4	408.4	436.4
Inflation differential with the United States	0.7	0.0	1.7	1.4	-0.2	0.0	0.4	3.2	1.0
Real private sector credit (percent change)	5.4	0.9	9.2	7.6	2.4	6.1	0.7	-1.7	0.5
Real money supply (M2) (percent change)	-1.8	3.0	7.2	5.2	0.8	2.8	-0.9	-1.2	1.9
Share of foreign currency deposits in total deposits (percent) 2/	11.23	9.16	9.31	7.59	8.07	9.06	6.79	5.77	…

Source: CBA, *Quarterly and Monthly Bulletins* .

1/ Stock series is typically low and contains negative values; percent change calculations based on the convention that a less negative number or a change to a positive number constitute an increase in domestic credit to the public sector.

2/ Figure for 2007 refers to actual data at end-October.

Table 7. Aruba: Public Sector Debt Sustainability Framework, 2002-2012
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Debt-stabilizing primary balance 9/
1 **Baseline: Public sector debt 1/**	48.8	40.8	46.8	49.4	48.8	**49.0**	**47.8**	**47.1**	**46.2**	**45.3**	**44.2**	**-0.2**
Of which: foreign-currency denominated	25.7	20.0	21.0	20.6	21.5	20.9	20.5	20.3	20.1	19.8	19.4	
2 Change in public sector debt	5.1	-8.0	5.9	2.6	-0.6	0.1	-1.2	-0.7	-0.8	-0.9	-1.1	
3 Identified debt-creating flows (4+7+12)	2.7	-3.9	4.9	1.0	0.6	-1.7	-1.2	-0.7	-0.8	-0.9	-1.1	
4 Primary deficit	1.8	-3.2	6.5	1.0	0.3	-0.2	-0.7	-0.6	-0.6	-0.8	-0.9	
5 Revenue and grants	21.7	27.3	21.0	21.9	22.7	23.4	23.1	22.7	22.7	22.7	22.7	
6 Primary (noninterest) expenditure	23.5	24.2	27.5	22.8	23.1	23.2	22.4	22.0	22.0	21.9	21.7	
7 Automatic debt dynamics 2/	1.0	-0.7	-1.6	0.1	0.2	-1.5	-0.5	-0.1	-0.2	-0.2	-0.2	
8 Contribution from interest rate/growth differential 3/	1.0	-0.7	-1.6	0.1	0.2	-1.5	-0.5	-0.1	-0.2	-0.2	-0.2	
9 *Of which:* contribution from real interest rate	0.0	-0.5	1.2	0.5	0.5	-0.5	0.5	0.8	0.8	0.8	0.8	
10 *Of which:* contribution from real GDP growth	0.9	-0.2	-2.8	-0.4	-0.3	-1.0	-1.0	-0.9	-1.0	-1.0	-0.9	
11 Contribution from exchange rate depreciation 4/	0.0	0.0	0.0	0.0	0.0	...	...	...	...	...	...	
12 Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
13 Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
14 Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
15 Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
16 Residual, including asset changes (2-3) 5/	2.3	-4.1	1.0	1.6	-1.2	1.9	0.0	0.0	0.0	0.0	0.0	
Public sector debt-to-revenue ratio 1/	224.8	149.4	222.9	226.0	214.8	209.4	206.6	207.8	204.1	200.0	195.2	
Gross financing need 6/	263.2	1873.9	-1019.7	500.9	209.0	207.6	202.4	199.4	195.8	191.8	187.1	
in billions of U.S. dollars	5.1	37.9	-22.7	11.6	5.1	5.4	5.6	5.8	6.0	6.2	6.4	
Scenario with key variables at their historical averages 7/						**49.0**	**48.2**	**47.4**	**46.6**	**45.9**	**45.1**	**-0.9**
Scenario with no policy change (constant primary balance) in 2007-2012						**49.0**	**48.2**	**47.9**	**47.5**	**47.1**	**46.7**	**-0.2**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	-2.1	0.4	7.5	1.0	0.6	2.1	2.1	2.0	2.3	2.2	2.2	
Average nominal interest rate on public debt (in percent) 8/	3.3	2.7	5.8	4.5	4.7	5.0	4.9	4.9	4.9	4.9	4.9	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	0.0	-1.0	3.4	1.1	1.1	-1.1	1.1	1.9	1.9	1.9	1.9	
Nominal appreciation (increase in US dollar value of local currency, in percent)	0.0	0.0	0.0	0.0	0.0	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	3.3	3.7	2.4	3.4	3.6	6.1	3.8	3.0	3.0	3.0	3.0	
Growth of real primary spending (deflated by GDP deflator, in percent)	10.3	3.3	22.2	-16.1	1.6	2.4	-1.1	0.1	2.3	1.5	1.5	
Primary deficit	1.8	-3.2	6.5	1.0	0.3	-0.2	-0.7	-0.6	-0.6	-0.8	-0.9	

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.
2/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
3/ The real interest rate contribution is derived from the denominator in footnote 2/ as r - π (1+g) and the real growth contribution as -g.
4/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).
5/ For projections, this line includes exchange rate changes.
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
8/ Derived as nominal interest expenditure divided by previous period debt stock.
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Table 8. Aruba: External Debt Sustainability Framework, 2002-2012
(In percent of GDP, unless otherwise indicated)

		Actual					Projections						
		2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	**Debt-stabilizing non-interest current account 6/**
1	**Baseline: External debt**	53.1	49.2	48.7	52.6	52.2	**50.8**	**50.1**	**49.7**	**48.9**	**48.1**	**47.0**	**-3.3**
2	Change in external debt	4.3	-3.8	-0.5	3.9	-0.4	-1.4	-0.7	-0.4	-0.7	-0.8	-1.1	
3	Identified external debt-creating flows (4+8+9)	3.6	1.3	-3.3	-0.5	-2.7	1.5	0.5	0.4	0.1	0.1	-0.2	
4	Current account deficit, excluding interest payments	8.0	8.7	5.1	6.6	12.2	7.4	6.2	4.5	3.5	2.5	1.8	
5	Deficit in balance of goods and services	0.1	4.2	-0.3	0.5	5.1	1.4	0.2	-0.9	-1.8	-2.8	-3.5	
6	Exports	55.7	54.6	58.4	58.6	57.5	60.1	61.3	62.8	63.8	64.8	65.6	
7	Imports	55.8	58.9	58.1	59.1	62.6	61.4	61.5	61.9	62.0	62.1	62.1	
8	Net non-debt creating capital inflows (negative)	-5.2	-6.2	-4.9	-6.0	-13.6	-5.4	-5.2	-4.2	-3.4	-2.5	-2.0	
9	Automatic debt dynamics 1/	0.8	-1.2	-3.5	-1.0	-1.2	-0.4	-0.5	0.1	-0.1	0.0	0.0	
10	Contribution from nominal interest rate	1.3	0.9	1.0	1.0	0.9	0.6	0.5	1.0	1.0	1.0	1.0	
11	Contribution from real GDP growth	1.2	-0.7	-3.3	-0.5	-0.3	-1.0	-1.0	-0.9	-1.1	-1.0	-1.0	
12	Contribution from price and exchange rate changes 2/	-1.8	-1.4	-1.2	-1.6	-1.8	...	...	...	...	...	...	
13	Residual, incl. change in gross foreign assets (2-3) 3/	0.7	-5.1	2.8	4.4	2.3	-3.0	-1.2	-0.9	-0.9	-0.9	-0.9	
	External debt-to-exports ratio (in percent)	95.3	90.1	83.4	89.8	90.8	84.5	81.7	79.1	76.7	74.2	71.7	
	Gross external financing need (in billions of U.S. dollars) 4/	0.6	0.6	0.4	0.5	0.7	0.6	0.6	0.6	0.6	0.5	0.5	
	In percent of GDP	28.5	28.1	16.3	19.4	27.7	21.8	20.4	19.2	18.1	16.8	15.8	
	Scenario with key variables at their historical averages 5/						**50.8**	**48.6**	**46.4**	**44.3**	**42.2**	**40.1**	**-6.3**
	Key Macroeconomic Assumptions Underlying Baseline												
	Real GDP growth (in percent)	-2.5	1.5	7.5	1.0	0.6	2.1	2.1	2.0	2.3	2.2	2.2	
	GDP deflator in U.S. dollars (change in percent)	3.7	2.6	2.4	3.4	3.6	6.1	3.8	3.0	3.0	3.0	3.0	
	Nominal external interest rate (in percent)	2.7	1.8	2.2	2.2	1.8	1.2	1.0	2.2	2.2	2.2	2.2	
	Growth of exports (U.S. dollar terms, in percent)	-1.1	2.2	17.7	4.7	2.3	13.2	8.1	7.6	7.1	7.0	6.4	
	Growth of imports (U.S. dollar terms, in percent)	4.7	10.0	8.6	6.1	10.5	6.3	6.1	5.7	5.6	5.4	5.3	
	Current account balance, excluding interest payments	-8.0	-8.7	-5.1	-6.6	-12.2	-7.4	-6.2	-4.5	-3.5	-2.5	-1.8	
	Net non-debt creating capital inflows	5.2	6.2	4.9	6.0	13.6	5.4	5.2	4.2	3.4	2.5	2.0	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in U.S. dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

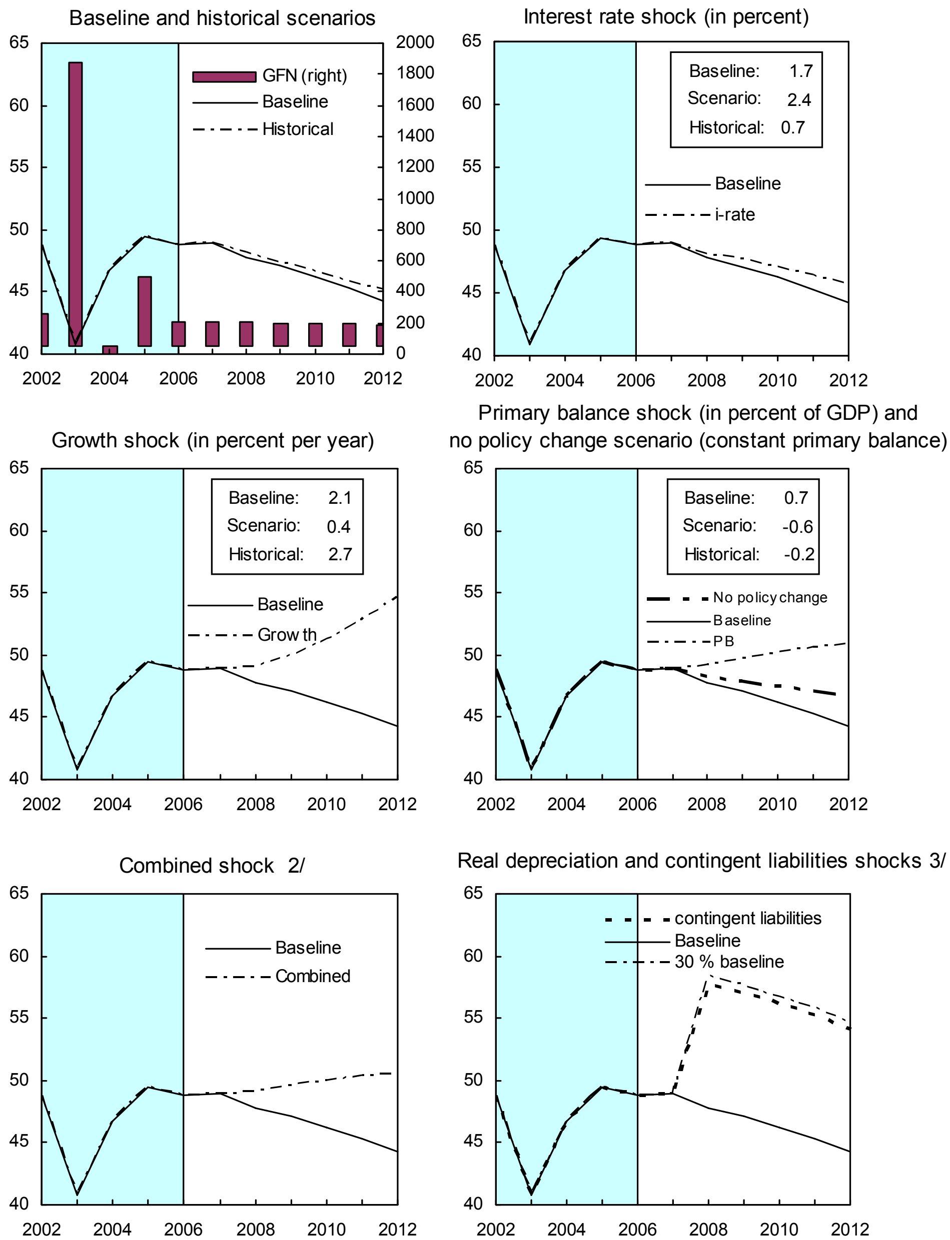
Table 9. Aruba: Medium-Term Macro Projection, 2006-2012

	Estimate		Staff Projections				
	2006	2007	2008	2009	2010	2011	2012
	(Percent change)						
GDP (in constant prices)							
GDP	0.6	2.1	2.1	2.0	2.3	2.2	2.2
Final consumption	2.0	1.3	1.3	1.1	1.7	1.9	1.7
Fixed gross capital formation	6.0	3.7	2.8	2.0	2.3	2.0	2.0
Exports	-4.3	3.8	3.7	4.6	4.1	3.5	3.5
Imports	-0.1	1.7	2.4	3.3	2.8	2.6	2.5
Inflation							
CPI (period average)	3.6	6.1	3.8	3.0	3.0	3.0	3.0
	(Percent of GDP)						
Balance of payments							
Current account	-2.7	0.1	1.3	2.2	2.8	3.5	3.9
Oil sector	10.4	8.1	8.0	7.7	7.3	7.0	6.7
Non-oil	-13.1	-8.0	-6.7	-5.5	-4.6	-3.5	-2.8
Financial and capital account	5.0	-0.7	-0.6	-0.9	-1.7	-2.8	-3.3
Change in reserves (-=increase) 1/	-2.3	0.0	-1.0	-1.0	-0.9	-0.9	-0.8
Public finances central government							
Revenue and grants	22.7	23.4	23.1	22.7	22.7	22.7	22.7
Expenditure	25.3	25.4	24.7	24.3	24.2	24.1	23.9
Balance incl. AZV 2/	-2.6	-2.0	-1.6	-1.6	-1.6	-1.4	-1.2
Balance of AZV 2/	-0.1	-0.5	-0.6	-0.7	-0.8	-0.9	-1.0
Government debt							
External	21.5	20.9	20.5	20.3	20.1	19.8	19.4
Domestic	24.5	23.8	23.3	22.9	22.6	22.1	21.6
Memorandum item:							
Nominal GDP (In millions of Aruban florins at market prices)	4,334.1	4,695.6	4,975.1	5,226.0	5,506.2	5,795.1	6,098.8

Sources: Data provided by the Aruban authorities; and IMF staff estimates.

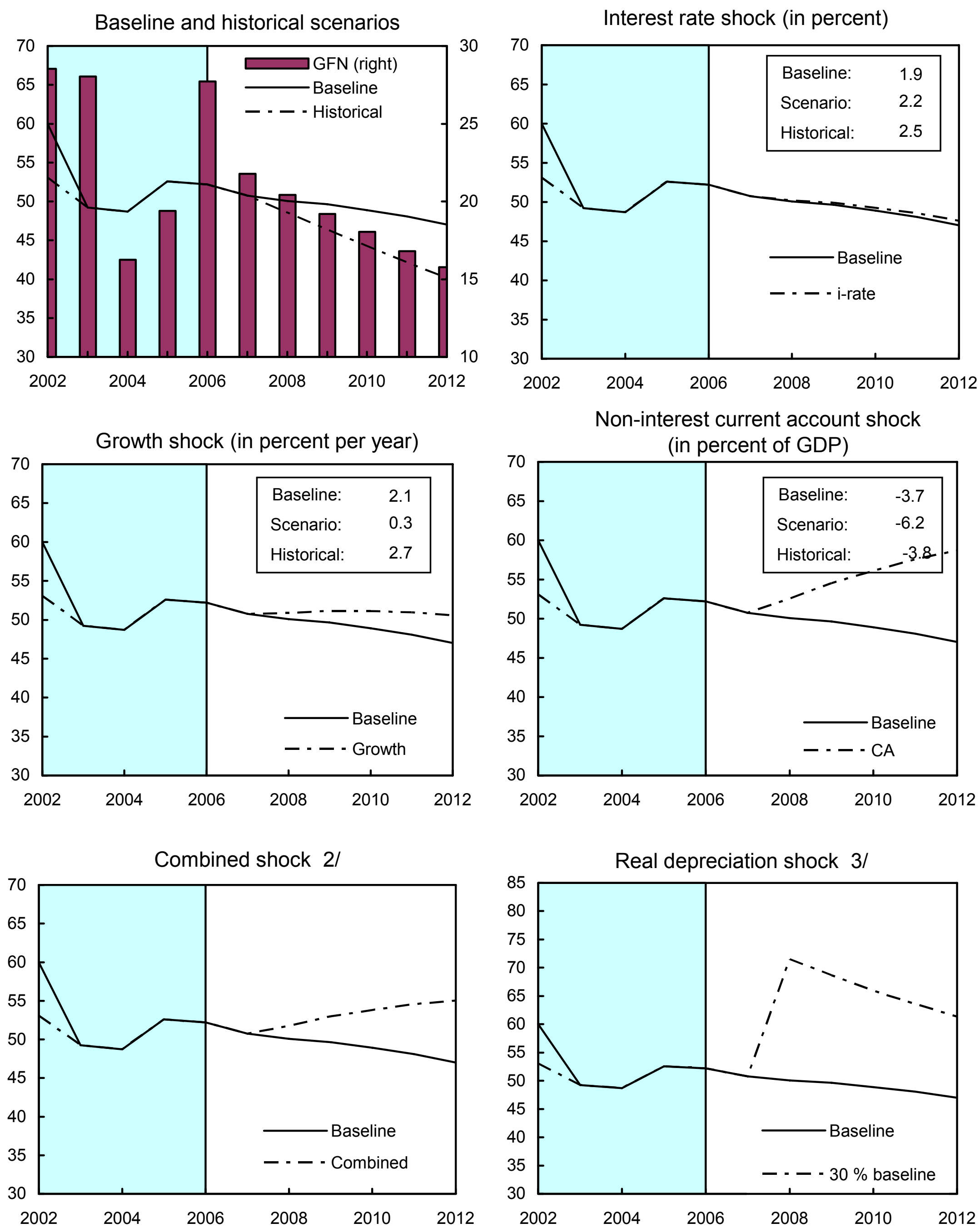
1/ Including gold, excluding revaluation differences.
2/ The health care fund (AZV) was introduced in 2001.

Figure 3. Aruba: Public Debt Sustainability: Bound Tests 1/
(Public debt in percent of GDP)



Sources: International Monetary Fund, country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2008, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Figure 4. Aruba: External Debt Sustainability: Bound Tests 1/
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
3/ One-time real depreciation of 30 percent occurs in 2008.

APPENDIX I. KINGDOM OF THE NETHERLANDS—ARUBA: FUND RELATIONS

(As of November 30, 2007)

- The consultation discussions, which are part of the 2007 Article IV consultation discussions with the Kingdom of the Netherlands, were held in Oranjestad during November 27–December 4, 2007. The staff team comprised Messrs. Zebregs (head), Daal, and Xiao (all EUR). It met with the governor, the prime minister, the finance minister, the president of the central bank, the labor minister, senior officials at the central bank and several ministries, representatives of labor unions, employer organizations, trade associations, and members of parliament. Mr. Bakker, Executive Director, also participated in the discussions.
- As part of the Kingdom of the Netherlands, Aruba has accepted the obligations under Article VIII and, apart from the foreign exchange tax described in the text, maintains an exchange system free of restrictions.
- The authorities held a joint press conference on the mission's concluding statement and have agreed to publish the staff report.

I. **Membership Status**: The Kingdom of the Netherlands is an original member of the Fund. On February 15, 1961, the Kingdom accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement for all territories.

II.	**General Resources Account:**	**SDR million**	**Percent of Quota**
	Quota	5,162.40	100.00
	Fund holdings of currency	4,806.62	93.11
	Reserve position in Fund	355.82	6.89
III.	**SDR Department:**	**SDR million**	**Percent of Allocation**
	Net cumulative allocation	530.34	100.00
	Holdings	588.61	110.99

IV. **Outstanding Purchases and Loans**: None

V. **Financial Arrangements:** None

VI. **Projected Payments to Fund** (SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming			
	2008	**2009**	**2010**	**2011**
Principal				
Charges/Interest	0.03	0.03	0.03	0.03
Total	0.03	0.03	0.03	0.03

VII. **Exchange Arrangements:**

The Aruban florin has been pegged to the U.S. dollar at Af. 1.79 per US$1 since January 1, 1986. In compliance with relevant UN resolutions, Aruba maintains exchange restrictions on financial transactions with Iraq and Kuwait.

There is an unapproved foreign exchange restriction arising from the foreign exchange tax on payments by residents to nonresidents. This tax, which amounts to 1.3 percent of the transaction value, was introduced when Aruba was part of the Netherlands Antilles to generate revenue for the government. Aruba adopted it after gaining autonomy (*status aparte*) in 1986. Since then, it has served as a source of general tax revenue for the central government of Aruba.

VIII. **Article IV Consultation:**

The Board concluded the last Article IV consultation discussions for Aruba on May, 25, 2005 on the basis of the staff report (IMF Country report 05/204) and the statistical appendix (IMF Country report 05/204). Consultations are conducted on a bi-annual cycle.

IX. **OFC Assessment:**

The Offshore Financial Sector Assessment was published in June 2002. An update of the assessment is scheduled to take place in the spring of 2008.

X. **Technical Assistance:**

Aruba participated in the Coordinated Portfolio Investment Survey (CPIS) in 2000–01 with the assistance of the Statistics Department. To assist the authorities in a self-assessment of the financial standards of its offshore center activities, a special mission from the Monetary and Exchange Affairs Department visited Aruba in late 2000 and early 2001.

Appendix II. Kingdom of the Netherlands—Aruba: Statistical Issues

Aruba's statistical base is broadly adequate for surveillance, but several shortcomings hinder effective policymaking. While the coverage, periodicity, and timeliness of balance of payments and monetary data are adequate, reporting of fiscal, national accounts, and labor market statistics needs to be strengthened.

1. Real sector

The Central Bureau of Statistics (CBS) has published national accounts for 1995 through 2002, as well as preliminary estimates for 2003–06. More detailed sector accounts have been made available for the years 1995–2000. The country also compiles CPI data.

2. Fiscal sector

Government finance statistics are not reported to STA, neither for publication in the *GSF Yearbook* nor in the *IFS*.

3. Monetary sector

The Central Bank of Aruba (CBA) reports monetary data to STA on a timely basis. The authorities have submitted test data in the format of Standardized Report Forms developed by STA for reporting monetary data, and work on finalizing these data is under way.

4. External sector

The CBA reports quarterly balance-of-payments data and annual IIP. It would be useful to publish a more detailed breakdown of exports and imports, for example by economic use (consumer goods, fuels, raw materials, and capital goods) and/or by commodity. It would be desirable to narrow—to the extent possible—the differences between trade data from the CBA and those from the CBS.

Monthly data on the official reserve position are published with a lag of one month. A breakdown in holdings of gold and foreign currency is provided. As prescribed by the SDDS, data on foreign liabilities of the monetary sector—including a breakdown by maturity and instrument—and the central government are published on a quarterly basis, with a lag of about one quarter. Data provision on foreign debt of the nonfinancial private sector is on an annual basis. A debt survey covering both the public and private sector provides information on the amount, average maturity, and currency denomination of foreign debt outstanding, but there is no disaggregation by instrument or information on amortization payments coming due.

TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE

	Date of Latest Observation	Date Received	Frequency of Data	Frequency of Reporting	Frequency of Publication
Exchange Rates	12/07	12/31/07	Monthly	Monthly	Quarterly
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	10/07	10/15/07	Weekly	Weekly	Monthly
Reserve/Base Money	10/07	12/12/07	Monthly	Monthly	Monthly
Broad Money	10/07	12/12/07	Monthly	Monthly	Monthly
Central Bank Balance Sheet	10/07	12/12/07	Monthly	Monthly	Monthly
Interest Rates[2]	10/07	12/12/07	Monthly	Monthly	Monthly
Consumer Price Index	10/07	12/12/07	Monthly	Monthly	Monthly
External Current Account Balance	Q2/07	10/30/07	Quarterly	Quarterly	Quarterly
Exports and Imports of Goods and Services	Q2/07	10/30/07	Quarterly	Quarterly	Quarterly
GDP/GNP[4]	2006	12/07	Irregular	Irregular	Irregular
Gross External Debt[3]	Q2/07	10/30/07	Annual	Annual	Annual

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes, and bonds.
[3] Including currency and maturity composition.
[4] 2003–06 are preliminary data.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 08/17
FOR IMMEDIATE RELEASE
February, 15 2008

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2007 Article IV Consultation with the Kingdom of the Netherlands—Aruba

On February 8, 2008, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Kingdom of the Netherlands—Aruba.[1]

Background

Aruba—pursuing open, market-friendly policies—continues to do well as one of the most developed islands in the Caribbean. Currently, the economy is on the rebound helped by a recovery in tourism, on which the economy is heavily dependent. A decline in tourist arrivals led to a slowdown in real GDP growth to 0.6 percent in 2006, but the deceleration proved to be temporary, and arrivals picked up again in the last quarter of 2006. The rebound in tourism continued in 2007, while activity in the construction and utility sectors was also robust.

Inflation has accelerated owing to one-off supply shocks. After broadly following changes in the U.S. Consumer Price Index (CPI) for several years, inflation in Aruba almost tripled from 2.5 percent year-on-year in December 2006 to 7.3 percent in October 2007. The acceleration is largely due to the introduction of a turnover tax in January 2007, which is estimated to have contributed 3 percentage points to CPI inflation in 2007.

There are signs that the labor market is tightening amid a further expansion of the tourist sector. The unemployment rate is estimated to have dropped from 6.9 percent in 2000 to 3.8 percent at

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

present. Wage pressures have been contained, however, by a large inflow of low-skilled migrant workers. This influx has helped Aruba maintain its international competitiveness.

Following the rebound in tourism, the deficit in the non-oil current account balance has begun to narrow again, coming in at 6 percent of GDP in the year ending in June 2007. The deficit had widened sharply to over 13 percent of GDP in 2006, as a result of declining tourism revenue, increasing workers’ remittances, and strong investment activity. Capital inflows have increased sharply as a result of increased investment activity. Foreign direct investment inflows more than doubled in 2006, reaching 13½ percent of GDP, though preliminary estimates indicate a slowdown in inflows in the first half of 2007.

The authorities have tightened macroeconomic policies to stem the rise in public debt and maintain a sufficient level of foreign exchange reserves. After a jump to an unusually large fiscal deficit (including losses of the general health insurance, AZV) of 8½ percent of GDP in 2004, the deficit narrowed to 2½ percent of GDP in 2006. The 2007 central government budget envisioned a further decline to 1½ percent of GDP but, because of renewed financial problems at the AZV, staff estimates a fiscal deficit of 2 percent of GDP in 2007. The monetary authorities have tightened credit ceilings and reserve requirements of commercial banks, contributing to a slowdown in the growth of real money balances.

Staff estimates real GDP to have expanded by about 2 percent in 2007 and to continue at this pace in 2008. The recovery in the tourist sector, together with continued robust investment, stands to be a key engine of growth in the near term. Average inflation is projected to ease from slightly more than 6 percent in 2007 to just below 4 percent in 2008 as the impact of the one-off supply shocks gradually dissipates. The deficit in the non-oil current account is projected to decline to about 8 percent of GDP in 2007 and 6¾ percent of GDP in 2008. The main risks to the outlook are a more pronounced and protracted slowdown in the U.S. economy and a further increase in oil prices. It is also possible that the full impact on inflation of the turnover tax will take longer to materialize, which, together with further increases in the oil price and signs of tightness in the labor market, could provide additional impetus to inflation.

Executive Board Assessment

Executive Directors commended the authorities’ promotion of an open economy and continued pursuit of market-friendly policies, which have fostered economic growth and stability. Directors noted that the outlook remains broadly favorable, although, given the heavy dependence on tourism and increasing public debt, the economy remains vulnerable to external shocks. Reducing this vulnerability will hinge on maintaining sustainable public finances and boosting economic growth.

Directors considered that, in the near term, maintaining macroeconomic stability will require further fiscal consolidation and an appropriately tight monetary policy. In order to meet this objective, they recommended prompt action to address the renewed financial problems of the general health insurance and, if needed, offsetting savings in current expenditure.

Directors supported the authorities' intention to keep monetary policy on hold until there are clear signs that inflationary pressures are abating. They welcomed plans to eliminate the credit ceilings and gradually increase the use of indirect monetary instruments.

Directors agreed that the peg of the florin to the U.S. dollar has served Aruba well and provides an effective nominal anchor. They considered the current exchange rate to be at a competitive level. Directors urged the authorities to eliminate the tax on foreign exchange transactions, which detracts from the investment climate and constitutes an unapproved exchange restriction under Article VIII of the Fund's Articles of Agreement.

Directors welcomed the authorities' plan for medium-term fiscal consolidation, and noted that additional measures to lower the growth of personnel costs and strengthen spending controls over goods and services would help achieve this objective. They observed that encouraging progress has been made in reforming the civil service pension fund, and underscored the importance of ensuring the financial soundness of the universal pay-as-you-go pension system in the face of rapid population ageing.

Directors welcomed improvements in Aruba's policy frameworks and public institutions, and encouraged the authorities to strengthen them further, including by advancing plans for increasing fiscal discipline through changing the budget law, improving fiscal management, and enhancing the fiscal framework. Recognizing that, in practice, the central bank enjoys a high degree of operational independence, Directors, nonetheless, viewed that formally establishing this principle in the central bank law would safeguard against undue interference. They noted that improving Aruba's statistical base would support more effective policymaking.

Directors looked forward to the development of a sustainable growth strategy and further improvements in the environment for private investment and diversification. In this regard, they welcomed recent tax reforms, and underscored the value of further simplification and greater reliance on indirect taxes.

Directors considered the financial system to be generally sound. They noted that the large exposure of commercial banks to the tourist sector warrants continued supervisory vigilance, and recommended that the central bank consider employing stress tests to gain additional insight in the banking sector's capacity to withstand large shocks.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Aruba: Selected Economic Indicators

	2003	2004	2005	2006	Est. 2007	Proj. 2008
			(Percent change)			
Real economy						
Real GDP	1.5	7.5	1.0	0.6	2.1	2.1
Nominal GDP	5.1	9.9	4.4	4.2	8.2	5.9
Real final consumption	1.7	1.9	2.1	2.0	1.3	1.3
Fixed gross capital formation	7.2	3.9	18.3	6.0	3.7	2.8
Real exports	-2.4	10.0	6.9	-4.3	3.8	3.7
Real imports	2.5	2.3	14.6	-0.1	1.7	2.4
Inflation and exchange rate						
CPI	3.7	2.4	3.4	3.6	6.1	3.8
Real exchange rate index (2000=100) 1/	100.1	98.5	100.7	98.9	99.4	98.8
			(In millions of U.S. dollars)			
Balance of payments						
Current account	-157.8	54.1	-208.8	-65.0	2.7	36.8
(In percent of GDP)	-7.8	2.4	-9.0	-2.7	0.1	1.3
Non-oil current account	-193.9	-136.2	-176.0	-316.5	-208.6	-186.3
(In percent of GDP)	-9.6	-6.1	-7.6	-13.1	-8.0	-6.7
Financial and capital account	96.2	-57.3	179.5	120.2	-19.3	-17.9
Errors and omissions	25.3	4.7	7.2	-0.2	5.4	0.0
Changes in reserves (-=increase) 2/	36.3	-1.6	22.2	-55.1	0.0	-27.9
			(Percent change)			
Monetary aggregates						
Net foreign assets	-8.8	3.1	-9.1	8.9	-3.1	5.4
Net domestic assets	18.1	3.2	12.4	0.7	7.8	5.8
Quasi-money	7.7	3.4	10.4	-1.7	4.9	5.7
			(In percent of GDP)			
Public finances central government						
Balance 3/	1.9	-8.6	-3.0	-2.6	-2.0	-1.6
External public debt	20.0	21.0	20.6	21.5	20.9	20.5
Domestic public debt	20.8	25.8	28.8	27.3	28.1	27.3
U.S. dollar	The Aruban florin is pegged to the U.S. dollar at Af. 1.79=US$1					
SDR (end of period)	2.7	2.8	2.6	2.7	2.8	...

Sources: Data provided by the Aruban authorities; and IMF staff estimates.
1/ Trade-weighted, CPI based. End of period.
2/ Including gold, excluding revaluation differences.
3/ Including the health care fund (AZV).

Statement by Age Bakker, Executive Director
for the Kingdom of the Netherlands—Aruba
February 8, 2008

I thank staff for their valuable work and subscribe to the main conclusions of the report.

Since the last Article IV mission in 2005, Aruba went through a difficult time as a consequence of a decline in tourism. However, a pick-up in tourist arrivals during 2007 and continued sound macroeconomic policies put the Aruban economy firmly back on the upward trend witnessed over the past 20 years. Due to the progress made over this period, Aruba has achieved a relatively high standard of living, a remarkable achievement given the challenges small open island economies typically face. While some short-term risks may arise from the slowdown of the U.S. economy, the solid economic fundamentals give reason for an optimistic medium-term outlook.

Fiscal policy

Staff rightly point out that the main challenge for Aruba lies on the fiscal front. Good progress has been made here in the past few years, with net lending on a declining path since 2004. The government is committed to further progress.

As regards the revenue side, a new turnover tax was introduced on January 1, 2007, which supported an increase in total government revenues of 3.8 percent in the first nine months of 2007. Staff point at the need to move away from direct taxation towards indirect consumption-based taxes given the mobility of capital and skilled labor, which certainly for a small and open economy as Aruba implies risks for government revenues. In fact, the shift towards indirect taxation is taking place. The introduction of the new turnover tax led to an increase of tax revenue on commodities by 4.8 percent in the first nine months of 2007, while the revenues from direct taxation decreased as a consequence of reductions in the wage tax rate and the corporate income tax rate.

Staff make three further concrete recommendations affecting government revenue (page 13). Concerning the recommendations on the rationalization of import duties and the reduction of income tax rates, the authorities tend to take these up as part of their mid-term policy objectives. The first priority in tax policy lies in assessing the full impact of the introduction of the turnover tax as well as an organizational restructuring of the tax department. Prudence requires to first reaching a period of relative calm in the tax administration before heading into the next phase of reform. At the same time, the changes in the foreign exchange taxation regime suggested by staff can be implemented at an earlier date as proposals have already been designed, which now have to be followed by a more detailed assessment of their fiscal impact and by translation into legislation to be submitted to Parliament.

The authorities are currently taking remedial measures to address the revenue shortfalls and expenditure overruns in the general health insurance (AZV) with the aim of closing the deficit by the end of 2008. Already before the identification of the AZV-deficit at the end of 2007, contingency plans had been drafted in order to deal with a hypothetical situation of deficit. The plans include the introduction of co-payments by the insured and a limitation of services provided, the latter being supported by the creation of possibilities for private sector parties to provide additional health insurance packages. These additional packages are targeted at health care for which the private sector is better suited to calculate the risks involved. Moreover, as a first immediate step, an increase in the government's contribution to the scheme has been effectuated amounting to 0.2% of GDP. Through expenditure cuts elsewhere in the budget the effects on the budget envelope have been limited.

The authorities realize well that further measures may be needed to address the medium- and long-term budgetary costs of an ageing population. In 2005, an initial reform of the civil servant pension fund has taken place, and this year reforms aiming at a further improvement of the coverage ratio to fully match future obligations are expected to be implemented. The authorities are aware that the public pay-as-you-go system should be reformed next. To contribute to the long-term sustainability of public finances, they also plan to balance the budget in 2009 and intend to bring the debt ratio below 40%. The latter will also help to create a safety buffer for dealing with external shocks and this buffer build-up is planned to be supplemented with a debt restructuring plan.

As the economic literature shows, strong budgetary institutions are a necessary condition for lasting budgetary consolidation and Aruba is making further progress on this front. A medium-term plan has been included in the budget and significant changes to the budget law will be implemented during the course of 2008. The reform initiatives aim for improved transparency in the budgetary process, among other things through the improvement of periodical reporting requirements regarding the budget execution. Moreover, the ability for the government to set numerical norms and enforce the fiscal envelopes in the medium term is ready to be introduced. The medium-term budgetary framework will include nominal expenditure ceilings which will be derived from revenue developments based on the economic growth assumptions, and which will target a decreasing deficit-to-GDP ratio.

Monetary policy and financial sector

The main objective of the CBA’s policies is to maintain relative price stability with the peg of the Aruban florin to the U.S. dollar as the key target in this regard. The Bank will therefore remain vigilant in monitoring foreign exchange flows and the net foreign exchange position of financial institutions to ensure that the level of international reserves remains appropriate. Official reserves at the end of the third quarter 2007 stood slightly below the 2006-level with an import coverage ratio of 3 months. Following the recovery of tourism, the non-oil current account improved sharply to -6 percent of GDP with the total current account registering a surplus.

During the last months of 2007, inflationary pressures have noticeably increased, which resulted in an inflation figure of 6.0 in 2007, the highest since 1994. To avoid a negative impact on the competitiveness of the island and to keep inflation expectations anchored, the central bank (CBA) has decided to put a ceiling on credit growth of 5% for 2008. Should there not be any comforting signs that inflation fades in the first months of this year, the Bank will take corrective measures to mop up excess liquidity and to curtail commercial lending below the ceiling, as has already been communicated to the banking sector.

Concerning the monetary policy framework, the authorities are working hard on further improvements. In 2007, a new President for the CBA has been appointed and the authorities wish to thank the IMF for their help in the selection process. Furthermore, the Bank started working towards further refinements in the policy framework, in line with staff's recommendations. 2008 will be a transition period, in which the reliance on more market-orientated indirect monetary instruments will be gradually increased, entailing initially cash reserve and liquidity requirements. By the end of the year credit ceilings are expected to be abolished.

The use of more market-orientated instruments should help to advance competition within the banking sector. The Aruban financial sector can be characterized as stable with profit margins on the high side. Nevertheless, the exposure of the banks to the tourist sector warrants special attention, especially in light of the slowdown of the US economy. While a negative impact on tourist arrivals cannot be excluded, the most recent figures based on preliminary bookings for the first quarter of 2008 do so far not point at a slowdown. To further improve the resilience of the sector, the CBA has increased the risk-weighted capital ratio from 10 to 12 percent in 2007. The international financial market turmoil has so far not affected the Aruban financial sector significantly, but the Bank remains vigilant in monitoring the situation and stands ready to take measures if need may be.