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Kingdom of the Netherlands—Aruba: 2010 Article IV Consultation Discussions—Staff Report; Informational Annex; Staff Statement; 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 2010 Article IV consultation discussions with the Kingdom of the Netherlands—Aruba, the following documents have been released and are included in this package:

- The staff report for the 2010 Article IV consultation discussions, prepared by a staff team of the IMF, following discussions that ended on September 9, 2010, with the officials of Aruba on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on October 6, 2010. 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 staff statement of October 20, 2010 updating information on recent developments.

- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its October 20, 2010 discussion of the staff report that concluded the Article IV consultation discussions.

- A statement by the Executive Director for 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.

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KINGDOM OF THE NETHERLANDS—ARUBA

Staff Report for the 2010 Article IV Consultation Discussions

Prepared by the Staff Representatives for the 2010 Consultation Discussions with the Kingdom of the Netherlands—Aruba

Approved by Erik de Vrijer and Aasim Husain

October 6, 2010

Context. Aruba is a small, open economy with a history of policies that successfully safeguarded macroeconomic stability. Tourism—which accounts for the bulk of economic activity—declined sharply with the global downturn, and Aruba's oil refinery closed temporarily in mid-2009. As a result, real GDP plummeted in 2009. A gradual recovery is now underway.

Challenges: An underlying fiscal shortfall of close to 6½ percent of GDP has piled up as a result of spending pressures that have built up over many years and tax cuts to combat the recession. If unaddressed, this would put public debt on an unsustainable path. A social dialogue between the government, employers, and trade unions has yielded an agreement on measures that enhance the financial soundness of Aruba's main pension and health care schemes, but yield limited fiscal savings in the short-term.

Focus of Consultation: Discussions focused primarily on the fiscal challenge and on options to address it within a medium-term framework. Staff recommended considering a simplified value-added tax as part of a comprehensive tax reform. As regards monetary policy, the central bank is moving from direct (credit ceiling) to more indirect (reserve requirement) instruments to enhance policy effectiveness. Staff welcomed the shift, but noted that the challenges to both monetary management and banking supervision would increase.

Authorities' response: The authorities consented largely with staff's advice on monetary policy and financial stability issues. On fiscal policy, the government agreed on the need for fiscal consolidation and noted that it intends to reduce the deficit to below 2 percent of GDP by 2014. However, the government emphasized cuts in the size of the civil service and investments in infrastructure to stimulate growth, and preferred to consider revenue measures only at a later stage.

Mission team: Messrs. Wiegand (head), Gottlieb, and Munteanu (all EUR). Staff met with Governor Refunjol, Prime Minister Eman, Minister of Finance de Meza, Central Bank President Semeleer, senior officials of the government and the central bank, members of parliament, and representatives of labor unions, business associations, think tanks, banks, and pension and health care funds. Ms. Barendregt (OED) participated in some of the discussions.

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I. Context and Recent Developments

1. **Aruba is a small, open economy with one of the highest living standards in the Caribbean and a history of stability-oriented macroeconomic policies** (Figure 1 and Table 1). In the period preceding the global financial crisis (2003–07), real GDP growth averaged 3 percent per year, boosted by tourism and foreign direct investment. The long-standing peg to the U.S. dollar helped create a positive investment climate. Annual credit ceilings set by the central bank kept credit growth at sustainable levels. A prudent fiscal policy—the central government deficit averaged 1.7 percent of GDP in the past 10 years—contained public debt at 40–45 percent of GDP, earning Aruba investment grade ratings from Standard & Poor's and Fitch.

2. **Since 2008, adverse external shocks have left Aruba in a difficult spot**.

- ***Tourism*** declined in the wake of the global downturn, compounded by a sharp decline of condominium construction for nonresidents. Between two-thirds and three-quarters of the economy are estimated to depend on tourism.
- ***Aruba's oil refinery*** shut down operations in July 2009, reflecting slim margins on refined petroleum products and a dispute over business turnover tax payments with the Aruban government. More than 2,000 jobs, accounting for about 5 percent of the workforce, were directly or indirectly linked to the refinery. In June of this year, however, the refinery's foreign owner unexpectedly announced to resume operations from November, as demand for refined petroleum products has recovered and the tax dispute with the authorities has been settled.
- Overall, ***real GDP*** contracted by 7½ percent in 2009, making Aruba's slump one of the most severe in the Caribbean (Figure 2 and Table 2). Unemployment increased sharply to 11.3 percent, amid rapid disinflation, sharp current account adjustment, and weak lending activity (Box 1 and Figure 3).

3. **The government reacted to the slump by loosening fiscal policy, using primarily permanent measures that have created a large underlying deficit** (Figure 4, Tables 3–4). Upon taking office in October 2009, the new government (Box 2) cut an unpopular business turnover tax (BBO) in half from 2010, in line with its economic program announced prior to the elections. The tax—introduced only in 2007, broadly in line with IMF recommendations to gradually shift from direct to indirect taxation—accounted for almost 20 percent of tax revenue in 2008, or close to 4 percent of GDP. The government also increased social transfers to mitigate the impact of the recession and initiated a social dialogue with labor unions and employers to address Aruba's most pressing socio-economic challenges.

4. **Monetary policy's effectiveness in the recession was hampered by a lack of instruments to stimulate lending** (Figures 5–6, Tables 5–6). Until last year, the central bank conducted monetary policy mostly by means of a ceiling on credit growth to the private sector, in the context of a fixed exchange rate with the U.S. dollar. In the downturn,

commercial banks cut lending volumes while preserving high interest margins, with no effective instrument at the disposal of the central bank to ease lending conditions. In response, the central bank abolished the credit ceiling at the beginning of this year and moved to conducting monetary policy by means of an unremunerated reserves requirement.

Box 1. Recent Macroeconomic Developments

Real GDP contracted by 7½ percent in 2009. Part of the decline owed to the shutdown of the refinery in July. However, GDP *excluding* refining also contracted by almost 5 percent, primarily reflecting a drop in tourism, reduced construction of condominiums, and knock-on effects on private consumption. The unemployment rate increased to 11.3 percent from 6.9 percent in 2008.

Consumer prices fell by 2.1 percent (annual average) in 2009, owing largely to a sharp decline in volatile energy and food prices. Core CPI inflation eased to 1.8 percent, down from 3.3 percent in 2008, and has declined further in the early months of 2010, reflecting weak domestic demand and the halving of the business turnover tax at the beginning of the year.

The external current account balance adjusted from a deficit of 5½ percent of GDP in 2008 to a surplus of 6 percent of GDP in 2009 (Figure 7, Tables 7a–7b). The refinery closure accounted for two-thirds of this shift, in part because the refinery imported reduced amounts of crude oil in 2009, but exported refined products using inventory. However, the non-oil current account also improved by almost 4 percentage points of GDP, amid lower non-oil imports, reduced dividend payments by foreign-owned companies, and a drop of remittances from nonresident workers to their home countries. The shift was accompanied by a fall in FDI and portfolio inflows.

Credit to the private sector contracted by about 1 percent in 2009, due to tight lending standards and weak demand for loans, especially from corporations. Corporate deposits increased, giving rise to large excess funds that banks invested either in foreign assets or deposited with the central bank.

The ***banking system*** remained profitable and preserved high capital and liquidity buffers, in spite of the downturn (Table 8). System-wide capital adequacy stood at 18 percent at end-June 2010, well above the prudential requirement of 14 percent. Nonperforming loans were 9½ percent of gross loans—with problem loans concentrated in commercial real estate and corporate lending—up from less than 7 percent at end-2008, but were almost fully provisioned.

Box 2. Constitutional Framework and Recent Political Developments

Aruba, a former Dutch colony, obtained autonomy ("status aparte") in 1986, thus becoming one of three countries that form the Kingdom of the Netherlands, together with the Netherlands and the Netherlands Antilles.[1] Aruba enjoys self-governance in internal affairs. Foreign and defense policy are conducted by the Kingdom.

Elections in September 2009 resulted in a majority for the *Arubaanse Volks Partij* (AVP), which controls 12 out of 21 seats in the Staten (parliament). Eight seats are occupied by the main opposition party *Movimiento Electoral di Pueblo* (MEP). The MEP controlled Aruba's government between 2001 and 2009. A cornerstone of Prime Minister Mike Eman's political program is improving relations with the Netherlands, which had deteriorated in previous years

5. **Aruba's external competitiveness appears solid and reserves coverage is broadly adequate, thus underpinning the peg with the U.S. dollar.** The real effective exchange rate measured in terms of core prices (i.e., excluding temporary fluctuations in food and energy prices) has depreciated slightly in recent years, while Aruba's market share in Caribbean tourism has held up well (Box 3). At end-2009, official reserves covered about 5½ months of imports and 100 percent of short term debt by residual maturity. Aruba's total external debt is high at more than 90 percent of GDP, but risks appear contained as much is in the form of FDI-related intra-company lending, while only small portions are short-term and/or portfolio funding. The largest short-term debt category—deposits of non-residents with Aruban banks, amounting to somewhat more than 10 percent of GDP—was stable during the crisis (Tables 9–10).

II. Macroeconomic Outlook

6. **A gradual recovery is under way, supported by a pick-up in tourism and the re-opening of the refinery**.

- In ***2010***, GDP is projected to contract by 2 percent. The drop reflects mostly the refinery closure during the first 10 months. GDP excluding refining is expected to stagnate, as some recovery in tourism and a surge in public spending are balanced by still weak private investment and consumption, notwithstanding some recent improvement in business perceptions and first signs of a recovery in construction activity (notably higher building permits). Inflation is projected to remain subdued.

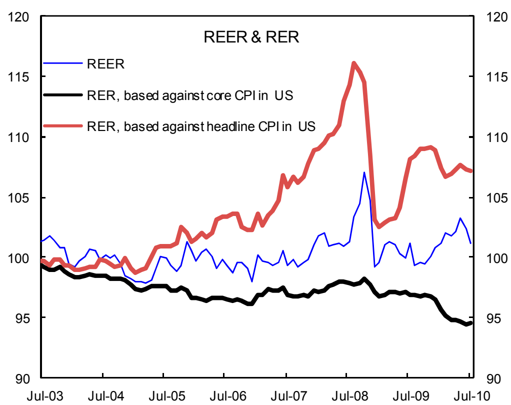
[1] The Netherlands Antilles will be dissolved on October 10 of this year. The two most populous islands, Curacao and Sint Maarten, will obtain status aparte for themselves, while three smaller islands will be integrated as municipalities into the Netherlands.

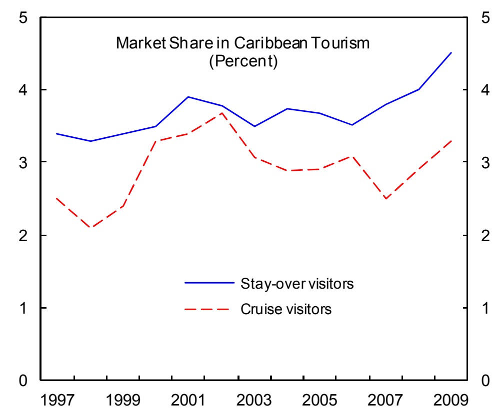
Box 3. External Competitiveness and Tourism Developments

Key drivers of Aruba's real effective exchange (REER) are (i) the inflation differential with the United States; and (ii) the exchange rate of the U.S. dollar vis-à-vis the euro, given that 15–20 percent of Aruba's trade is with the euro area. In 2007 and 2008, the REER appreciated sharply, as a result of increasing food and energy-related prices that have a weight of one-quarter in the Aruban consumer price index.

Excluding food and energy-related prices, Aruba's real exchange rate against the U.S. dollar remained flat or even depreciated slightly. Temporary import price pressures did therefore not spill over into Aruba's general price level, suggesting that second-round cost increases in reaction to higher food and energy prices remained contained.[2]

Another—and possibly more illuminating—approach to assessing competitiveness is to analyze the market share of Aruba's main export: tourism. Tourism exports fell (in real terms) by 6.3 percent in 2009, but such declines have been common across the Caribbean in the wake of the global recession. Data from the Caribbean Tourism Organization suggest that Aruba's market share actually *increased* in both 2008 and 2009, with respect to both stay-over and cruise visitors. Aruba's reputation as a "high-end" destination may have helped, as tourism losses have been concentrated in lower-cost segments of the market. Over the longer-term, Aruba's market share has been roughly stable.





Sources: Aruban authorities; and IMF staff estimates and calculations.

- In ***2011***, overall GDP growth is projected to surge temporarily to 7 percent as the refinery returns to full capacity. GDP excluding refining is projected to expand by more than 3 percent, owing to the realization of investment projects in hotel

[2] No unit labor cost-based REER is available.

construction and infrastructure, stronger tourism exports, and a general recovery in private consumption.

- **Risks to the outlook** are broadly balanced around this baseline, and relate primarily to the prospects for tourism and construction activity. With two-thirds of tourist coming from the United States, a significant factor is the strength of the recovery in the U.S. Uncertainties surrounding the government's planned investment program (¶14) also add to short- to medium-term risks.

7. **The authorities agreed with staff that over the longer-term Aruba's growth model from the pre-crisis years appears unsustainable.** Long-term prospects for tourism are dampened by the fact that U.S. consumption growth is expected to remain below pre-crisis levels, and by space constraints that limit the potential for a further quantitative expansion of tourism. As a consequence, the government is pursuing a growth strategy focused on upgrading existing tourism facilities, improving Aruba's infrastructure, and moving to more energy-efficient modes of production. IMF staff estimates Aruba's long-term potential annual real growth rate at about 1½ percent.

III. Policy Discussions

A. Restoring Sustainability of the Public Finances

Recent Fiscal Developments

8. **Notwithstanding Aruba's good fiscal track record, underlying pressures have built up over many years.** The main pension and health care schemes accumulated sizeable financial imbalances over time, reflecting in part the impact of population ageing (Box 4). The defined-benefit pension fund for civil servants (APFA) accrued a large actuarial deficit, and the general health care system (AZV) required increasing transfers from the central government, exceeding 3 percent of GDP in 2009. Spending pressures also built up on goods and services. One-off windfall receipts often camouflaged the underlying state of the public finances, such as a payment of more than 4 percent of GDP in 2008 from the Dutch government related to the sale of hotel shares.

9. **The fiscal loosening implemented this year further increased challenges, given the measures' permanent nature**. The overall fiscal deficit for 2010 is projected at slightly above 4 percent GDP, but it would have been much higher in the absence of the one-off tax settlement with the oil refinery (yielding more than 4½ percent of GDP). Cyclically weak revenue collection exacerbates the fiscal shortfall.

Box 4. Aruba's Main Health Care and Pension Schemes

APFA *(Algemeen Pensioenfonds Aruba),* a defined-benefit pension scheme for civil servants, was until recently structurally underfunded, reflecting generous benefits (70 percent of the final wage), an early retirement age (55 years), and losses on its investment portfolio during the financial crisis. Its financial position will improve significantly as a result of entitlement reforms agreed in the context of the social dialogue, including the computation of pension claims on the basis of average career wages instead of final wages, an increase in the retirement age from 55 to 60 years, and the calculation of APFA pensions net of AOV pension claims.

AOV *(Algemeen Ouderdomspensioen Verzekering)*, the general pay-as-you-go pension scheme, has been running a cash-flow deficit since 2009 but is still drawing down reserves accumulated in previous years. The increase in premium income agreed in the context of the social dialogue will postpone the need for government transfers from 2013 to 2014. The statutory retirement age is 60 years.

Ever since the introduction in 2001 of ***AZV*** *(Algemene Ziektekosten Verzekering),* the universal health care system, insurance premiums have been insufficient to cover expenditures, resulting in transfers from the budget that exceeded 3 percent of GDP in 2009 (on a cash basis). The funding shortfall—that the government is obliged to cover by law—is expected to fall to about 2 percent of GDP as a result of the premium increase agreed in the context of the social dialogue.

Going forward, further reforms will be needed to secure the sustainability of AOV's and AZV's finances. For AOV, an increase in the retirement age may be unavoidable. As regards AZV, reform options include the introduction of co-payments, increasing competition between health care providers by relaxing entry restrictions, and the strengthening of expenditure controls.

Financial Balance of AZV /1
(Percent of GDP)

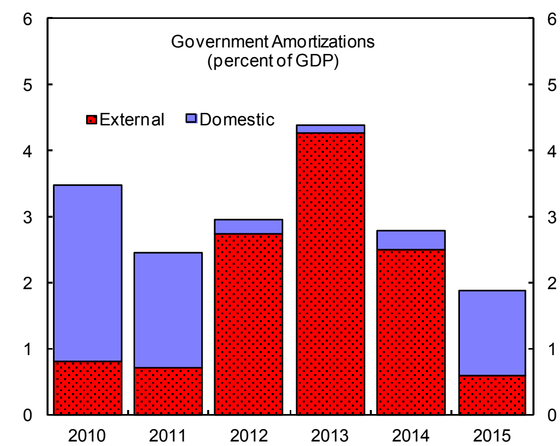
	2006	2007	2008	2009	2010 (Proj)
Premium Revenue	4.1	3.6	3.6	4.0	4.0
Expenditures	6.3	6.4	6.4	7.2	7.2
Health	5.9	6.0	6.0	6.8	6.8
Management	0.3	0.4	0.4	0.4	0.4
Deficit	-2.2	-2.8	-2.8	-3.2	-3.2
Transfer from Central Govt	2.2	2.8	2.8	3.2	3.2
Primary Transfer	2.2	2.1	2.4	2.7	3.2
Additional Transfer	0.0	0.7	0.4	0.5	0.0

1/ This table is presented on a cash basis
Sources: Aruban authorities; and IMF staff estimates and projections.

10. **In a first round of the social dialogue, participants agreed in August on steps that reduce longer-term risks to the public finances but yield limited fiscal savings in the short-term.** In particular, important measures were agreed that improve the financial health of Aruba's health care and pension schemes (Box 4). Participants also consented to keep the business turnover tax rate at its 2010 level—instead of eliminating it in 2011 as the government had planned originally—and to raise excise taxes by modest amounts. To limit the burden from these measures for select income groups, the government introduced a tax allowance for the working poor, and increased transfers for welfare recipients as well as wages for civil servants. Overall, staff estimates that the measures agreed on in the social dialogue reduce the underlying fiscal deficit by 2–2½ percent of GDP. This estimate excludes some expansionary measures that are difficult to cost, however, such as reduced import duties on green products.

The Fiscal Outlook and Aruba's Fiscal Adjustment Need

11. **Overall, IMF staff projects a fiscal deficit of almost 7 percent of GDP for 2011, and—in the absence of further consolidation measures—an underlying medium-term shortfall of 6–6½ percent of GDP.** The authorities agreed with staff that such a fiscal stance was unsustainable. Public debt would increase to about 65 percent of GDP by 2015, triggering a rapid increase in the government's interest burden. Moreover, financing constraints could arise. At this juncture, excess liquidity in Aruba's financial system supports demand for government paper, and the government's bank deposits of 6½ percent of GDP—much of it relating to the hotel sale receipts obtained in 2008—can be drawn down to cover financing needs. However, once private sector demand for credit recovers, the government would compete for funds. Attracting or rolling-over external funding could also become difficult, in particular from 2012 when significant amortizations on the government's commercial external debt are falling due.[3]



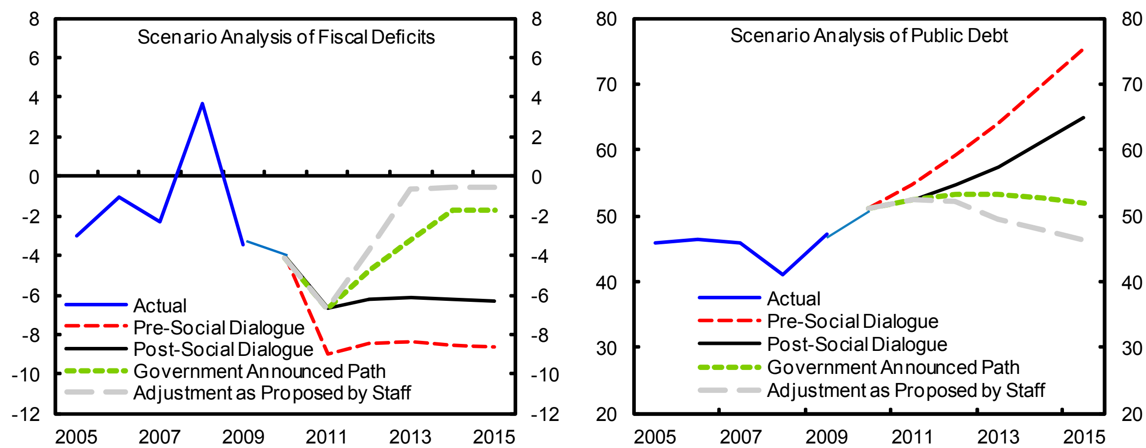
Sources: Aruban authorities; and IMF staff estimates and projections.

12. **Well aware of these pressures, the government has committed to reducing the deficit by about 1½ percentage points of GDP per year in 2012–14.** This would imply a deficit of somewhat above 3 percent of GDP in 2013 (the last budget to be passed in the current legislative term) and of below 2 percent of GDP by 2014. With this path, public debt

[3] Aruba's public external debt consists mostly of private over-the-counter placements. Issuance requires approval by the Kingdom of the Netherlands.

is estimated to stabilize at a level of around 52 percent of GDP. The measures needed to achieve this adjustment remain to be specified, however.

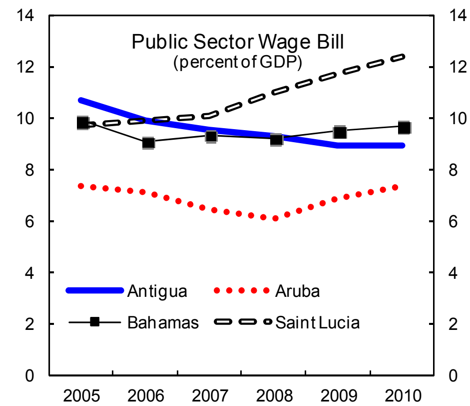
13. **Staff advocated a somewhat more ambitious adjustment path with a view to creating fiscal space to react to external shocks.** Specifically, staff recommended targeting a deficit of below 1 percent of GDP by 2013, corresponding to a primary surplus of 2¼ percent of GDP. This would put public debt as a share of GDP on a gradually falling path even under cautious assumptions about future growth. The target implies a fiscal effort of about 5½ percent of GDP, starting in 2011, beyond the initiatives announced in the context of the social dialogue. Given that Aruba's public debt is not yet at excessive levels, and in view of the still fragile recovery, IMF staff recommended stretching fiscal consolidation over a period of two to three years. The authorities were reluctant to agree with staff's more ambitious adjustment path, reflecting in part more optimistic views about future growth.



Options for Fiscal Adjustment

14. **The authorities emphasized that a cornerstone of their fiscal adjustment strategy was to create the conditions for higher and higher-quality growth.** Pivotal was an infrastructure investment program envisaged for 2011–13 that encompasses road construction projects and the relocation of Aruba's commercial port. Financing is envisaged to come largely from government owned enterprises or from the private sector through private-public partnerships (PPPs), with no financial burdens for the central government budget. The government argued that the program would not only provide a temporary boost to activity but also remove bottlenecks that currently impede long-term growth. Staff noted that the returns of such programs were inherently uncertain, and cautioned against basing longer-term fiscal projections on optimistic growth forecasts. Moreover, possible contingent fiscal liabilities should be minimized and monitored carefully.

15. **The authorities preferred expenditure cuts to meet any remaining adjustment needs.** They argued that tax increases would reduce the population's purchasing power and have undesirable social consequences. Specifically, the authorities saw room to reduce spending in the following areas:



- ***Public sector wage bill.*** The government has imposed a hiring freeze and plans to reduce the public work force by natural attrition. Further, the authorities are considering privatization of some government activities, such as trash collection. However, the public sector wage bill is already modest in regional comparison, which restricts the potential for savings.
- ***Spending on goods and services,*** which has increased from less than 4 percent of GDP in 2008 to more than 5 percent.
- ***Health care.*** Further premium increases could eliminate the need for a government transfer to AZV (projected at about 2 percent of GDP for 2011).

16. **Staff noted that achieving the entire needed adjustment through expenditures measures seemed exceedingly difficult.** In staff's estimate, expenditure cuts that can be implemented within a reasonable time frame amount to at most 3 percent of GDP, well short of both the authorities' (4½ percent) and staff's (5½ percent) estimated adjustment need.[4] It therefore appears unavoidable that some adjustment would have to come from revenues, where international comparison suggests that Aruba has room for maneuver. On unchanged policies, Aruba's tax revenues are projected at about 18 percent of GDP going forward. This compares to a regional average of about 25 percent of GDP across 15 other Caribbean countries. Moreover, only about half of Aruba's tax revenues result from indirect taxes, compared to a regional average of almost two-thirds.

17. **Staff suggested considering a tax reform that balances fiscal constraints with social priorities.** The following principles could usefully guide reform efforts: (i) the tax system should raise sufficient revenue; (ii) it should be growth-friendly, fair and transparent; and (iii) it should trigger high taxpayer compliance with low administrative costs. A comprehensive reform may also help achieve other objectives, such as lowering high income tax rates (among the highest in the Caribbean), eliminating nuisance taxes such as Aruba's

[4] This assumes savings of close to 2 percent of GDP from AZV (reflecting the elimination of the government transfer which would, however, trigger higher premium payments for government employees), and of about ½ percent of GDP from each the public sector wage bill and goods and services.

foreign exchange tax,[5] and protecting real income levels of the poor, especially when combined with targeted social spending initiatives.

18. **A key component of a reformed tax system could be a value-added tax (VAT) to replace the BBO.** A VAT would avoid the BBO's distortionary cascading effects that are partly responsible for the BBO's unpopularity. Further, a VAT would be born to a significant degree by nonresidents, thus restraining the impact on purchasing power of Arubans. To limit administrative costs for both the government and the private sector, the VAT could exempt small businesses. International experience suggests that a VAT introduction would require careful preparation of at least 1½–2 years. IMF staff encouraged the authorities to seek technical expertise oriented on international best practices, for example by joining the Caribbean Technical Assistance Center (CARTAC), which has helped with the implementation of similar reforms in other Caribbean countries and territories.

19. **The authorities agreed that a structural shift to more indirect taxation is desirable.** They noted that reforms in other Caribbean countries and territories had increased the pressure on Aruba to reduce direct tax rates to remain competitive. In this context, the authorities pointed to a tri-partite working group that will analyze reform options and report to the participants in the social dialogue by April 2011. The authorities remarked that they would study the working group's recommendations with an open mind, but also noted an initial preference for raising excise taxes—whose real value has eroded from more than 4 percent of GDP in the early 1990s to less 2½ percent of GDP—or possibly higher import duties.

B. Enhancing the Effectiveness of Monetary Policy

20. **Aruba's monetary policy is anchored by the long-standing peg with the U.S. dollar and was, until end-2009, conducted with relatively blunt instruments.** The key policy instrument was a ceiling on banks' annual increase in lending to the private sector, complemented by a limit on banks' net foreign asset position, a de-facto capital control obliging commercial banks to transfer excess foreign assets to the central bank.

21. **The experience with the credit ceiling has been mixed.**

- On the one hand, ***confidence in the peg was high,*** as evidenced by a low degree of dollarization in Aruba's banking system (17 percent of deposits at end-2009). Moreover, unsustainable credit booms were prevented and underlying inflation remained contained, thus safeguarding external competitiveness.

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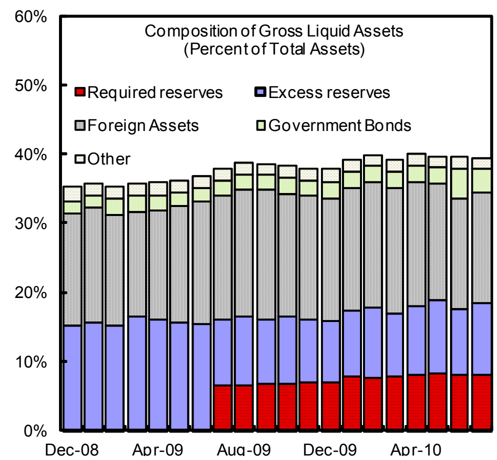
[5] The tax on foreign exchange transactions represents an exchange restriction under Article VIII, Section 2(a) of the Fund's Articles of Agreement.

- On the other hand, ***the credit ceiling discouraged competition***, thus helping sustain an oligopolistic banking system characterized by large interest rate spreads and outsized fee revenues.

- Moreover, during the downturn ***the central bank lacked an instrument to stimulate lending.*** In 2009, banks' average lending rates remained virtually unchanged at 11 percent while lending volumes contracted. Rather than vying for new business, banks placed a third of their funds in low-yielding central bank deposits or foreign assets.

22. Recognizing these constraints, **the central bank eliminated the credit ceiling at end-2009 and replaced it with an unremunerated reserves requirement as key policy instrument.**[6] Staff welcomed this overhaul, noting that it should help spurring competition between banks to bid down interest rates and allow for a more efficient conduct of monetary policy going forward. The transition to the new monetary arrangement and the associated risks required careful management, however.

23. **Staff and the authorities agreed that in the short-term monetary policy should remain accommodative.** At this juncture, required reserves are set rightly well below commercial banks' actual deposits at the central bank, giving rise to substantial excess liquidity in the banking system. These liquidity buffers should remain in place as long as credit demand is depressed. In addition, staff encouraged the central bank to emphasize that it no longer restricts credit growth—several commercial banks had misunderstood central bank communiqués mentioning "targeted credit growth" as if the credit ceiling was still in effect.



Source: IMF Staff, Central Bank of Aruba

24. **Staff encouraged the central bank to explore additional ways of fostering competition between banks, such as temporarily relaxing some regulations that effectively block the entry of new competitors.** The central bank agreed with staff that in particular the requirements of a non-negative net foreign asset position and of conservative loan-to-deposit ratios could have the unintended side-effect of impeding foreign banks from setting up Aruban subsidiaries. The central bank noted that temporary waivers to these rules could be considered, provided the subsidiaries were owned by reputable, international parent banks that are subject to comprehensive, consolidated supervision by their home supervisors.

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[6] A reserves requirement existed also prior to the reform, but its effectiveness was hampered as mandatory reserves counted towards the (stricter) prudential liquidity requirement. This provision has been removed.

25. **The central bank agreed with staff that tightening may become necessary once demand for credit rebounds.** If pressure on the central bank's foreign reserves position would emerge, the central bank had to be prepared to use the reserves requirement rapidly and to the full extent needed. Possible concerns that a large increase in mandatory reserves may be overly costly for banks could be addressed by modest remuneration, provided it was within the financial means of the central bank. At the same time, staff and the central bank agreed that a rapid introduction of certificates of deposits could be problematic, given the absence of a liquid interbank market and the potential for negative repercussions on the central bank's financial position. Over the longer-term, however, the development of market-based monetary instruments would remain an important objective.

C. Safeguarding Financial Stability

26. **Conservative regulatory requirements and high underlying profitability have helped Aruba's banking system getting through the recession without major strains** (see also Box 1). Prudential requirements for capital adequacy (14 percent of risk-weighed assets) and liquidity (15 percent of assets excluding goodwill) are set at adequately elevated levels in view of the banking system' systemic importance (Box 5). Going forward, nonperforming loans are expected to increase for another 6–12 months, but at a relatively modest pace. Banks seem well prepared to manage this challenge, in view of ample capital cushions and continued profitability. Large buffers of excess liquidity also place the banking system well to satisfy demand for lending once economic activity picks up.

27. Elsewhere in the financial system, **good progress has been made in restoring financial soundness to corporate defined-benefit pension funds** in the context of recovery plans. In the wake of the recession, the coverage ratios of some funds fell below 100 percent as a result of losses on their investment portfolios.

28. **The authorities agreed with staff that the central bank's new monetary policy framework would likely increase the challenges to prudential regulation and supervision.** The absence of a credit ceiling could well result in more aggressive lending, which, in turn, could trigger a deterioration in banks' lending standards. Supervisors will therefore need to monitor market developments closely as well as the strategies and actions of individual institutions. The mission also noted that enhancing the forward-looking character of the central bank's stress tests could help in this endeavor.

29. **Staff and the authorities agreed that Aruba's off-shore financial sector—while small—carries a potential for reputational risk.** The mission argued that off-shore banks should be permitted to operate only to the extent that the central bank can monitor their activities and enforce prudential rules. The central bank confirmed that it had recently stepped up efforts to ensure a sufficient physical presence of all off-shore banks operating in Aruba to permit effective supervision. Failure to comply would trigger regulatory steps by

the central bank that could include issuing a formal directive, imposing penalties, or, ultimately, revoking the bank's license.

Box 5. The Structure of Aruba's Financial System

The Aruban financial sector is relatively large, with assets of 184 percent of GDP. Commercial banks dominate the sector with more than half of total assets. The rest of the financial system is divided among pension funds, insurance funds and bank-like institutions.

The four commercial banks are foreign owned and are largely funded by resident deposits, which account for 78 percent of liabilities. More than half of assets are loans to the private sector. Holdings of public debt are low (only 2.5 percent of GDP).

Aruba also has two off shore banks with assets amounting to 12 percent of GDP. They have limited physical presence in Aruba and are only engaged in banking activities with nonresidents.

After banks, pension funds form the next largest component of the financial sector, dominated by the civil service pension fund (APFA), which has assets of 37 percent of GDP. APFA and insurance companies hold together 17 percent of GDP in government securities.

Financial Sector Structure

	Number of institutions	2009 /1					
		Total Assets			Capital and Reserves /2		
		Mill. USD	Share	% of GDP	Mill. USD	Percent	% of GDP
Banks	6	2,716	57.2	105	503	99.2	20
Commercial banks	4	2,405	50.6	93	310	61.1	12
Offshore banks	2	311	6.5	12	193	38.1	7
Non-Banks	5	400	8.4	16	155	30.6	6
Bank like institutions	3	396	8.3	15	151	29.8	6
Credit unions	2	4	0.1	0	4	0.8	0
Insurance	24	547	11.5	21	139	27.4	5
Life insurance companies	7	397	8.4	15	68	13.4	3
Nonlife insurance companies	13	121	2.5	5	49	9.7	2
Captive insurance companies	4	29	0.6	1	22	4.3	1
Pension	12	1,088	22.9	42	-290	-57.2	-11
Company pension funds	11	136	2.9	5	17	3.4	1
Civil servants pension fund (APFA)	1	952	20.0	37	-307	-60.6	-12
Total	47	4,751	100	184	507	100	20

Source: Centrale Bank van Aruba
/1 Preliminary
/2 Includes general (unallocated) reserves.

IV. Staff Appraisal

30. **Aruba's economy is gradually recovering from a severe recession triggered by a series of external shocks.** Tourism declined in the wake of the global downturn, and Aruba's oil refinery temporarily closed in July 2009. A slow and gradual recovery is underway now, but the growth rates from pre-crisis years will be difficult to achieve going forward, reflecting lower expected U.S. consumption growth (Aruba's main trading partner) and limits to a further quantitative expansion of tourism.

31. **Serious fiscal challenges need to be addressed.** Aruba's health care and pension schemes have long been structurally underfunded, giving rise to sizeable fiscal liabilities. Recent tax cuts, notably the halving of Aruba's business turnover tax, and spending increases to combat the recession have further contributed to a large underlying fiscal deficit. If unaddressed, this would put public debt on an unsustainable path. The reforms agreed in the context of the social dialogue between the government, labor unions and employers enhance the soundness of Aruba's pension and health care schemes and reduce longer-term downside risks to the fiscal outlook. However, their short-term budgetary impact is limited.

32. **Staff encourages the authorities to develop a medium-term fiscal adjustment program to safeguard the sustainability of the public finances.** The program should aim to put public debt as a share of GDP on a declining path even under cautious assumptions about future growth, with a view to limiting the government's interest expenditures, maintaining access to domestic and external financing at attractive rates, and leaving some room for maneuver in case Aruba is again affected by external shocks as in 2001/02 and in 2009.

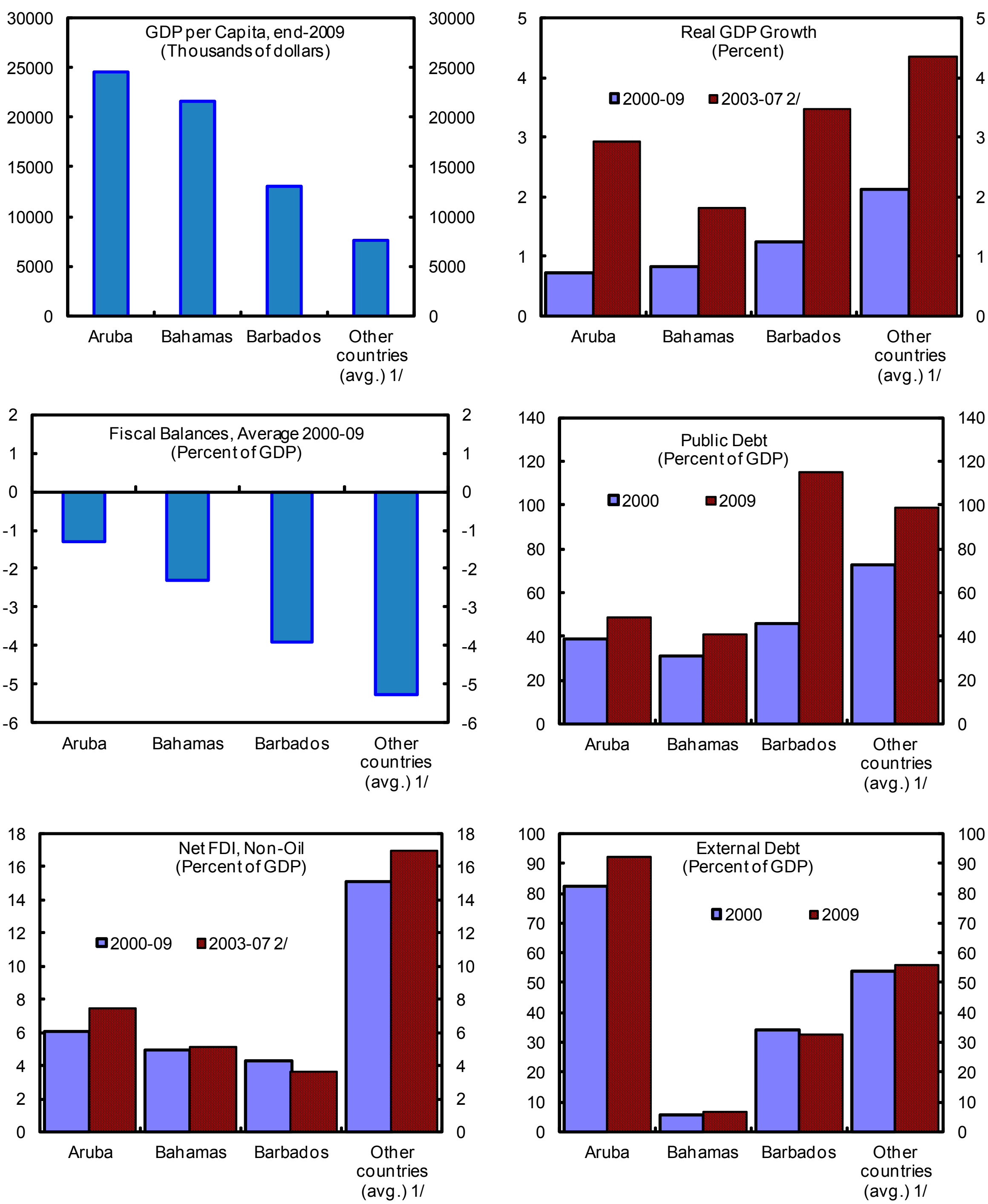
33. **Staff agrees with the authorities' intention to achieve a large part of the needed fiscal adjustment through expenditure cuts.** However, recourse to some revenue measures seems unavoidable in view of the size of the fiscal shortfall. In this context, staff recommends considering a tax reform that balances fiscal constraints with social priorities. A key component could be a value-added tax designed to fit Aruba's specific needs. Should the authorities decide to pursue such a reform, staff encourages the authorities to seek technical assistance based on international best practices, for example by joining CARTAC.

34. **The central bank's switch from a credit ceiling to an unremunerated reserves requirement as key policy tool is welcome and should allow for a more efficient conduct of monetary policy going forward.** However, the transition to the new monetary arrangement and the associated risks need to be managed carefully. As long as credit conditions remain depressed, the central bank should continue to leave excess liquidity in the market. Once demand for credit rebounds, however, the central bank needs to be prepared to use the reserves requirement to the full extent needed, with a view to protecting the central bank's foreign reserves position and safeguarding the currency peg.

35. **Challenges to prudential regulation and supervision will likely increase with the new monetary policy framework.** The absence of a credit ceiling may result in more aggressive lending, which, in turn, could trigger a deterioration in banks' lending standards. Supervisors will need to monitor market developments closely as well as the strategies and actions of individual institutions.

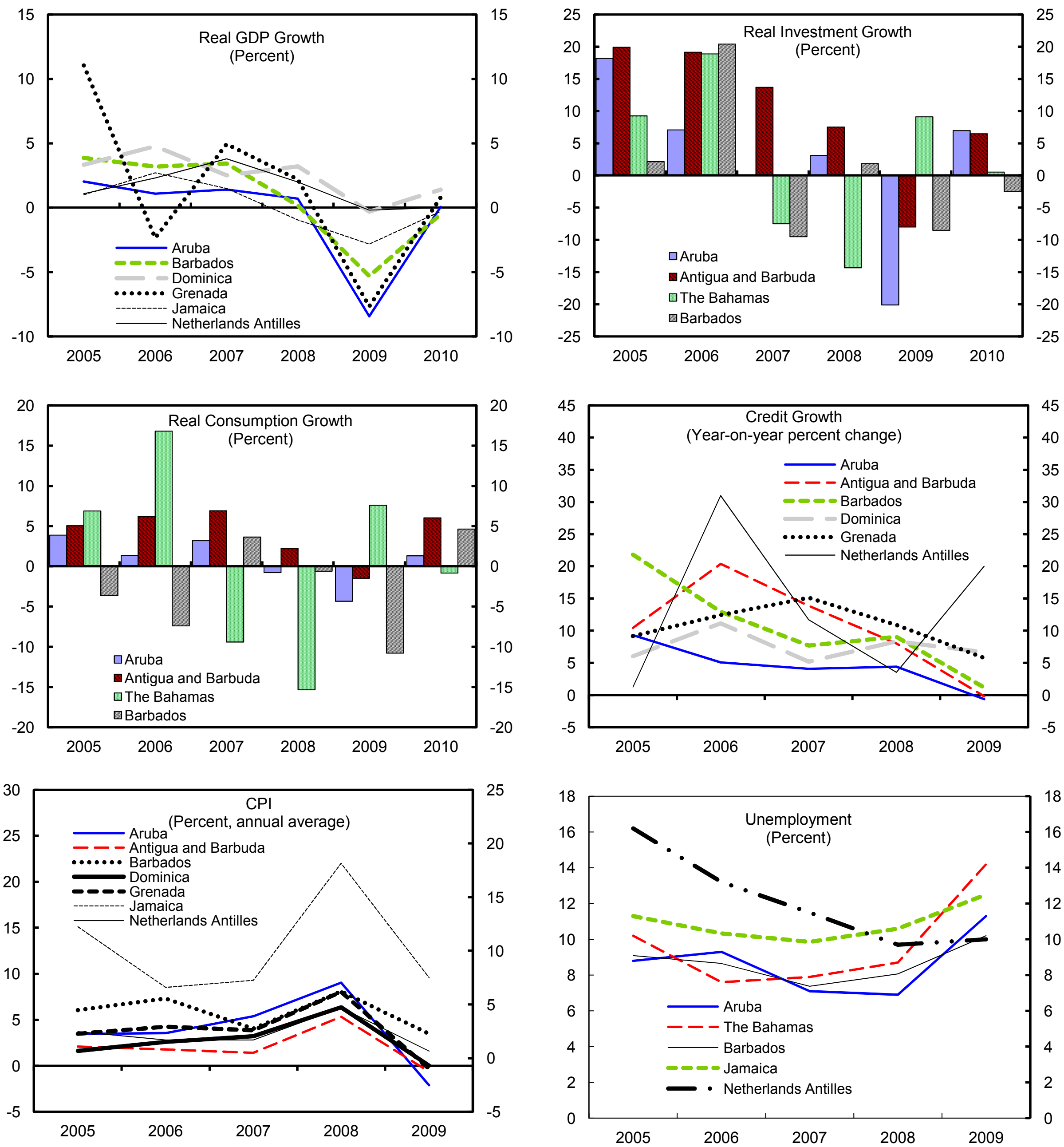
36. **It is currently envisaged that the next Article IV consultation discussions with Aruba will be held in 24 months time.**

Figure 1. Aruba: Regional Comparison I, 2000–09



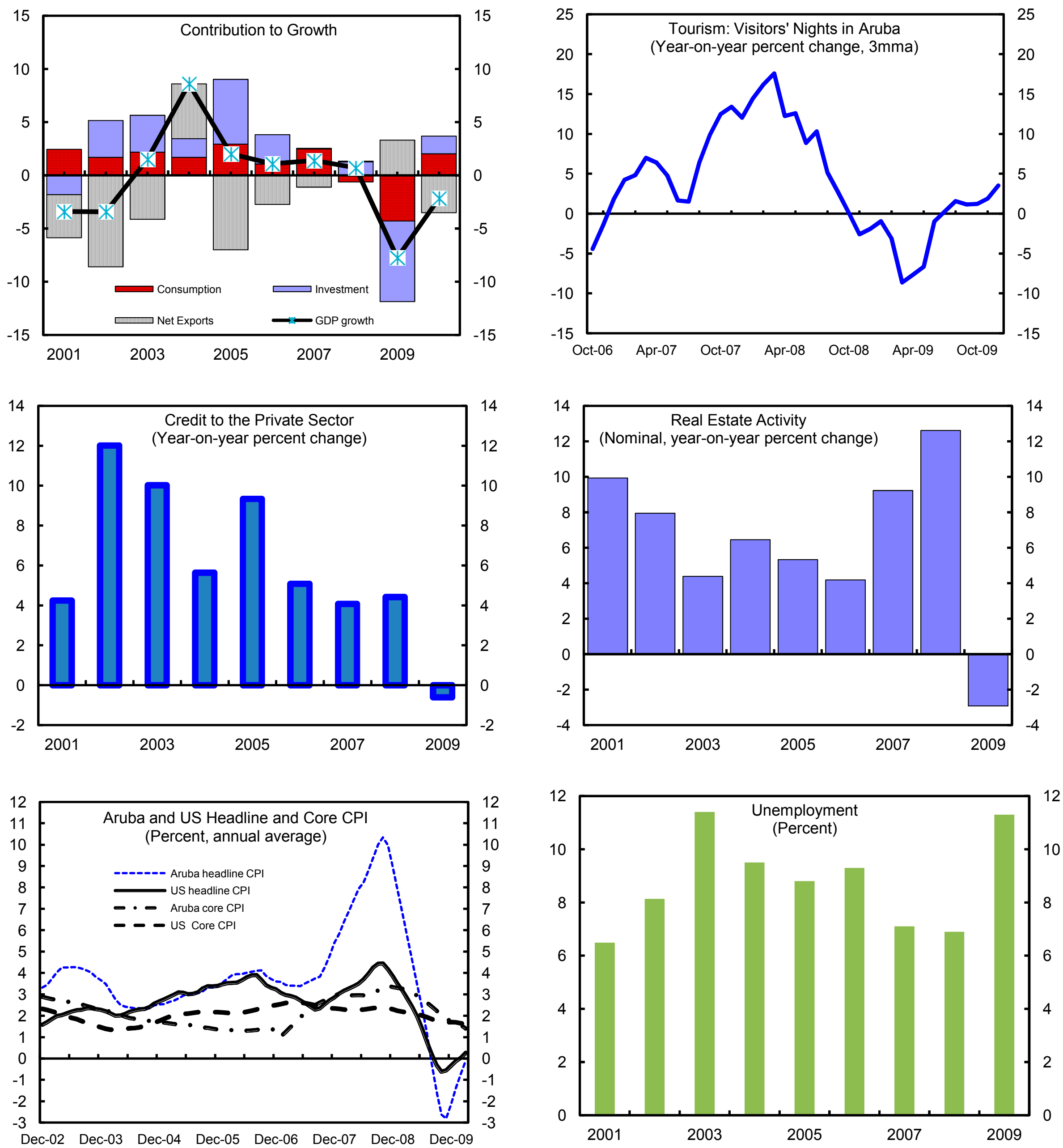
Sources: WEO; Central Bank of Aruba; and IMF staff calculations.
1/ Antigua and Bermuda, Dominica, Grenada, St. Kitts and Nevis, St. Lucia, and St. Vincent and Grenadines.
2/ Boom years.

Figure 2. Aruba: Regional Comparison II, 2005–10



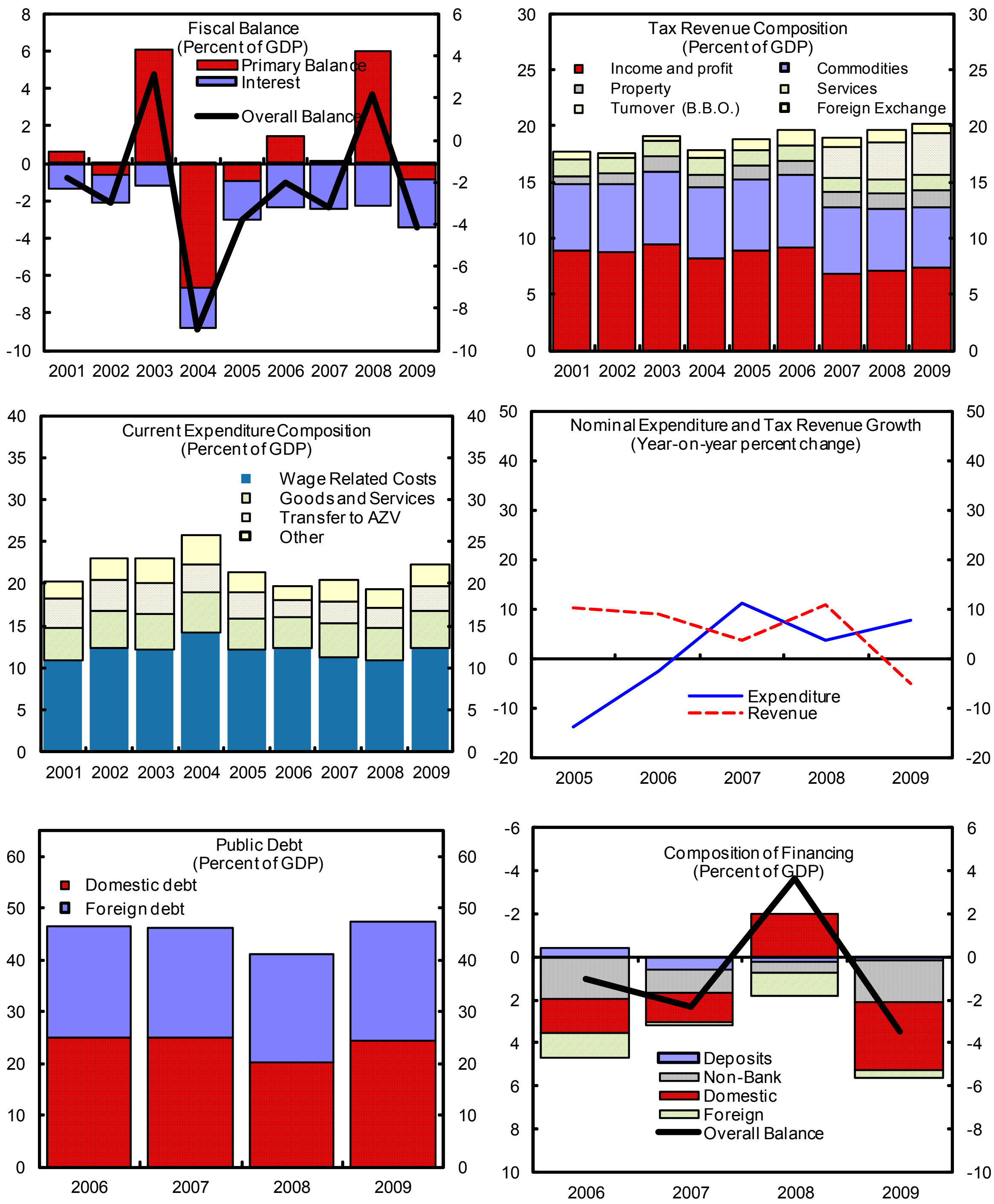
Sources: National authorities; and IMF staff estimates and projections.

Figure 3. Aruba: Real Sector Developments, 2001–09



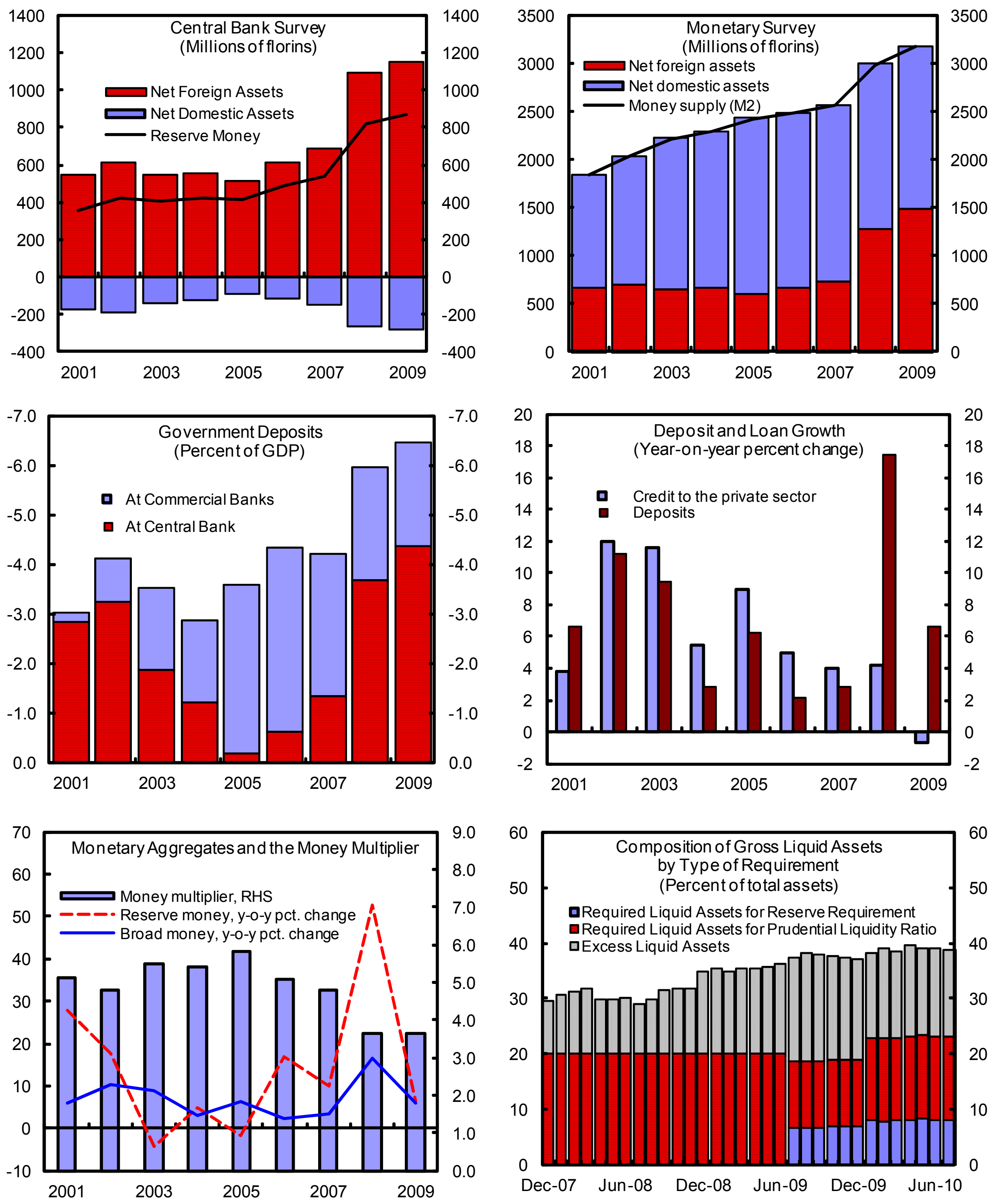
Sources: Aruban authorities; and IMF staff estimates.

Figure 4. Aruba: Fiscal Developments, 2001–09



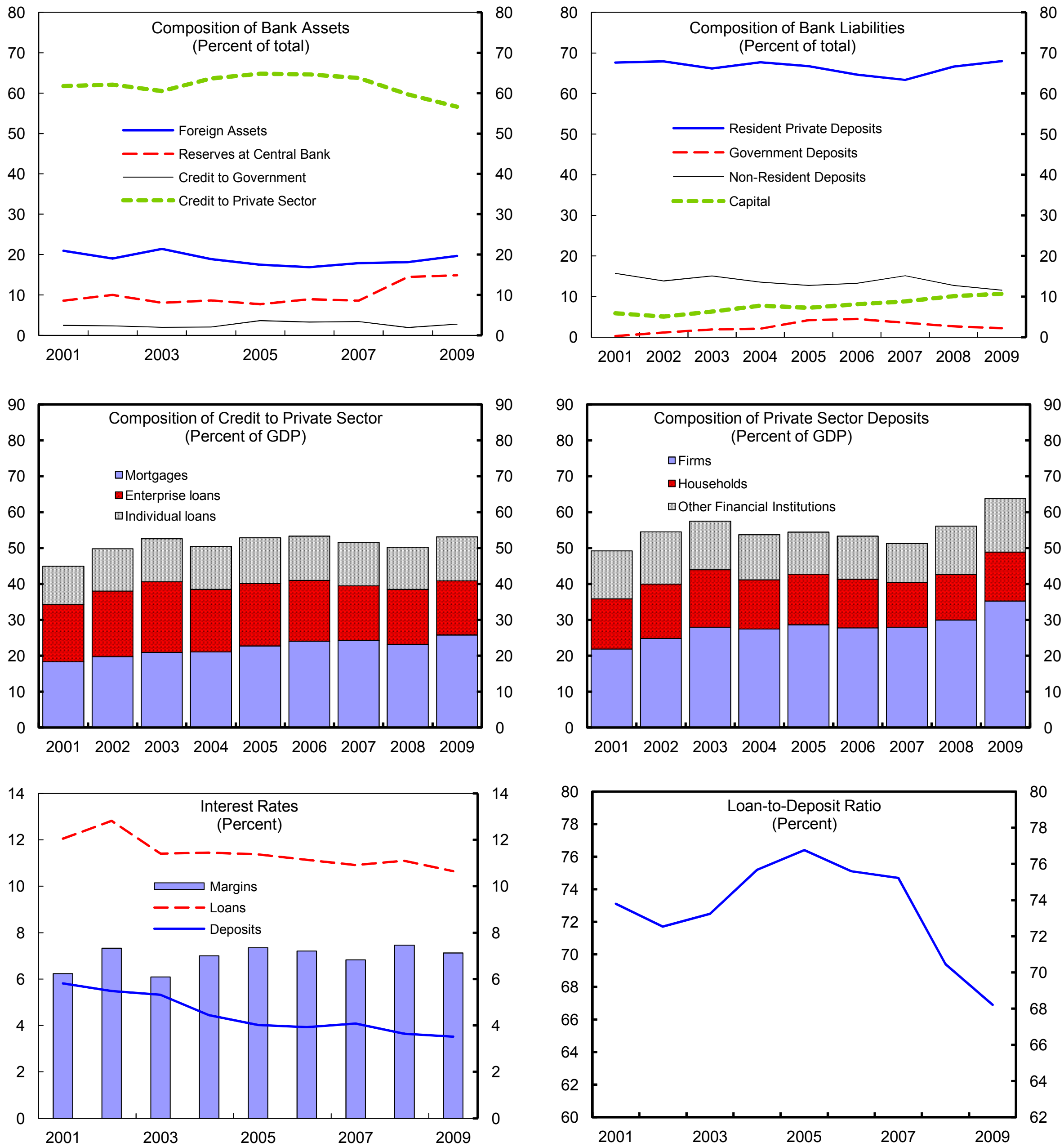
Sources: Aruban authorities; and IMF staff estimates.

Figure 5. Aruba: Developments in the Monetary Sector, 2001-09



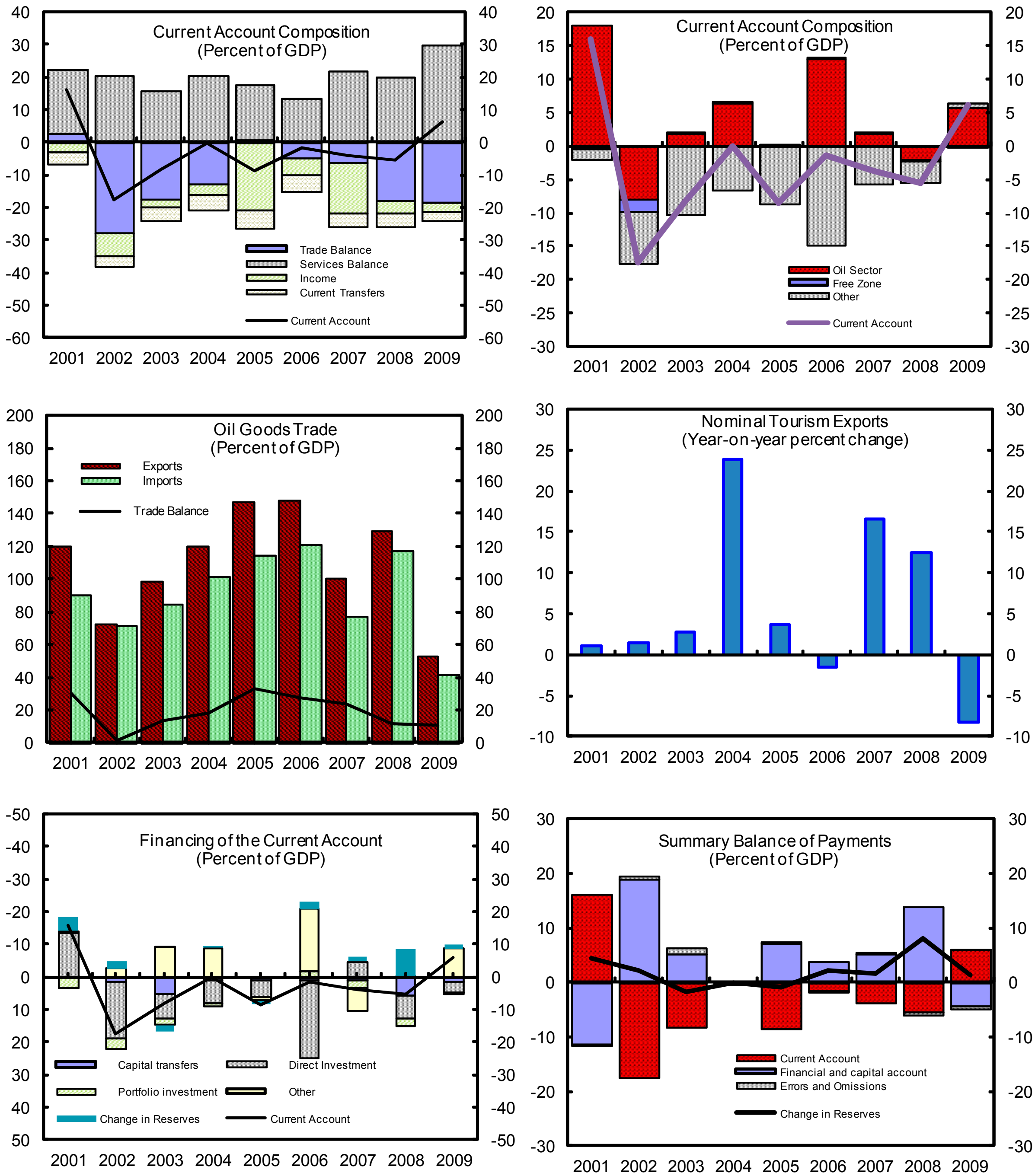
Sources: Central Bank of Aruba, and IMF staff estimates.

Figure 6. Aruba: Developments in Commercial Banks, 2001–09



Sources: Aruban authorities; and IMF staff estimates.

Figure 7. Aruba: Balance of Payments, 2001–09



Sources: Aruban authorities; and IMF staff estimates.

Table 1. Aruba: Selected Economic Indicators, 2007–15

I. Basic Data, Social and Demographic Indicators

Area (sq. km)	180	Infant mortality (per thousand)	13.3
Population (thousands) 1/	108	Literacy rate (percent)	97.3
GDP (millions of U.S. dollars) 1/	2,562	Percent of population below age 15 (percent)	18.8
GDP per capita (thousands of U.S. dollars) 1/	24	Percent of population age 65+ (percent)	10.9
Unemployment (2009, percent)	11	Life expectancy at birth (years)	75.1

II. Economic Indicators

	2007	2008	2009	2010	2011	2012	2013	2014	2015
						Projections			
					(Percent change)				
Real GDP	1.4	0.7	-7.7	-2.2	7.1	2.0	1.4	1.5	1.5
Real domestic demand	2.1	0.5	-8.7	1.1	6.5	2.0	0.9	1.5	1.5
Consumption	3.2	-0.8	-3.0	2.1	1.6	1.6	1.4	1.5	1.5
Private	6.5	-1.7	-5.6	-0.4	4.1	2.0	1.5	1.5	1.5
Public	-4.8	1.6	4.0	8.1	-3.9	0.6	1.2	1.4	1.4
Gross investment	0.1	3.1	-19.5	-1.3	18.1	3.0	0.1	1.6	1.6
Private	0.7	2.1	-20.6	0.0	18.5	3.0	0.0	1.7	1.7
Public	-14.4	28.4	3.3	-22.2	10.0	2.5	1.2	1.0	1.0
Exports of goods and services	3.7	7.1	-13.5	-5.4	11.6	1.9	1.9	1.6	1.6
Imports of goods and services	4.1	5.5	-13.6	-0.5	9.8	2.0	1.2	1.7	1.7
					(Percent change)				
Consumer prices									
Period average	5.4	9.0	-2.1	2.2	2.5	3.1	3.1	3.0	3.0
End-period	1.4	3.0	3.3	1.8	2.8	3.1	3.0	3.0	3.0
					(Percent of GDP)				
Central government operations (without measures) 2/									
Primary balance	0.1	6.0	-0.9	-1.2	-3.9	-3.2	-3.0	-3.1	-3.2
Revenues	22.2	27.3	24.0	24.6	20.7	21.1	21.1	21.1	21.1
Expenditures	22.1	21.4	24.9	25.8	24.6	24.3	24.1	24.1	24.3
Of which: capital	1.2	1.6	1.8	1.4	1.5	1.4	1.4	1.4	1.3
Overall balance (including transfers to AZV)	-2.3	3.7	-3.5	-4.1	-6.7	-6.1	-6.1	-6.2	-6.3
Of which: transfers to AZV	2.6	2.5	2.8	2.8	2.1	2.1	2.2	2.3	2.4
Gross central government debt (percent of GDP)	45.9	41.0	47.3	50.9	52.1	54.4	57.2	60.9	64.6
Net central government debt (percent of GDP) 3/	41.7	35.1	40.8	45.1	47.9	51.8	55.6	59.3	63.1
Central government operations (with measures) 4/									
Primary balance	…	…	…	…	…	-1.8	-0.1	1.4	1.5
Overall balance	…	…	…	…	…	-4.7	-3.2	-1.7	-1.7
Gross central government debt	…	…	…	…	…	53.0	53.0	52.4	51.8
Net central government debt (percent of GDP) 3/	…	…	…	…	…	50.4	51.3	50.9	50.3
Savings and investment (percent of GDP)									
Gross investment	33.2	33.6	29.4	30.2	33.1	33.2	32.4	32.1	31.8
Private	32.0	32.1	27.6	28.8	31.7	31.7	31.0	30.7	30.5
Public	1.2	1.6	1.8	1.4	1.4	1.4	1.4	1.4	1.3
Foreign saving	3.8	5.4	-6.1	1.2	2.6	3.5	3.2	3.2	3.2
Domestic saving	29.4	28.2	35.5	29.0	30.5	29.7	29.2	28.9	28.6
Private	30.5	23.0	37.2	31.6	35.7	34.4	33.8	33.7	33.6
Public	-1.1	5.2	-1.7	-2.7	-5.2	-4.7	-4.7	-4.8	-5.0
Balance of payments									
Current account balance	-3.8	-5.4	6.1	-1.2	-2.6	-3.5	-3.2	-3.2	-3.2
Oil	1.7	-2.2	5.6	-1.4	2.4	1.0	1.0	1.0	1.0
Non-oil	-5.5	-3.3	0.5	0.1	-5.1	-4.5	-4.3	-4.3	-4.2
Non-oil FDI	6.1	6.9	3.0	2.7	3.8	2.1	1.6	1.5	1.5
Gross official reserves (millions of U.S. dollars)	465	701	701	729	742	770	810	844	878
Gross official reserves (months of non-oil imports of following year)	3.5	5.8	5.7	5.4	5.3	5.3	5.3	5.3	5.3
External debt (percent of GDP)	87.4	83.9	89.5	89.7	82.0	80.5	79.6	78.8	78.0
					(Local currency, millions, unless otherwise indicated)				
Monetary									
NFA	717	1,269	1,475	1,525	1,547	…	…	…	…
NDA	1,850	1,721	1,695	1,878	2,262	…	…	…	…
Credit to private sector (year-on-year percent change)	4.0	4.2	-0.7	3.0	10.0	…	…	…	…
Broad money	2,566	2,990	3,171	3,403	3,810	…	…	…	…
Deposits (year-on-year percent change)	2.8	17.5	6.7	7.7	12.6	…	…	…	…
Memorandum items:									
Nominal GDP (millions of Aruban florins)	4,658	4,996	4,611	4,586	5,022	5,269	5,508	5,758	6,020
Nominal GDP (millions of U.S. dollars)	2,602	2,791	2,576	2,562	2,806	2,944	3,077	3,217	3,363

Sources: Aruban authorities; and IMF staff estimates and projections.

1/ Estimate, 2010.

2/ On unchanged policies

3/ Net of government deposits at central bank and commercial banks.

4/ Deficit path announced by the government.

Table 2. Aruba: Real Growth, 2007–15
(Percent change)

	2007	2008	2009	2010	2011	2012	2013	2014	2015
			Est.			Projections			
GDP	1.4	0.7	-7.7	-2.2	7.1	2.0	1.4	1.5	1.5
Consumption	3.2	-0.8	-3.0	2.1	1.6	1.6	1.4	1.5	1.5
Private	6.5	-1.7	-5.6	-0.4	4.1	2.0	1.5	1.5	1.5
Public	-4.8	1.6	4.0	8.1	-3.9	0.6	1.2	1.4	1.4
Investment	0.1	3.1	-19.5	-1.3	18.1	3.0	0.1	1.6	1.6
Private	0.7	2.1	-20.6	0.0	18.5	3.0	0.0	1.7	1.7
Public	-14.4	28.4	3.3	-22.2	10.0	2.5	1.2	1.0	1.0
Imports	4.1	5.5	-13.6	-0.5	9.8	2.0	1.2	1.7	1.7
Exports	3.7	7.1	-13.5	-5.4	11.6	1.9	1.9	1.6	1.6
Tourism exports	14.8	5.6	-6.3	1.2	2.1	1.8	2.0	1.6	1.6
Non-tourism exports (oil)	-11.3	9.5	-25.6	-19.4	36.8	2.0	1.8	1.7	1.7
GDP excl. refinery 1/	1.2	0.3	-4.8	0.2	3.2	2.5	1.6	1.7	1.7
Memorandum items:									
CPI (average)	5.4	9.0	-2.1	2.2	2.5	3.1	3.1	3.0	3.0
Core CPI (average)	3.0	3.3	1.8	1.5	2.2	3.0	3.0	3.0	3.0
U.S. CPI (average)	2.9	3.8	-0.3	…	…	…	…	…	…
U.S. core CPI (average)	2.3	2.3	1.7	…	…	…	…	…	…
GDP deflator	6.0	6.5	0.0	1.7	2.3	2.9	3.1	3.0	3.0
GDP per capita (Aruban florins)	44,790	47,455	43,986	42,366	45,712	47,253	48,662	50,119	51,626
GDP per capita (U.S. dollars)	25,022	26,511	24,573	23,668	25,538	26,398	27,186	27,999	28,841
Population 2/	104,006	105,287	106,749	108,243	109,867	111,515	113,187	114,885	116,608
Unemployment (percent)	7.1	6.9	11.3	…	…	…	…	…	…

Sources: Aruban authorities; WEO; and IMF staff estimates and projections.
1/ Staff estimates.
2/ Mid-year population.

Table 3. Aruba: Operations of the Central Government, 2007–12 1/
(Percent of GDP)

	2007	2008	2009	2010	2011	2012
				Projections		
Total revenue	22.2	27.3	24.0	24.6	20.7	21.1
Tax revenue	18.9	19.6	20.1	21.8	17.5	18.3
Income and profit	6.7	7.1	7.3	6.5	6.7	6.8
Commodities	6.0	5.5	5.4	5.2	5.6	6.1
Property	1.3	1.4	1.4	1.3	1.4	1.5
Services	1.3	1.3	1.4	1.3	1.3	1.5
Turnover (B.B.O.)	2.8	3.4	3.7	6.6	1.6	1.5
Of which: oil refinery tax settlement	0.0	0.0	0.0	4.6	0.0	0.0
Foreign exchange	0.8	1.0	0.9	0.9	0.9	1.0
Nontax revenue	3.3	7.8	3.9	2.7	3.2	2.7
Grants	0.7	5.5	1.1	0.3	0.7	0.3
Other	2.5	2.3	2.8	2.4	2.4	2.4
Total expenditure and net lending	22.1	21.4	24.9	25.8	24.6	24.3
Current expenditure	20.4	19.3	22.2	23.9	22.6	22.3
Wage related costs	11.3	10.9	12.4	13.4	13.0	12.8
Wages	6.5	6.1	6.8	7.5	7.5	7.4
Employers contributions	1.8	1.8	2.2	2.6	2.1	2.1
Wage subsidies	3.1	3.0	3.3	3.3	3.3	3.3
Goods and services	3.9	3.8	4.4	5.2	5.0	4.9
Transfers to AZV	2.6	2.5	2.8	2.8	2.1	2.1
Other	2.6	2.2	2.6	2.5	2.5	2.5
Subsidies	0.5	0.5	0.6	0.7	0.7	0.7
Other transfers	1.3	0.8	1.6	1.8	1.8	1.8
Contributions/settlements	0.8	0.9	0.4	0.0	0.1	0.1
Capital expenditure	1.2	1.6	1.8	1.4	1.5	1.4
Investment	0.4	0.8	0.9	0.7	0.7	0.7
Development fund spending	0.8	0.7	0.9	0.7	0.8	0.8
Lending (net)	0.5	0.5	0.9	0.5	0.5	0.5
Lending	0.5	0.5	1.0	0.7	0.7	0.7
Repayments	-0.1	0.0	-0.1	-0.2	-0.2	-0.2
Primary balance	0.1	6.0	-0.9	-1.2	-3.9	-3.2
Unidentified measures 2/	…	…	…	…	…	1.4
Interest	2.4	2.3	2.6	2.8	2.8	2.9
Domestic	1.3	1.2	1.3	1.8	1.5	1.7
External	1.1	1.1	1.2	1.0	1.2	1.2
Overall balance	-2.3	3.7	-3.5	-4.1	-6.7	-6.1
After measures 2/	…	…	…	…	…	-4.7
Financing (assuming measures taken)	2.3	-3.7	3.5	4.1	6.7	4.7
Domestic	1.4	-2.0	3.2	2.5	5.0	3.3
Banks	1.1	0.0	1.4	1.2	2.5	1.4
Loans	0.5	-0.2	1.3	0.8	2.0	0.9
Disbursed	0.5	0.7	1.9	2.1	2.9	1.8
Repaid	0.0	-0.9	-0.6	-1.3	-0.9	-0.9
Deposits	0.6	0.2	0.1	0.4	0.5	0.5
Non-Bank	1.1	0.5	2.0	1.0	2.0	1.0
Disbursed	1.2	0.9	3.2	2.1	2.9	1.8
Repaid	-0.1	-0.4	-1.3	-1.2	-0.9	-0.8
Central Bank	-0.8	-2.6	-0.2	0.4	0.5	0.9
Loans	0.0	0.0	0.0	0.0	0.0	0.0
Deposits	-0.8	-2.6	-0.2	0.4	0.5	0.9
Foreign	0.1	1.0	0.4	1.5	1.7	1.4
Disbursed	1.8	2.7	1.3	2.5	2.4	4.3
Repaid	-1.6	-1.7	-0.9	-0.9	-0.7	-2.8
Unmet financing requirements 3/	0.8	-2.6	-0.1	0.0	0.0	0.0
Memorandum items:						
Gross debt (assuming measures taken)	45.9	41.0	47.3	50.9	52.1	53.0
Domestic debt	24.9	20.1	24.1	26.1	27.8	28.4
Foreign debt	21.1	20.9	23.1	24.8	24.3	24.6
Gross assets (government deposits)	4.2	5.9	6.5	5.8	4.3	2.7
Net debt (assuming measures taken)	41.7	35.1	40.8	45.1	47.9	50.4
Stock of unmet financing requirements 3/	4.2	1.3	1.3	1.3	1.3	1.3

Sources: Aruban authorities; and IMF staff estimates and projections.
1/ The table is presented on an accrual basis.
2/ The scenario with "measures" refers to the deficit path announced by the government in its 2010 budget submission.
3/ "Unmet Financing Requirements" are accrued but unpaid obligations of the central government.

Table 4. Aruba: Public Debt, 2006–09
(Percent of GDP, unless otherwise indicated)

	2006	2007	2008	2009
Gross debt	46.4	45.9	41.0	47.3
Domestic debt	24.9	24.9	20.1	24.1
Negotiable	10.7	11.3	10.3	14.1
Tbills	0.9	0.9	0.8	0.9
Cash certificates	0.2	0.2	0.0	0.2
Government bonds	9.6	10.3	9.5	13.1
Nonnegotiable	14.2	13.6	9.8	10.0
ST	3.7	4.2	1.3	0.8
APFA	2.0	2.1	0.3	0.2
Suppliers credit	1.6	1.3	0.6	0.6
Other	0.1	0.8	0.5	0.1
LT	10.5	9.4	8.5	9.2
APFA	5.0	4.6	4.3	4.6
Svb	2.2	2.2	1.9	2.1
Private loans	2.9	2.6	2.4	2.5
Other	0.5	0.0	0.0	0.0
Foreign debt	21.5	21.1	20.9	23.1
Netherlands	3.9	3.6	2.9	3.0
Development cooperation	3.9	3.6	2.9	2.9
Commercial loans	0.1	0.1	0.0	0.1
EIB	0.3	0.3	0.3	0.3
USA	3.2	3.9	2.9	4.5
Commercial debt	14.2	13.2	14.8	15.4
GDP (millions of florins)	4,334	4,658	4,996	4,611
GDP (millions of U.S. dollars)	2,421	2,602	2,791	2,576

Sources: Aruban authorities; and IMF staff estimates.

Table 5. Aruba: Central Bank Survey, 2006–11
(Millions of Aruban florins, end of period)

	2006	2007	2008	2009	2010	2011
					Projections	
Net Foreign Assets	608	686	1089	1150	1200	1222
Gross Foreign Assets	731	833	1255	1255	1305	1327
Gross Foreign Liabilities	-17	-4	-8	-3	-3	-3
Valuation Changes	-106	-143	-159	-102	-102	-102
Net Domestic Assets	-120	-149	-270	-280	-265	-241
Central Government Deposits	-25	-20	-99	-96	-88	-75
Development Funds Deposits	-3	-42	-85	-105	-97	-84
Other Domestic Entities (net)	-15	-2	-4	-1	-3	-3
Other Items (net)	-77	-85	-82	-78	-81	-81
Reserve Money	488	537	819	870	935	981
Bank Notes Issued	180	203	212	201	206	204
Bank Reserves	308	334	607	669	728	778
Demand	46	76	144	195	212	226
Time	262	258	463	474	516	552
	(Percent change, year on year)					
NFA	19.4	12.7	58.8	5.6	4.3	1.9
NDA	29.5	24.5	81.0	3.9	-5.3	-9.1
Reserve Money	17.1	9.8	52.7	6.2	7.5	5.0
	(Percent change, by contribution to change in reserve money)					
NFA	23.6	15.9	75.2	7.5	5.7	2.4
NDA	-6.5	-6.0	-22.5	-1.3	1.7	2.6
	(Percent of GDP)					
Government Deposits at Central Bank (percent of GDP)	0.6	1.3	3.7	4.4	4.0	3.2
Central Government	0.6	0.4	2.0	2.1	1.9	1.5
Development Fund	0.1	0.9	1.7	2.3	2.1	1.7

Sources: Central Bank of Aruba; and IMF staff estimates.

Table 6. Aruba: Monetary Survey, 2006–11
(Millions of Aruban florins, end of period)

	2006	2007	2008	2009	2010	2011
					Projections	
Net foreign assets	654	717	1,269	1,475	1,525	1,547
Central bank	608	686	1,089	1,150	1,200	1,222
Commercial banks	46	31	180	325	325	325
Net domestic assets	1,831	1,850	1,721	1,695	1,878	2,262
Domestic credit	2,268	2,364	2,319	2,342	2,525	2,909
Net claims on the government	-71	-68	-215	-175	-67	58
Deposits	-188	-195	-297	-298	-265	-215
At central bank	-27	-62	-184	-201	-185	-160
At commercial banks	-161	-133	-113	-97	-81	-56
Loans	116	127	82	123	198	273
From central bank	0	0	0	0	0	0
From commercial banks	116	127	82	123	198	273
Claims on the private sector	2,339	2,432	2,534	2,517	2,592	2,851
From central bank	0	0	0	0	0	0
From commercial banks	2,339	2,432	2,534	2,517	2,592	2,851
Securities	29	28	23	21	25	25
Loans and advances	2,310	2,404	2,511	2,495	2,567	2,826
Enterprise loans	734	708	762	708	729	802
Mortgages	1,042	1,132	1,161	1,210	1,245	1,371
Individuals loans	534	565	588	577	593	653
Other items net	-437	-514	-598	-647	-647	-647
Money supply (M2)	2,484	2,566	2,990	3,171	3,403	3,810
Money (M1)	1,047	1,147	1,397	1,548	1,662	1,860
Currency in circulation outside banks	157	175	181	175	177	178
Demand deposits	890	972	1,216	1,374	1,485	1,683
Local currency	791	850	1,082	1,231	1,331	1,508
Foreign currency	99	123	134	142	154	174
Quasi money	1,437	1,419	1,594	1,622	1,741	1,949
Savings deposits	681	727	763	830	891	998
Local currency	665	721	757	824	884	990
Foreign currency	16	6	6	7	7	8
Time deposits	756	693	831	792	850	952
Local currency	713	673	823	785	843	943
Foreign currency	43	19	8	7	8	8
Tbills	0	0	0	0	0	0
	(Percent change, year-on-year)					
Net foreign assets	9.3	9.6	77.1	16.3	3.3	1.5
Net domestic assets	0.1	1.1	-7.0	-1.5	10.8	20.5
Credit to the private sector	4.9	4.0	4.2	-0.7	3.0	10.0
Broad money	2.4	3.3	16.5	6.0	7.3	12.0
Deposits	2.2	2.8	17.5	6.7	7.7	12.6
	(Percent change, by contribution to change in broad money)					
Net foreign assets	2.3	2.5	21.5	6.9	1.6	0.7
Net domestic assets	0.1	0.8	-5.0	-0.9	5.8	11.3
	(Percent of GDP)					
Credit to the private sector	54.0	52.2	50.7	54.6	56.5	56.8
Government deposits (at central bank and commercial bank)	4.3	4.2	5.9	6.5	5.8	4.3
Broad money	57.3	55.1	59.8	68.8	74.2	75.9
Memorandum items:						
Money multiplier	5.1	4.8	3.7	3.6	3.6	3.9
Loan to total deposit ratio (percent)	99.3	100.5	89.4	83.3	79.6	77.8

Source: Central Bank of Aruba; and IMF staff estimates.

Table 7a. Aruba: Balance of Payments, 2007–15
(Millions of U.S. dollars)

	2007	2008	2009	2010	2011	2012	2013	2014	2015
				Projections					
Current account	-99	-152	158	-31	-74	-102	-99	-103	-108
Trade balance	-162	-496	-473	-766	-356	-337	-351	-366	-383
Oil sector	615	327	269	0	500	512	535	559	585
Exports	2,617	3,615	1,356	200	3,200	3,345	3,496	3,655	3,821
Imports	2,001	3,288	1,088	200	2,700	2,833	2,961	3,095	3,236
Free zone	9	3	4	9	9	10	10	11	11
Exports	64	75	77	65	71	75	78	82	85
Imports	56	72	73	56	62	65	68	71	74
Rest of economy	-786	-826	-746	-775	-865	-858	-896	-936	-979
Exports	10	15	12	13	14	15	15	16	17
Imports	796	841	758	788	879	873	911	953	996
Services	569	564	775	894	642	628	668	698	730
Exports	1,513	1,692	1,601	1,619	1,682	1,747	1,830	1,913	2,000
Of which: tourism exports	1,253	1,409	1,293	1,338	1,389	1,442	1,511	1,579	1,651
Imports	945	1,128	826	725	1,040	1,120	1,162	1,215	1,270
Of which: oil sector imports	249	355	115	22	270	312	326	341	356
Income (net)	-404	-106	-68	-67	-155	31	-171	-180	-189
Of which: investment income (net)	-399	-105	-69	-117	-119	-25	-132	-139	-147
Current transfers	-102	-114	-76	-89	-113	-125	-136	-143	-149
Of which: private transfers (net)	-108	-121	-88	-84	-94	-108	-102	-107	-112
Financial and capital account	137	389	-112	59	86	131	139	138	142
Capital account	18	157	34	26	28	29	31	32	34
Of which: government capital transfers	19	159	28	…	…	…	…	…	…
Financial account	118	232	-146	33	58	102	108	105	108
Direct investment (net)	-125	192	79	98	120	75	50	47	50
Of which: oil	-285	0	1	28	14	14	0	0	0
Portfolio (net)	59	63	5	12	20	14	28	28	28
Of which: government	29	53	23	…	…	…	…	…	…
Issuance	59	88	40	…	…	…	…	…	…
Repayment	-29	-36	-17	…	…	…	…	…	…
Financial derivatives (net)	1	-10	-1	…	…	…	…	…	…
Other	183	-13	-230	-77	-81	12	30	30	30
Trade credits (net)	0	0	0	…	…	…	…	…	…
Loans (net)	-47	-32	-28	…	…	…	…	…	…
Of which: government (net)	-13	-25	-12	…	…	…	…	…	…
Amortizations	-13	-25	-11	…	…	…	…	…	…
Disbursements	0	0	-1	…	…	…	…	…	…
Currency and deposits (net)	248	59	-176	…	…	…	…	…	…
Banks	8	-67	-70	…	…	…	…	…	…
Non-banks	240	127	-106	…	…	…	…	…	…
Other (net)	-18	-41	-26	…	…	…	…	…	…
Errors and omissions	6.0	-11.8	-11.1	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	43	225	35	28	13	29	40	34	34
Financing									
Increase (-) in official reserves	-43	-225	-34	-28	-13	-29	-40	-34	-34
Memorandum items:									
Central Bank Net Foreign Assets (millions of U.S. dollars)	383	609	643	670	683	710	751	784	818
Gross Foreign Assets (millions of U.S. dollars)	465	701	701	729	742	770	810	844	878
(months of following year non-oil imports)	3.5	5.8	5.7	5.3	5.3	5.3	5.3	5.3	5.3
(percent of broad money)	32	42	40						
(percent of short term external debt residual maturity)	70	86	98	104	97	97	103	104	104
Gross Foreign Liabilities (millions of U.S. dollars)	82	93	59	59	59	59	59	59	59
External Debt (percent of GDP)	87.4	83.9	89.5	89.7	82.0	80.5	79.6	78.8	78.0

Sources: Aruban authorities; and IMF staff estimates and projections.

Table 7b. Aruba: Balance of Payments, 2007–15
(Percent of GDP)

	2007	2008	2009	2010	2011	2012	2013	2014	2015
				Projections					
Oil sector									
Current account	1.7	-2.2	5.6	-1.4	2.4	1.0	1.0	1.0	1.0
Trade balance	23.6	11.7	10.4	0.0	17.8	17.4	17.4	17.4	17.4
Exports	100.5	129.5	52.7	7.8	114.1	113.6	113.6	113.6	113.6
Imports	76.9	117.8	42.2	7.8	96.2	96.2	96.2	96.2	96.2
Services	-9.5	-12.6	-4.3	-0.9	-9.6	-10.6	-10.6	-10.6	-10.6
Income	-11.6	0.0	0.0	0.0	-5.0	-5.0	-5.0	-5.0	-5.0
Transfers	-0.9	-1.3	-0.5	-0.5	-0.8	-0.8	-0.8	-0.8	-0.8
Capital and financial account	-1.7	2.2	-5.6	1.4	-2.4	-1.0	-1.0	-1.0	-1.0
Capital account	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	-1.7	2.2	-5.6	1.4	-2.4	-1.0	-1.0	-1.0	-1.0
FDI (net)	-11.0	0.0	0.1	1.1	0.5	0.5	0.0	0.0	0.0
Portfolio investment (net)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial derivatives	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	9.2	2.2	-5.6	0.3	-2.9	-1.5	-1.0	-1.0	-1.0
Errors and omissions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Free zone									
Current account	0.1	-0.2	-0.3	0.0	0.0	0.0	0.0	0.0	0.0
Trade balance	0.3	0.1	0.2	0.3	0.3	0.3	0.3	0.3	0.3
Exports	2.5	2.7	3.0	2.5	2.5	2.5	2.5	2.5	2.5
Imports	2.1	2.6	2.8	2.2	2.2	2.2	2.2	2.2	2.2
Services	-0.2	-0.2	-0.4	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Income	0.0	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Transfers	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital and financial account	-0.1	0.2	0.3	0.0	0.0	0.0	0.0	0.0	0.0
Capital account	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	-0.1	0.2	0.3	0.0	0.0	0.0	0.0	0.0	0.0
FDI (net)	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Portfolio investment (net)	0.0	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Financial derivatives	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	-0.1	-0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Rest of economy									
Current account	-5.6	-3.1	0.8	0.1	-5.1	-4.5	-4.3	-4.3	-4.2
Trade balance	-30.2	-29.6	-29.0	-30.2	-30.8	-29.2	-29.1	-29.1	-29.1
Exports	0.4	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Imports	30.6	30.1	29.4	30.8	31.3	29.7	29.6	29.6	29.6
Services	31.5	33.0	34.8	36.0	32.7	32.1	32.5	32.5	32.5
Of which: tourism exports	48.1	50.4	50.1	52.2	49.5	49.0	49.1	49.1	49.1
Income	-3.9	-3.8	-2.6	-2.7	-3.8	-4.1	-4.0	-4.0	-4.0
Transfers	-3.1	-2.7	-2.4	-3.0	-3.2	-3.4	-3.6	-3.6	-3.6
Capital and financial account	7.1	11.6	1.0	0.9	5.5	5.5	5.5	5.3	5.2
Capital account	0.7	5.6	1.3	1.0	1.0	1.0	1.0	1.0	1.0
Financial account	6.4	6.0	-0.4	-0.1	4.5	4.5	4.5	4.3	4.2
FDI (net)	6.1	6.7	3.0	2.7	3.8	2.1	1.6	1.5	1.5
Portfolio investment (net)	1.7	2.2	0.0	0.5	0.7	0.5	0.9	0.9	0.8
Financial derivatives	0.0	-0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	-1.4	-2.5	-3.4	-3.3	0.0	1.9	2.0	1.9	1.9
Errors and omissions	0.2	-0.5	-0.4	0.0	0.0	0.0	0.0	0.0	0.0
Total									
Current account	-3.8	-5.4	6.1	-1.2	-2.6	-3.5	-3.2	-3.2	-3.2
Trade balance	-6.2	-17.8	-18.4	-29.9	-12.7	-11.4	-11.4	-11.4	-11.4
Exports	103.4	132.7	56.1	10.9	117.1	116.7	116.7	116.7	116.7
Imports	109.6	150.5	74.5	40.8	129.8	128.1	128.0	128.0	128.0
Services	21.9	20.2	30.1	34.9	22.9	21.3	21.7	21.7	21.7
Income	-15.5	-3.8	-2.6	-2.7	-8.8	-9.1	-9.1	-9.1	-9.1
Transfers	-3.9	-4.1	-2.9	-3.5	-4.0	-4.2	-4.4	-4.4	-4.4
Capital and financial account	5.3	14.0	-4.4	2.3	3.1	4.5	4.5	4.3	4.2
Capital account	0.7	5.6	1.3	1.0	1.0	1.0	1.0	1.0	1.0
Financial account	4.6	8.3	-5.7	1.3	2.1	3.5	3.5	3.3	3.2
FDI (net)	-4.8	6.9	3.1	3.8	4.3	2.6	1.6	1.5	1.5
Portfolio investment (net)	1.7	2.2	0.2	0.5	0.7	0.5	0.9	0.9	0.8
Financial derivatives	0.0	-0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	7.7	-0.4	-8.9	-3.0	-2.9	0.4	1.0	0.9	0.9
Errors and omissions	0.2	-0.5	-0.4	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	1.7	8.1	1.3	1.1	0.5	1.0	1.3	1.1	1.0
Change in reserves (- = increase)	-1.7	-8.1	-1.3	-1.1	-0.5	-1.0	-1.3	-1.1	-1.0

Sources: Aruban authorities; and IMF estimates and projections.

Table 8. Aruba: Financial Soundness Indicators, 2007–09
(Percent, unless indicated otherwise)

	2007	2008	2009
Capital			
Tier 1 capital to risk weighted assets	7.2	8.3	10.6
Tier 1 and Tier 2 capital to risk weighted assets	13.0	14.7	17.9
Asset quality			
NPLs/gross loans	6.7	6.9	7.8
NPLs net of allocated provisions/gross loans	4.0	3.9	4.2
NPLs net of all provisions/gross loans	0.6	0.5	0.8
Large exposures to capital	102.8	98.8	74.8
Earnings and profitability			
ROA before taxes	4.1	3.0	2.6
ROA after taxes	3.1	2.3	1.9
ROE before taxes	50.2	32.4	25.2
ROE after taxes	38.4	24.7	18.5
Interest margin/gross income	60.5	62.4	62.8
Non-interest expenses to gross income	65.7	71.1	73.3
Liquidity			
Liquid assets/total assets	29.0	34.7	30.1
Liquid assets/short term liabilities	82.6	88.7	71.5
Loans/deposits	74.7	69.4	67.0
Sensitivity to market risk			
NFA/regulatory capital	47.1	54.6	72.3
Interest rate margin (percentage points)	6.8	7.5	7.1

Source: Central Bank of Aruba.

Table 9. Aruba: External Debt, 2004–09
(Percent of GDP)

	2004	2005	2006	2007	2008	2009
Government 1/	22.7	22.7	23.0	22.2	21.4	23.6
Short-term (trade credits)	0.4	0.5	0.2	0.1	0.0	0.1
Long-term	22.3	22.2	22.8	22.1	21.4	23.5
Bonds and notes	12.9	13.6	15.0	15.1	15.9	18.2
Loans	8.1	7.0	6.6	6.0	5.0	5.0
Trade credits and advances	1.3	1.6	1.3	1.0	0.5	0.3
Centrale Bank van Aruba	0.0	0.1	0.4	0.1	0.2	0.1
Commercial banks	12.3	12.1	12.9	13.8	11.7	11.7
Short-term	10.9	10.2	11.4	11.9	10.3	10.5
Long-term	1.4	1.9	1.4	1.9	1.4	1.2
Bonds and notes	0.0	0.8	0.8	0.7	0.0	0.0
Loans	0.3	0.3	0.3	0.1	0.1	0.1
Of which: currency and deposits	1.1	0.8	0.4	1.0	1.3	1.1
Other debt liabilities	0.0	0.0	0.0	0.0	0.0	0.0
Other sectors 2/	28.6	22.5	18.1	15.3	16.4	17.2
Short-term	4.0	5.8	2.7	2.5	2.2	2.4
Long-term	24.6	16.7	15.4	12.9	14.2	14.8
Bonds and notes	4.2	3.7	3.1	2.7	2.7	2.6
Loans	20.4	13.0	12.3	10.2	11.5	12.1
Direct investment: intracompany lending	12.6	13.2	43.4	35.9	34.3	37.0
Gross external debt	76.2	70.6	97.7	87.4	83.9	89.5
Short-term	15.4	16.5	14.7	14.6	12.7	13.1
Long-term	60.9	54.1	83.0	72.8	71.3	76.4

Sources: Aruban authorities; and IMF staff calculations.
1/ Including official entities.
2/ Include nonmonetary financial institutions, public and private nonfinancial corporations, nonprofit institutions serving households and households.

Table 10. Aruba: International Investment Position, 2004–09
(Percent of GDP)

	2004	2005	2006	2007	2008	2009
Net position	-32.1	-35.7	-36.4	-39.3	-46.5	-44.6
Assets	75.3	70.0	92.5	81.8	77.5	90.7
Direct investment	15.7	14.6	13.5	13.7	12.9	14.0
Portfolio	17.2	17.6	21.0	20.2	14.5	18.6
Equity securities	11.7	12.0	14.2	14.4	10.0	11.7
Debt securities	5.5	5.6	6.8	5.8	4.5	6.9
Bonds and notes	3.8	4.5	4.0	4.6	3.4	5.6
Monetary authorities	0.0	0.0	0.0	0.0	0.0	0.0
General government	0.0	0.0	0.0	0.0	0.0	0.0
Banks	0.6	0.4	0.1	0.0	0.0	0.0
Other sectors	3.2	4.1	3.9	4.6	3.4	5.5
Money market instruments	1.7	1.1	2.8	1.2	1.1	1.4
Other	27.0	23.5	41.2	30.1	25.0	31.0
Trade credits	0.0	0.0	0.0	0.0	0.0	0.0
Loans	4.1	3.2	2.4	2.4	2.7	3.2
Currency and deposits	22.3	19.7	38.3	27.1	21.8	27.4
Monetary authorities	0.0	0.0	0.0	0.0	0.0	0.0
General government	0.0	0.0	0.0	0.0	0.0	0.0
Banks	10.0	10.4	10.9	11.9	12.8	16.0
Other sectors	12.3	9.4	27.5	15.2	9.0	11.3
Other assets	0.6	0.6	0.5	0.6	0.5	0.4
Reserve assets	15.5	14.2	16.9	17.9	25.1	27.2
Liabilities	107.5	105.7	129.0	121.1	123.9	135.4
Direct investment	50.7	53.4	76.5	67.9	72.1	81.4
Portfolio	17.0	17.4	18.1	20.1	21.7	24.2
Equity securities	0.0	0.0	0.0	0.0	0.0	0.0
Debt securities	17.0	17.4	18.1	20.1	21.7	24.2
Bonds and notes	17.0	17.4	18.1	20.1	21.7	24.2
Monetary authorities	0.0	0.0	0.0	0.0	0.0	0.0
General government	12.9	13.6	15.0	15.1	15.9	18.2
Banks	0.0	0.0	0.0	0.0	0.0	0.0
Other sectors	4.2	3.7	3.1	5.1	5.8	6.1
Money market instruments	0.0	0.0	0.0	0.0	0.0	0.0
Other	39.7	34.9	34.4	33.0	30.1	29.7
Trade credits	0.0	0.0	0.0	0.0	0.0	0.0
Loans	26.0	21.3	20.3	17.3	15.5	15.9
Monetary authorities	0.0	0.0	0.0	0.0	0.0	0.0
General government	8.1	7.0	6.6	6.0	5.0	5.0
Banks	1.2	1.4	1.7	1.3	0.5	0.5
Other sectors	16.7	12.9	12.0	10.0	10.0	10.5
Currency and deposits	10.8	10.4	11.3	12.3	10.9	11.1
Monetary authorities	0.0	0.1	0.4	0.1	0.2	0.1
General government	0.0	0.0	0.0	0.0	0.0	0.0
Banks	10.8	10.4	10.9	12.3	10.7	11.1
Other sectors	0.0	0.0	0.0	0.0	0.0	0.0
Other liabilities	2.9	3.2	2.8	3.4	3.8	2.6
Monetary authorities	1.6	1.9	2.4	3.1	3.2	2.2
General government	0.0	0.0	0.0	0.0	0.0	0.0
Banks	0.3	0.4	0.3	0.3	0.4	0.2
Other sectors	0.9	0.9	0.0	0.0	0.2	0.2

Sources: Central Bank of Aruba; IMF staff estimates.

Appendix I. Public Sector Debt Sustainability Framework, 2005–15

Table 1A. Aruba: Public Sector Debt Sustainability Framework, 2005–15

(Percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Debt-stabilizing primary balance 9/
Baseline: Public sector debt 1/	45.8	46.4	45.9	41.0	47.3	50.9	52.1	53.0	53.0	52.4	51.8	0.8
o/w foreign-currency denominated	20.6	21.5	21.1	20.9	23.1	24.8	24.3	24.6	24.9	25.1	25.3	
Change in public sector debt	2.7	0.6	-0.5	-4.9	6.2	3.6	1.3	0.9	0.0	-0.6	-0.6	
Identified debt-creating flows (4+7+12)	1.2	-0.8	-0.9	-6.8	6.9	4.3	2.3	2.3	0.9	-0.6	-0.6	
Primary deficit (after measures) 10/	1.0	-1.4	-0.1	-6.0	0.9	1.2	3.9	1.8	0.1	-1.4	-1.5	
Revenue and grants	21.9	22.7	22.2	27.3	24.0	24.6	20.7	21.8	22.5	23.3	23.4	
Primary (noninterest) expenditure	22.9	21.3	22.1	21.4	24.9	25.8	24.6	23.6	22.6	21.9	21.9	
Automatic debt dynamics 2/	0.2	0.5	-0.8	-0.8	6.0	3.1	-1.6	0.5	0.8	0.8	0.9	
Contribution from interest rate/growth differential 3/	0.2	0.5	-0.8	-0.8	6.0	3.1	-1.6	0.5	0.8	0.8	0.9	
Of which contribution from real interest rate	1.0	1.0	-0.2	-0.5	2.6	2.1	1.7	1.5	1.5	1.6	1.6	
Of which contribution from real GDP growth	-0.8	-0.5	-0.6	-0.3	3.4	1.0	-3.3	-1.0	-0.7	-0.8	-0.7	
Contribution from exchange rate depreciation 4/	0.0	0.0	0.0	0.0	0.0	...	...	...	...	...	...	
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	
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	
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	
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	
Residual (Asset Changes) (2-3) 5/	1.5	1.5	0.4	1.9	-0.6	-0.7	-1.0	-1.4	-0.9	0.0	0.0	
Central Government debt-to-revenue ratio 1/	209.5	204.2	207.0	150.2	196.6	207.1	251.8	243.6	235.4	225.1	221.4	
Gross financing need 6/	8.5	9.8	8.4	4.0	8.6	9.1	12.5	12.9	12.5	9.5	7.6	
in billions of U.S. dollars	0.2	0.2	0.2	0.1	0.2	0.2	0.4	0.4	0.4	0.3	0.3	
Scenario with key variables at their historical averages 7/						50.9	49.4	47.4	46.0	45.5	45.1	
Scenario with no policy change (constant primary balance) in 2010-2015						50.9	58.5	63.5	69.4	76.3	83.4	
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	2.0	1.1	1.4	0.7	-7.7	-2.2	7.1	2.0	1.4	1.5	1.5	
Average nominal interest rate on public debt (in percent) 8/	4.9	5.5	5.6	5.4	5.8	5.9	6.0	5.9	6.0	6.1	6.3	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	2.6	2.4	-0.4	-1.1	5.8	4.3	3.7	3.0	3.0	3.1	3.2	
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)	2.3	3.1	6.0	6.5	0.0	1.7	2.3	2.9	3.1	3.0	3.0	
Growth of real primary spending (deflated by GDP deflator, in percent)	-15.9	-5.6	5.0	-2.7	7.7	1.3	2.0	-2.3	-2.7	-1.7	1.6	
Primary deficit	1.0	-1.4	-0.1	-6.0	0.9	1.2	3.9	1.8	0.1	-1.4	-1.5	

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 $r - \pi(1+g)$ 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.

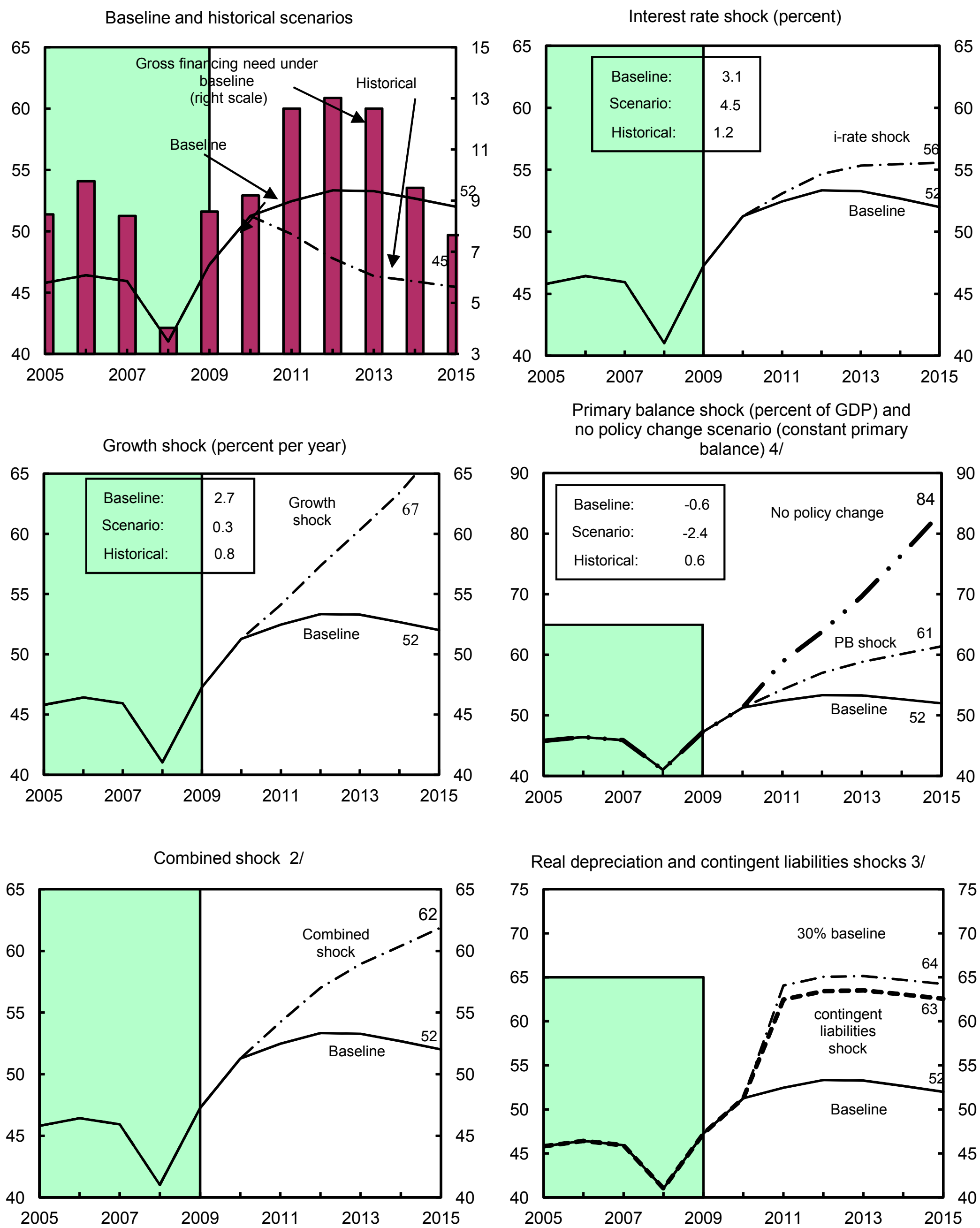
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

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.

10/ Assumes the government follows the deficit path announced in the 2010 budget submission.

Figure 1A. Aruba: Public Debt Sustainability: Bound Tests 1/
(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 2010, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).
4/ The "constant primary balance" scenario removes the oil refinery settlement (4.6% of GDP) from the 2010 primary balance .

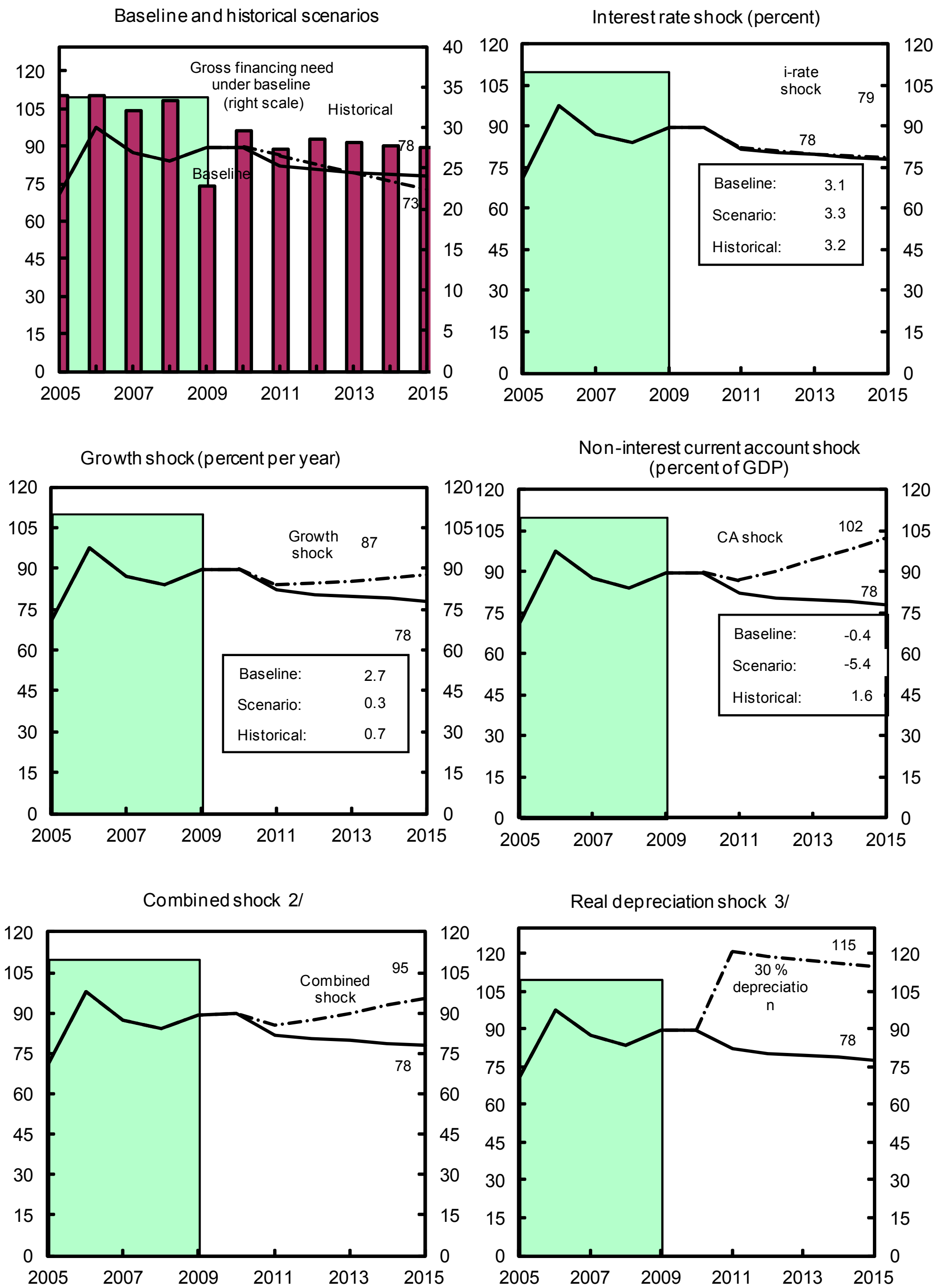
Appendix II. External Sector Debt Sustainability Framework, 2005–15

Table 2A. Aruba: External Debt Sustainability Framework, 2005–15
(Percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2005	2006	2007	2008	2009			2010	2011	2012	2013	2014	2015	Debt-stabilizing non-interest current account 6/
Baseline: External debt	70.6	97.7	87.4	83.9	89.5			89.7	82.0	80.5	79.6	78.8	78.0	-1.6
Change in external debt	-5.6	27.2	-10.4	-3.4	5.5			0.2	-7.6	-1.5	-0.9	-0.8	-0.8	
Identified external debt-creating flows (4+8+9)	1.3	29.3	-2.6	-6.6	-2.4			1.6	-5.6	0.8	1.5	1.5	1.5	
Current account deficit, excluding interest payments	5.7	-1.0	1.3	3.1	-8.6			-1.2	-0.2	1.2	0.8	0.8	0.8	
Deficit in balance of goods and services	17.8	8.5	15.6	2.4	11.7			5.0	11.5	10.1	10.3	10.3	10.3	
Exports	206.1	206.2	161.6	193.4	118.3			74.1	177.0	176.0	176.1	176.1	176.1	
Imports	-188.3	-197.7	-145.9	-190.9	-106.5			-69.1	-165.6	-165.9	-165.8	-165.8	-165.8	
Net non-debt creating capital inflows (negative)	-4.0	30.7	0.4	-6.1	-3.3			-1.5	-2.1	-1.3	-0.7	-0.6	-0.6	
Net foreign direct investment, equity	4.0	-30.7	-0.4	6.1	3.3			1.5	2.1	1.3	0.7	0.6	0.6	
Net portfolio investment,equity	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
Automatic debt dynamics 1/	-0.4	-0.4	-4.3	-3.5	9.5			4.4	-3.4	0.9	1.4	1.3	1.3	
Contribution from nominal interest rate	2.9	2.5	2.5	2.4	2.5			2.4	2.4	2.4	2.4	2.4	2.4	
Contribution from real GDP growth	-1.5	-0.7	-1.3	-0.6	7.0			1.9	-5.8	-1.5	-1.1	-1.1	-1.1	
Contribution from price and exchange rate changes 2/	-1.7	-2.1	-5.5	-5.3	0.0			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	-6.9	-2.1	-7.8	3.1	8.0			-1.5	-2.0	-2.3	-2.4	-2.3	-2.3	
External debt-to-exports ratio (in percent)	34.3	47.4	54.1	43.4	75.7			121.1	46.3	45.8	45.2	44.7	44.3	
Gross external financing need (in billions of US dollars) 4/	0.8	0.8	0.8	0.9	0.6			0.8	0.8	0.8	0.9	0.9	0.9	
in percent of GDP	34.0	33.9	32.1	33.3	22.9			29.7	28.2	28.8	28.1	27.8	27.5	
Scenario with key variables at their historical averages 5/								89.7	86.2	82.8	79.4	76.1	72.7	-1.7
						10-Year Historical Average	10-Year Standard Deviation							
Key Macroeconomic Assumptions Underlying Baseline														
Real GDP growth (in percent)	2.0	1.1	1.4	0.7	-7.7	0.7	4.8	-2.2	7.1	2.0	1.4	1.5	1.5	
GDP deflator in US dollars (change in percent)	2.3	3.1	6.0	6.5	0.0	3.5	2.2	1.7	2.3	2.9	3.1	3.0	3.0	
Nominal external interest rate (in percent)	3.9	3.7	2.8	2.9	2.7	3.2	0.4	2.7	3.0	3.1	3.2	3.2	3.2	
Growth of exports (US dollar terms, in percent)	20.4	4.3	-15.8	28.4	-43.6	6.9	29.5	-37.7	161.8	4.3	4.6	4.5	4.6	
Growth of imports (US dollar terms, in percent)	15.2	9.4	-20.7	40.3	-48.5	3.8	25.9	-35.5	162.5	5.2	4.5	4.5	4.6	
Current account balance, excluding interest payments	-5.7	1.0	-1.3	-3.1	8.6	1.6	9.9	1.2	0.2	-1.2	-0.8	-0.8	-0.8	
Net non-debt creating capital inflows	4.0	-30.7	-0.4	6.1	3.3	0.9	16.3	1.5	2.1	1.3	0.7	0.6	0.6	

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 US 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.

Figure 2A. Aruba: External Debt Sustainability: Bound Tests 1/
(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 2010.

INTERNATIONAL MONETARY FUND

KINGDOM OF THE NETHERLANDS—ARUBA

Staff Report for the 2010 Article IV Consultation Discussions—Informational Annex

Prepared by the European Department

October 6, 2010

Contents Page

Appendix I. Kingdom of the Netherlands—Aruba: Fund Relations

(As of October 6, 2010)

- The consultation discussions, which are part of the 2010 Article IV consultation discussions with the Kingdom of the Netherlands, were held in Oranjestad during August 30–September 9, 2010. The staff team comprised Messrs. Wiegand (head), Gottlieb, and Munteanu (all EUR). It met with the Governor, the Prime Minister, the Minister of Finance, the Minister of Economic Affairs, the President of the central bank, senior officials of the central bank and the government, members of parliament, and representatives of labor unions, business associations, think tanks, banks, and pension and health care funds. Ms. Barendregt (OED) participated in some of 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.

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	3,996.95	77.42
	Reserve position in Fund	1,165.48	22.58
	Lending to the Fund	276.00	
III.	**SDR Department:**	**SDR million**	**Percent of Allocation**
	Net cumulative allocation	4,836.63	100.00
	Holdings	4,887.31	101.05

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			
	2011	**2012**	**2013**	**2014**
Principal				
Charges/Interest	0.04	0.04	0.04	0.04
Total	0.04	0.04	0.04	0.04

VII. **Exchange Rate Arrangement**:

The Aruban florin has been pegged to the U.S. dollar at Af. 1.79 per US$1 since January 1, 1986.

Aruba maintains 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. On June 25, 2010 Aruba introduced a Sanctions Decree for the combat of terrorism and terrorist financing, in compliance with UN resolutions 1267 (1999) and 1373 (2001), and the Special Recommendation III of the Financial Action Task Force (FATF). Restrictions on financial transactions with Iraq and Kuwait were lifted in November 2008 based on UN resolution 1483 (2003).

VIII. **Article IV Consultation**:

The Board concluded the last Article IV consultation discussions for Aruba on February 22, 2008 on the basis of the staff report (IMF Country report 08/78) and the statistical appendix (IMF Country report 08/79). Consultations are conducted on a bi-annual cycle.

IX. **Financial Sector Supervision, FATF Evaluation, and OFC Assessment**:

The evaluation of Aruba's compliance with the Financial Action Task Force (FATF) 40+9 Recommendations on AML/CFT was conducted jointly by the FATF and the Caribbean Financial Action Task Force during November 24–December 5, 2008. A mutual Evaluation Report was published on the FATF website in October, 2009.

A Detailed Assessment of Compliance with the Basel Core Principals for Effective Banking Supervision (Country report 08/316) and the Assessment of Financial Sector Supervision and Regulation (Country report 08/317) were published in September 2008. An update OFC was conducted in 2008.

X. **Technical Assistance**:

To assist the Central Bank of Aruba with the implementation of the Standardized Report Forms (SRFs), a monetary and financial statistics mission visited Aruba in February 2009.

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

Aruba's statistical base is broadly adequate for surveillance, but improvements in several areas would support effective economic analysis and policymaking. In particular, the fiscal accounts, national accounts, and labor market statistics need to be strengthened.

1. Real sector

Real sector data are compiled by the Central Bureau of Statistics (CBS). The CBS has published national accounts data for 1995 through 2006, and preliminary estimates for 2007–09. On the expenditure side, data on changes in inventories are lacking. Moreover, the data on imports and exports of goods and services do not match BOP statistics, reflecting different methodological approaches and raw sources. Furthermore, the CBS' use of the Consumer Price Index (CPI) as deflator for real GDP can give rise to distortions. CPI data are compiled and published on a monthly basis.

2. Fiscal sector

Government finance statistics are prepared and published on a regular basis, but not reported to STA. The presentation of the fiscal accounts could be improved in several respects. First, a residual expenditure category "not included elsewhere" that can amount to 3 percent GDP should be disaggregated. Second, below-the-line financing does not add up to the fiscal deficit without further adjustments. Third, each financing category has a large component "other" (in addition to disbursements and amortizations) whose nature is not clear. And fourth, the authorities combine commercial bank financing and Central Bank financing into one aggregate entitled "net recourse to the monetary system". This aggregate should be disaggregated given that central bank financing of the deficit has an impact on money supply.

3. Monetary sector

The methodology used by the Central Bank of Aruba (CBA) for compiling monetary statistics published in CBA's Monthly Bulletin, Quarterly Bulletin, and Annual Statistical Digest is broadly consistent with the IMF's Monetary and Financial Statistics Manual 2000 (MFSM). The CBA reports monetary data to STA on a timely basis. The authorities submit the data in the format of Standardized Report Forms developed by STA. The shortcomings in the monetary data reports were discussed with the CBA during the STA technical assistance (TA) mission in February, 2009. The STA mission concluded that CBA staff is capable of implementing the mission's short-term recommendations, but recommended additional TA after the development and implementation of the new Chart of Accounts (COAs) for banks in Aruba, currently under implementation (implementation period 2009–11).

4. External sector

The CBA reports quarterly balance-of-payments data and an annual IIP. A more detailed breakdown of exports and imports would be useful, for example by economic category (consumer goods, fuels, raw materials, and capital goods) and by commodity.

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.

A debt survey covering both the public and private sectors provides information on the amount, currency denomination of foreign debt outstanding, as well as on disaggregation by instrument and amortization payments coming due. Areas requiring improvement include: (i) make changes in external debt data consistent with the debt creating flows in the balance of payments, (ii) report maturity schedules on private sector external debt; and (iii) report flow data on trade credits and intercompany loans.

Table of Common Indicators Required for Surveillance

	Date of Latest Observation	Date Received	Frequency of Data	Frequency of Reporting	Frequency of Publication
Exchange Rates	7/10	8/18/10	Monthly	Monthly	Quarterly
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	6/10	8/24/0	Weekly	Weekly	Monthly
Reserve/Base Money	6/10	8/18/10	Monthly	Monthly	Monthly
Broad Money	6/10	8/18/10	Monthly	Monthly	Monthly
Central Bank Balance Sheet	6/10	8/18/10	Monthly	Monthly	Monthly
Interest Rates[2]	6/10	8/18/10	Monthly	Monthly	Monthly
Consumer Price Index	6/10	7/19/10	Monthly	Monthly	Monthly
External Current Account Balance	Q4/09	7/7/10	Quarterly	Quarterly	Quarterly
Exports and Imports of Goods and Services	Q4/09	7/7/10	Quarterly	Quarterly	Quarterly
GDP/GNP[3]	2009	5/10	Annual	Annual	Annual
Gross External Debt[4]	2009		Annual	Annual	Annual
IIP	2009	6/10	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 discounts rates, money market rates, rates on treasury bills, notes, and bonds.
[3] 2007–09 are preliminary data.
[4] Including currency and maturity composition.

Statement by the IMF Staff Representative
October 20, 2010

1. **This statement provides information that has become available since the Staff Report (SM/10/270) was circulated to the Executive Board on October 7, 2010**. The information does not alter the thrust of the staff appraisal.

2. **The resumption of operations at Aruba's oil refinery has been postponed and is now envisaged for January 2011 rather than November 2010.** This delay triggers a downward revision of staff's projected real GDP growth rate for 2010 to -3.2 percent (from -2.2 percent) and an upward revision for 2011 to 8.1 percent (from 7.1 percent). The projections for real GDP growth excluding refining remain unchanged at 0.2 percent (2010) and 3.2 percent (2011) respectively.

3. **The central bank has taken important steps to emphasize its accommodative policy stance and to clarify that it no longer targets credit growth.** In early October, the central bank cut its advance rate to 1 percent (from 3 percent). The step is largely symbolic, given that banks have large liquidity buffers and hence do not use the advance borrowing window at this juncture. However, the cut signals that the central bank considers current monetary conditions too tight. The central bank has also sent letters to Aruba's commercial banks that explain the functioning of its new monetary policy framework based on an unremunerated reserves requirement as the key policy tool.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 10/143
FOR IMMEDIATE RELEASE
October 26, 2010

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

IMF Executive Board Concludes 2010 Article IV Consultation Discussions with the Kingdom of the Netherlands—Aruba

On October 20, 2010, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation discussions with the Kingdom of the Netherlands—Aruba.[1]

Background

Aruba is a small, open economy with one of the highest living standards in the Caribbean and a history of policies that have successfully safeguarded macroeconomic stability over the years. Since 2008, however, adverse external shocks have left Aruba in a difficult spot. Tourism declined in the wake of the global downturn and Aruba's oil refinery closed temporarily in July 2009, reflecting slim margins on refined petroleum products. Overall, real GDP contracted by 7½ percent in 2009, making Aruba's slump one of the most severe in the Caribbean. Unemployment increased sharply to 11.3 percent, amid rapid disinflation, sharp current account adjustment, and weak lending activity. A gradual recovery is underway now.

The government reacted to the slump by loosening fiscal policy, using primarily permanent measures that have created a large underlying deficit. Upon taking office at end-October 2009, the new government cut an unpopular business turnover tax in half starting in 2010, in line with its economic program announced prior to the elections. The government also increased social transfers to mitigate the impact of the recession and initiated a social dialogue with labor unions and employers to address Aruba's most

[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.

pressing socio-economic challenges. The social dialogue participants agreed in August 2010 on important measures that improve the financial health of Aruba's main pension and health care schemes. These steps reduce longer-term risks to the public finances but yield limited fiscal savings in the short-term. The government also announced a path that would bring the fiscal deficit to below 2 percent by 2014, but the measures to achieve this objective remain to be specified.

Monetary policy was, until last year, conducted mostly by means of a ceiling on credit growth to the private sector, in the context of a fixed exchange rate with the U.S. dollar. In the downturn, however, commercial banks cut lending volumes while preserving high interest margins, with no instrument at the disposal of the central bank to ease lending conditions. To enhance policy effectiveness, the central bank abolished the credit ceiling at the beginning of this year and moved to conducting monetary policy by means of an unremunerated reserves requirement.

Aruba's external competitiveness appears solid and reserves coverage is broadly adequate, thus underpinning the longstanding peg with the U.S. dollar. The real effective exchange rate measured in terms of core prices has depreciated slightly in recent years, while Aruba's market share in Caribbean tourism has held up well. At end-2009, official reserves covered about 100 percent of short term debt by residual maturity and 5½ months of imports. Aruba's total external debt is high at more than 90 percent of GDP, but risks appear contained as much is in the form of FDI-related intra-company lending, while only small portions are short-term and/or portfolio funding.

Executive Board Assessment

Executive Directors noted that Aruba had been hard hit by the global crisis. While a gradual recovery is underway, diminished prospects for a further expansion of the tourism industry dampen the outlook for growth in the period ahead.

Directors encouraged the authorities to develop a medium-term fiscal adjustment program to ensure that public debt remains on a sustainable path and to provide space to react to external shocks. They commended the reforms of the pension and health care schemes agreed in the context of the social dialogue, but noted that the short-term budgetary impact of these measures is limited. Directors welcomed the authorities' intention to strengthen the fiscal position through expenditure cuts, and considered that some revenue measures would also be needed. A tax reform would help balance fiscal constraints and social priorities. A key component could be a value-added tax. Directors encouraged the authorities to seek technical assistance based on international best practices, for example by joining CARTAC.

Directors agreed that the peg to the U.S. dollar has served Aruba well. They welcomed the switch from a credit ceiling to an unremunerated reserves requirement as the key monetary policy tool, and noted that the transition to the new arrangement and the attendant risks need to be managed carefully by the central bank. Directors also noted that challenges to prudential supervision would likely increase, as the absence of a credit ceiling could lead to a deterioration in banks' lending standards. They called on the authorities to eliminate the tax on foreign exchange transactions, which constitutes an unapproved exchange restriction under Article VIII of the Fund's Articles of Agreement.

Directors noted that a prudent regulatory environment and strong capital positions have helped Aruba's banking system weather the downturn without major strains. They encouraged the authorities to foster greater competition in the financial sector by temporarily relaxing some barriers to entry for foreign banks, provided close cooperation is established with home country supervisors.

Aruba: Selected Economic and Social Indicators

	2006	2007	2008	2009	2010 1/	2011 1/
Real economy (percent annual change)						
Real GDP	1.1	1.4	0.7	-7.7	-2.2	7.1
Domestic demand	3.3	2.1	0.5	-8.7	1.1	6.5
Consumption	1.4	3.2	-0.8	-3.0	2.1	1.6
Investment	7.1	0.1	3.1	-19.5	-1.3	18.1
CPI (period average)	3.6	5.4	9.0	-2.1	2.2	2.5
Unemployment rate (percent)	9.3	7.1	6.9	11.3	...	...
Gross national saving (percent of GDP)	33.0	29.4	28.2	35.5	29.0	30.5
Gross investment (percent of GDP)	34.5	33.2	33.6	29.4	30.2	33.1
Central government (percent of GDP)						
Overall balance	-1.0	-2.3	3.7	-3.5	-4.1	-6.7
Primary balance	1.4	0.1	6.0	-0.9	-1.2	-3.9
Gross debt	46.4	45.9	41.0	47.3	50.9	52.1
Net debt	42.1	41.7	35.1	40.8	45.1	47.9
Interest rates (percent)						
Central bank deposit rate (30 day) 2/	2.4	2.6	0.5	0.1	0.1	...
Government t-bill yield 2/	4.5	4.8	2.3	0.6	0.3	...
Balance of payments (percent of GDP, unless otherwise indicated)						
Trade balance	-4.9	-6.2	-17.8	-18.4	-29.9	-12.7
Current account	-1.5	-3.8	-5.4	6.1	-1.2	-2.6
Oil	13.0	1.7	-2.2	5.6	-1.4	2.4
Non-oil	-14.4	-5.5	-3.3	0.5	0.1	-5.1
Non-oil FDI	6.5	6.1	6.9	3.0	2.7	3.8
Exports of goods and services	206.2	161.6	193.4	118.3	74.1	177.0
Imports of goods and services	197.7	145.9	190.9	106.5	69.1	166.9
Net oil exports (millions of US$)	661	615	327	269	0	500
Official reserves (US$ million)	408	465	701	701	...	...
Monetary Sector (percent annual change)						
Credit to the private sector	4.9	4.0	4.2	-0.7	...	...
Deposits	2.2	2.8	17.5	6.7	...	...
Exchange rate						
Florin per U.S. dollar	1.79	1.79	1.79	1.79	...	...
Real effective rate (2000=100)	97.1	101.0	99.5	100.7	...	...

Sources: Aruban authorities; and IMF staff estimates.
1/ Staff projections.
2/ As of end-June for 2010.

Statement by Age Bakker, Executive Director for the Kingdom of the Netherlands—Aruba
October 20, 2010

Introduction

The new government came into power on 30 October 2009, in the midst of a severe economic recession. In 2009 real GDP contracted by 7.7 percent, reflecting a drop in tourism caused by the global financial and economic crisis, a blow to construction activities especially in the tourism sector, and the temporary ceasing of refining activities by the Valero refinery. Unemployment rose to about 11 percent. The year 2009 was preceded by a few years of modest real GDP growth and increasing inflation, especially in food and housing. In this context, social problems on the island had aggravated.

A first essential initiative by the new government was to improve relations with strategic external partners as well as with domestic stakeholders. Great efforts were put into this, and have yielded important results. The Valero refinery, accounting for about 5% of the workforce and which had interrupted operations, is now preparing for its operations to restart probably early next year. KLM and Carnival Cruise Lines, which had stopped their flights/calls to the island now have resumed their activities in Aruba, bringing high-end tourists to spend time on the island. Relations with the Netherlands have significantly improved, leading inter alia to an agreement on front-loading investments by the partly Dutch government-financed Aruba Development Fund, and Aruba has played a positive role in the constitutional reform of the Kingdom.

The authorities initiated a Social Dialogue creating consensus-building between government, employers and unions. A first agreement between the participants was signed end-August. The agreed measures will contribute substantially to the medium-term fiscal sustainability of Aruba's welfare system. Furthermore, it was agreed that a tripartite committee for tax reforms will be established and will report on its finding in April 2011. More work is foreseen in a second Social Dialogue starting in November 2010, which will address the issues of education, safety, security and the aging population. The aim is to implement necessary action as of January 2012. Already the Social Dialogue has led to a much stronger engagement and commitment of different stakeholders in society, which the government considers to be a necessary condition for moving forward on the path towards durable and sustainable growth.

Public finances

The authorities agree with staff that the fiscal challenges are serious. In the 2010 budget, the government presented a medium-term deficit path, envisaging a reduction of the deficit by around 1.5 percentage points per year in 2012-2014. The Parliament, in which the government party has a majority, has made clear that it attaches great importance to reducing the fiscal deficit.

The first Social Dialogue led to an agreement in August of this year. It contained a balanced set of measures, providing relief of immediate pressure on vulnerable groups in society, while making important progress in addressing the structural underfunding of Aruba's welfare system, in particular its main pension schemes. Arrangements were also made to address part of the shortfall in revenues in the short term. The tariff of the business turnover tax (BBO) had already been halved by the current government in an earlier stage as part of an economic stimulus plan to improve the purchasing power of the population and expand the financial limits of businesses. It was agreed in the context of this dialogue that the planned cancellation of the business turnover tax will be delayed and dealt with in the context of broader tax reform. Furthermore, excise taxes will be increased on demerit goods so as to achieve the 2009 price level, offsetting the loss in revenue from the halving of the BBO in those particular categories.

Agreed reforms of the defined-benefit pension scheme for civil servants (APFA) will significantly reduce the government's obligatory payments to the Fund. It was agreed to raise the pension age from 55 to 60 years; benefits will no longer be based on final wage but on the basis of average career wages; and importantly, claims on APFA pensions will be computed net of AOV-pension claims (the general pension). Moreover, a recovery plan was agreed until 2019 to restore the Fund’s solvency position.

The premium income for the AOV (the general pay-as-you-go pension scheme) will increase as a result of the agreed arrangements in the Social Dialogue, postponing the need for government transfers. Participants in the dialogue also decided to further look into demographic and labor market developments in relation to the AOV pensionable age. An obligatory second pillar pension for the private sector will be introduced as part of labor contracts, with contributions split between employers and employees. In the longer term, this will improve financial conditions for the elderly and reduce the pressure on the AOV.

Other arrangements agreed in the Social Dialogue include an increase in the premium for the universal health care system AZV, by 2 percent, equally shared between employers and employees, and a reduction in the number of civil servants by a hiring freeze (except for teachers and public order staff).

Notwithstanding the reforms outlined above, the government is aware that the fiscal deficit will need to be reduced in the short-to-medium term, as outlined in the 2012-2014 deficit reduction path. It sees some room for cuts in government spending, in particular by reorganizing government tasks, lowering the public wage bill and taking action to reduce government transfers to the AZV (general health insurance). On the revenue side, it is noteworthy that the new government changed the practice that hotel and oil industries paid very little taxes. Importantly, the recent tax settlement with Valero not only involved a large one-off tax payment but also includes a provision that as of 2012 Valero will pay a minimum of $10 million yearly in corporate tax. Finally, the government expects that its broad investment program will have its share of returns in revenues for the government.

Strategy for growth

The government aims to raise the economy's potential growth by pursuing investments that improve the island's infrastructure and enhance the quality of services and the overall experience that Aruba offers to the population and tourists, so as to enhance the added value of our economic activities. The authorities thus aim for higher-end rather than more tourists.

Investments for a total amount of Afl. 1.2 billion are foreseen, mostly privately or through private-public partnerships. Part of this effort is a planned Afl. 200 million investment program by the (pre-funded and thus off-budget) Aruba Development Fund, which will focus in the next one to two years on job-creating projects improving neighborhoods, schools and roads.

Public-private partnerships in the pipeline include relocating the container-harbor out of the city of Oranjestad to the industrial area of Barcadera in the South-Center of the island, and improving the island's road network.

Large private investments currently being made are the construction of a large luxury hotel and the preparations by the Valero refinery to restart refining operations. These projects have encountered delays, leading the Central Bank of Aruba (CBA) to revise its real GDP growth forecasts for 2010 downward to -3.7 percent, while revising upward the figure for 2011 to 9 percent, as the bulk of these investments will be realized next year.

Energy policies are high on the political agenda of the new administration. It is also foreseen that a LNG-plant will be built by the refinery in cooperation with public utilities so as to improve the sustainability of the island's energy-supply.

The authorities furthermore envisage lowering the cost of doing business. Aware of the incentives and disincentives that tax structures may bring, the government aims to create a fiscal regime that permits growth. The fiscal regime, as stated above, will be reviewed as part of the ongoing efforts of the Social Dialogue.

Monetary policy and financial sector supervision

The main objective of the monetary policy of the (CBA) is to maintain relative price stability through the preservation of a fixed exchange rate of the florin with the U.S. dollar. This peg to the USD has been maintained ever since Aruba gained 'status aparte' within the Kingdom of the Netherlands in 1986. To support the confidence in the currency peg, the CBA strives to maintain a comfortable level of foreign exchange reserves.

Until 2009, the CBA's main monetary instrument was a ceiling on credit growth. As of January 2010, the CBA has moved to more indirect monetary instruments, i.e. an unremunerated reserve requirement. In meetings with commercial banks, IMF staff found that this change in policy had not been fully perceived by market participants as such. Since then and as a direct follow-up to staff's recommendation, the CBA has adapted its communication to market participants, including at a recent meeting with the Aruba Bankers Association and in its most recent monetary policy press release, clarifying the change in policy.

The financial sector generally remains in solid conditions. Whereas empirical evidence shows that some competition between banks exists, for instance through acquirement of business account of competitors, authorities generally agree with staff that competition between banks is modest, as is illustrated by the very high interest rate differentials, despite a lack of credit demand. The CBA plans to explore how changes in prudential and consumer protection policy could enhance competition in the banking sector, while maintaining the sector's solidity.

The CBA invests continuously in the quality of supervision. Following the IMF's recommendations in the 2008 Article IV consultation, the CBA in 2009 has introduced stress testing, using IMF models. Based on the lessons learned from the international financial crisis, the CBA decided to increase the required liquidity and solvency rations. A second stress test was conducted in September 2010. The CBA's supervision division is in the process of broadening its scope of activities to include supervision of the securities and investment business sector and all AML/CFT obligations of financial institutions and DNFBPs (Designated Nonfinancial Businesses and Professions). In order to enhance integrity supervision, including for AML/CFT purposes, a separate integrity unit within the supervision department was set up in the CBA.