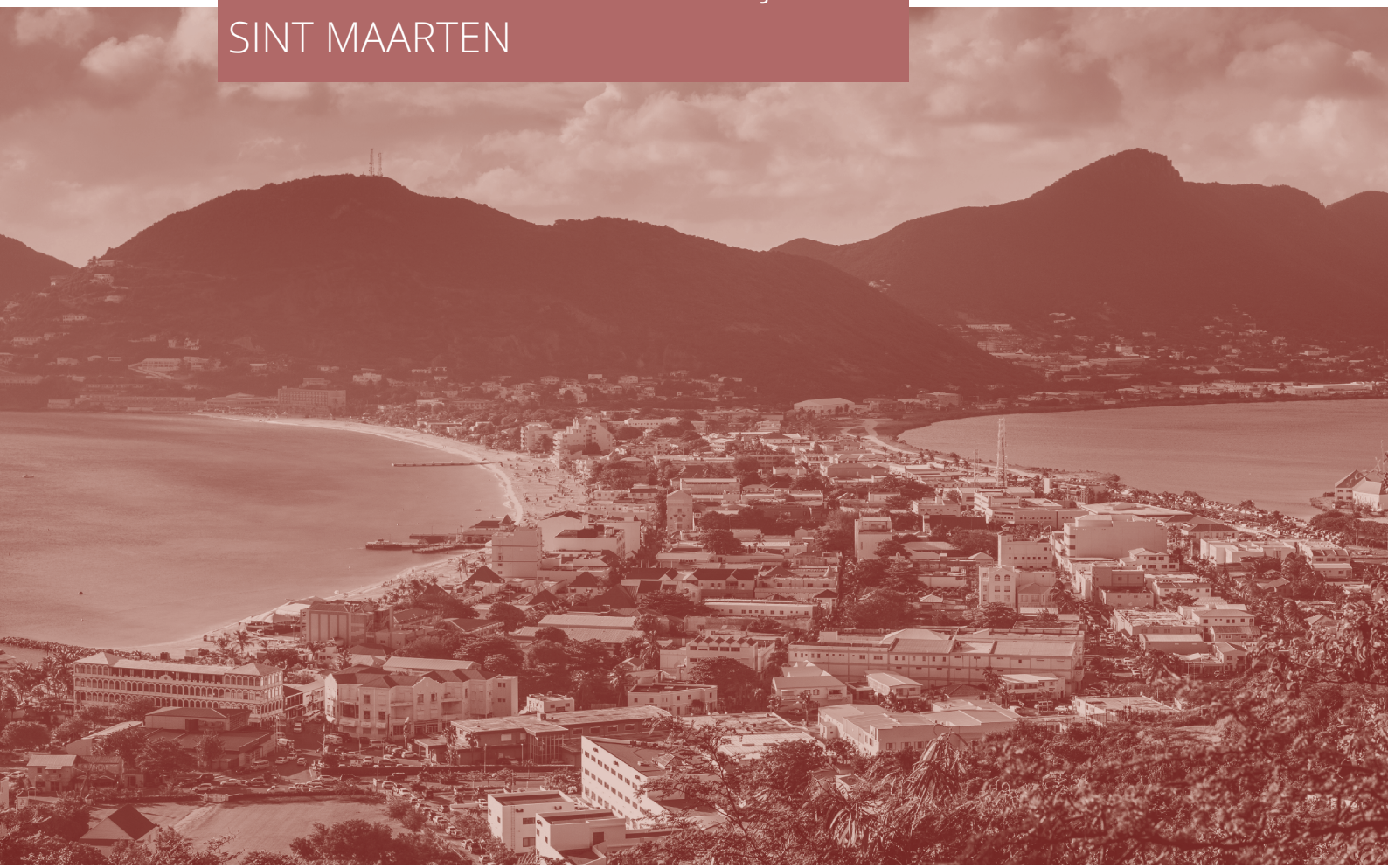
NOTE ECONOMIC DEVELOPMENTS SINT MAARTEN

AUGUST 2019

CENTRALE BANK VAN CURAÇAO EN SINT MAARTEN



Centrale Bank van Curaçao en Sint Maarten

Note Economic Developments Sint Maarten

Centrale Bank van Curaçao en Sint Maarten

August 2019

Simon Bolivar Plein 1
Willemstad,
Curaçao
Phone: (599 9) 434-5500
Fax: (599 9) 461-5004
E-mail: info@centralbank.cw

GENERAL ECONOMIC DEVELOPMENTS

According to estimates of the CBCS, Sint Maarten's real GDP contracted further by 6.6% in 2018, following a contraction of 4.8% in 2017, because of the lingering effects of Hurricane Irma's crippling damage to much of the country's production capacity. However, the positive rebound of cruise tourism dampened the contraction. Meanwhile, inflationary pressures increased in 2018, largely because of a rise in the prices of consumer goods and insurance premiums.

Aggregate demand (expenditure) analysis of GDP shows that Sint Maarten's domestic expenditure contributed negatively to real GDP in 2018 largely because of reduced (procyclical) public demand. However, private demand rose because of the growth in private investment due to countrywide reconstruction efforts. By contrast, private consumption dropped due to higher unemployment and lower income. Public demand contracted because both public investments and consumption dropped. The decrease in consumption resulted from lower disbursements on goods & services by the government because of acute liquidity challenges. Net foreign demand dropped significantly and was the main cause of the sharp economic contraction because, in real terms, imports rose and exports dropped. The higher imports reflected mainly an increase in construction-related materials and replenishment of inventory. Meanwhile, the contraction in exports was caused primarily by the partial or complete shutdown of tourism-related businesses, such as hotels, for repairs and reconstruction due to the severity of the damage caused by the hurricane.

An analysis of GDP by sector reveals that the effects of Hurricane Irma's dramatic disruption of tourism-related activities in Sint Maarten in September 2017 imparted a full-year effect in 2018, resulting in a worse year-over-year real GDP shrinkage. The contraction reflected the sharp reductions in the utilities, wholesale & retail trade, restaurants & hotels, transportation, storage, & communication, and financial intermediation sectors. However, the manufacturing and construction sectors responded to the rebuilding efforts and recorded positive growth, thereby mitigating the decline in activities in other sectors. Meanwhile, real value added by the public sector also dropped due to lower taxes collected on goods & services, particularly taxes related to tourism activities, i.e., room tax, car rental tax, and timeshare tax.

Real value added in the manufacturing sector grew in 2018. The 2018 yachting season and its related yacht repair activities rebounded toward the end of

the year since much of the marine sector infrastructure, including private marinas in the Simpson Bay Lagoon and docks in Philipsburg harbor, were repaired by then and able to receive and service yachts.

Activities in the construction sector accelerated in 2018. Real value added grew mainly due to the repair and reconstruction activities that began almost immediately after the hurricane and continued apace throughout the country. There were, however, no major public projects started in 2018 as they awaited the necessary financing arrangements.

By contrast, the utilities sector shrank rapidly in 2018. Both water and electricity production dropped consistent with the dramatically reduced demand for electricity and water because of the shutdown of large consumers such as hotels, and damage to critical utilities infrastructure such as water tanks.

The transport, storage, & communication sector was severely negatively affected by Hurricane Irma. Harbor-related activities decreased sharply in 2018, mostly because fewer smaller vessels and tankers visited Sint Maarten. The decline was mitigated, however, by a positive turnaround in the number of both freighter and cruise ship calls. Meanwhile, airport-related activities shrank in line with the decline in total passenger traffic because of the protracted limited operations at the airport terminal. This development was anticipated due to the significantly lower number of stay-over tourists that visited Sint Maarten in 2018 due to restrained room capacity. In addition, Sint Maarten's domestic carrier, Winair, experienced a profound contraction in its activities in 2018.

Meanwhile, activities in the wholesale & retail trade sector contracted further in 2018. The lingering effects of Hurricane Irma contributed to the full-year decline in both domestic consumption and tourism spending in 2018.

Real value added in the restaurants & hotels sector plunged in 2018. The deeper full-year contraction was a direct consequence of the hurricane's disruption to regular economic activities and its damage to Sint Maarten's tourism-related infrastructure, in particular, the Princess Juliana International Airport and major hotels. Thus, the performance in stay-over arrivals was affected negatively by the storm's aftermath. Stay-over arrivals fell severely in 2018, a significant negative acceleration compared to the drop seen in 2017.

The prolonged shutdown of the airport's main terminal building hampered its ability to process several flights at once, and the acute shortage of hotel room inventory created by Hurricane Irma resulted in deeper contractions in stay-over arrivals from all of Sint Maarten's main travel markets. Stay-over arrivals from both the United States and Canada virtually collapsed. Similarly, stay-over arrivals from the European market contracted sharply. Prior to Hurricane Irma, stay-over arrivals from the Caribbean and South American markets already were declining. Stay-over arrivals from the Caribbean market registered a deep contraction while the South American market also dropped precipitously in 2018.

In contrast to the dismal drop in stay-over arrivals was the positive rebound of cruise passenger arrivals in Sint Maarten in 2018. Cruise ship arrivals surged in 2018, a dramatic turnaround compared to the contraction endured in 2017. The increase in the number of cruise passenger arrivals occurred largely because of the return of some loyal cruise lines. In addition, the government's quick action along with a sensible beach policy also helped instill cruise lines' confidence to return quickly.

Finally, the financial intermediation sector also contributed negatively to Sint Maarten's real GDP growth in 2018, although slightly smaller than in 2017, as fees & other income decreased due to fewer bank transactions completed, despite the slight increase in net interest income.

DEVELOPMENTS IN THE PUBLIC FINANCES

In the aftermath of Hurricane Irma, the public finances of Sint Maarten deteriorated further in 2018 compared to 2017. As a result, the deficit on the current budget widened by NAf.17.8 million, reaching NAf.90.2 million in 2018. However, the Kingdom Council of Ministers agreed on March 16, 2018, that Sint Maarten is allowed to deviate from the norms stated in Article 15 of the Kingdom Law on Financial Supervision (Rft), including that no deficit is allowed on the current budget. Worth mentioning is that Sint Maarten managed to record a lower deficit than initially projected for 2018.

A review of the components of the current budget reveals that the higher deficit in 2018 was due to a drop in revenues of NAf.33.6 million mitigated by a decline of NAf.15.8 million in expenditures. Revenues declined mainly as a result of less tax proceeds, particularly profit tax and taxes on goods & services. The decline in tax revenues was consistent with the overall contraction in economic activity in 2018. By contrast, taxes on property, particularly land tax, rose, mainly because transactions were processed in a timelier and more complete manner. Furthermore, expenditures went down mainly due to a drop in spending on goods & services. In particular, spending on waste collection & district cleaning dropped to normal levels after the hurricane cleaning was finished. The government included a provision in 2017's budget to cover the Sint Maarten Medical Center (SMMC) tariff increases. However, this provision was withdrawn in 2018, resulting in a drop in social security spending. The drop in expenditures was mitigated by a rise in wages & salaries.

The total outstanding public debt of Sint Maarten was NAf.772.6 million at the end of 2018, an increase of NAf.165.3 million compared to the end of 2017. The domestic debt component went up by NAf.86.3 million due particularly to more arrears with the Social & Health Insurances, SZV, and the public pension fund, APS. Meanwhile, the foreign debt component increased by NAf.81.6 million, due to two zero-interest loans issued in January and March 2018 through which the Dutch government provided liquidity support. Consequently, the debt-to-GDP ratio of Sint Maarten increased substantially by 10.5 percentage points to 43.1% at the end of 2018.

Meanwhile, the fiscal position of the government of Sint Maarten turned around from a deficit of NAf.12.9 million in the first quarter of 2018 to a surplus of NAf.3.8 million in the first quarter of 2019. This turnaround was caused by an increase in revenues of NAf.7.8 million combined with a decline in expenditures of NAf.8.9 million. Revenues increased

due to more proceeds from taxes, particularly turnover tax, reflecting that Sint Maarten's economy is recovering from the devastations caused by Hurricane Irma. Besides the increase in taxes, a rise in the proceeds from concessions & fees (NAf.2.5 million) and licenses (NAf.2.5 million) also contributed to the increase in government revenues in the January-March period of 2019.

The drop in expenditures was caused primarily by less spending on goods & services (NAf.5.7 million) and less interest payments (NAf.3.0 million). Spending on goods & services dropped because the 2019 budget was not yet approved by parliament.

Sint Maarten's public sector debt dropped by NAf.13.5 million to NAf.759.1 million at the end of March 2019 compared to the end of December 2018, caused by a drop in domestic debt compoenent. Sint Maarten's domestic debt dropped because the government reduced its outstanding arrears towards the Social Security Bank, SZV. Sint Maarten did not borrow on the capital market during the first quarter of 2019, so the foreign debt component remained unchanged at the end of March 2019 compared to the end of December 2018. As a consequence of the drop in the public debt, the debt-to-GDP ratio of Sint Maarten decreased to 40.4% at the end of March 2019.

DEVELOPMENTS IN THE BALANCE OF PAYMENTS

The deficit on the current account of the balance of payments widened by NAf.943.5 million in 2018 compared to 2017 caused by a sharp decline in the net export of goods and services, moderated by an improvement in the income and current transfers balances. Following a decline of NAf.17.6 million in 2017, gross official reserves dropped by NAf.274.3 million in 2018 as the external financing and capital transfers from abroad fell short of the current account deficit. The average import coverage dropped from 5.0 months in 2017 to 4.2 months in 2018 due to the increase in the import of goods and services combined with a decline in official reserves.

In Sint Maarten, net exports dropped considerably (NAf.607.1 million) as a result of an increase in imports combined with lower exports. The contraction in exports can be ascribed to a sharp decline in the foreign exchange earnings from the tourism sector, Sint Maarten's main economic pillar. In September 2017, Hurricane Irma caused immense damage to key infrastructure of Sint Maarten's tourism sector, particularly major hotels and the airport. In line with the resulting sharp decline in the number of stay-over visitors, the foreign exchange earnings from stay-over tourism shrank significantly (54.3%). By contrast, an increase in the revenues from cruise tourism, which recovered relatively quickly from the hurricane, moderated the contraction in exports. Also, the export of merchandise rose, particularly construction materials, car parts, and retail products to the neighbouring islands. This increase in exports can be explained largely by the ongoing reconstruction efforts in the aftermath of hurricanes Irma and Maria on these islands, for which Sint Maarten is an important trade hub. The foreign exchange revenues from business services provided to abroad, including legal, accounting, project development, and real estate services also rose.

The increase in imports reflected mainly the ongoing reconstruction activities in Sint Maarten. Therefore, merchandise imports by the construction, real estate, hotels, and transportation sectors rose. Furthermore, the wholesale & retail trade businesses imported more merchandise to replenish their inventories that were destroyed by the hurricane in 2017. In addition, construction, project development, real estate, insurance, and management services were imported from abroad to support the reconstruction efforts. Similar to Curaçao, the oil import bill rose on the back of higher international oil prices.

The income balance improved by NAf.15.4 million due mainly to a decline in dividend payments by local companies to their

foreign shareholders. Furthermore, labor income earned abroad rose. The improvement of the income balance was mitigated, however, by a drop in dividend earned on foreign investments. Meanwhile, net current transfers into the monetary union rose by NAf.738.2 million. This marked increase was primarily the result of the inflow of funds related to the claims of local insurance companies to pay their clients in Sint Maarten whose properties were damaged by Hurricane Irma.

In line with the higher deficit on the current account, external financing into the monetary union rose, causing a worsening in the International Investment Position (IIP). The portfolio investment and loans & credits balances increased, while net direct investmnets into the monetary union dropped. The worsening of the portfolio investment balance was largely caused by matured debt securities held by institutional investors that were not entirely reinvested abroad during 2018. In the second half of 2018, however, the appetite of institutional and other investors to invest abroad grew because of the gradually increasing international interest rates. The net sale of foreign equity held by local institutional investors and the zero-interest loans that the government of Sint Maarten obtained for liquidity support from the Dutch State also contributed to the deterioration of the portfolio investment balance. The loans & credits balance deteriorated because of an increase in trade credit received on imports, the repayment of trade credit extended in the past on exports, the repayment of loans provided to abroad, and a decline in the balances of local companies' foreign bank accounts. The deterioration of the loans & credits balance was moderated by a drop in the balances on nonresidents' accounts in the monetary union and the repayment of foreign loans. By contrast, the direct investment balance improved due mainly to the foreign parent companies' divestments of real estate properties in Sint Maarten that were damaged by the hurricanes in 2017 and an increase of investments by local companies in their foreign subsidiaries, notably in Aruba and Bonaire. Meanwhile, net capital transfers into the monetary union rose in 2018 because of the transfer of funds by the World Bank from the Sint Maarten Recovery, Reconstruction and Resilience Trust Fund to finance reconstruction projects in Sint Maarten.

MONETARY DEVELOPMENTS

During 2018, the Bank kept the reserve unchanged at 18.00%.[1] Nevertheless, as a result of the higher base amount upon which the reserve requirement is calculated, the amount of required reserves rose by NAf.11.7 million to NAf.1,298.5 million at the end of 2018.

Furthermore, the Bank increased its official interest rate, the pledging rate, by 0.50 percentage point to 2.00% on March 27, 2018, after which it remained unchanged throughout the remainder of 2018. On January 1st, 2019, the pledging rate was increased again by 0.50 percentage point to 2.50%. The increases in the pledging rate was based on the upward adjustments in the U.S. federal funds rate, its impact on international interest rates, and, thereby, on domestic money market rates.

Meanwhile, the Bank continued its policy to gradually reduce the amount of outstanding certificates of deposit (CDs). Therefore, at the bi-weekly CD-auctions, the Bank offered a lower amount of CDs than matured, combined with a higher haircut on the interest rate offered. As a result, by the end of December 2018, there were no outstanding CDs anymore and the auctions were temporarily suspended.

The current account balances of the commercial banks at the Bank were NAf.93.0 million lower at the end of 2018 compared to the end of 2017.

Broad money remained practically unchanged in 2018 compared to 2017 (0.0%) as the decline in net domestic assets was offset by an increase in net foreign assets. During the first quarter of 2019, broad money increased by 1.8% fueled by developments in net foreign assets as net domestic assets declined.

Credit extension to the private sector rose by 1.4% during 2018 as a result of an increase in outstanding loans in Curaçao (2.5%) moderated by a decrease in Sint Maarten (-1.7%). The decrease in Sint Maarten was the result of declines in mortgages (-1.7%), business loans (-3.7%) and the “other loan” component (-65.6%), moderated by an increase in consumer loans (4.9%).

Meanwhile, up to May 2019, private credit extension in the monetary union grew by 3.4% on an annual basis as a result of an increase of outstanding loans in Curaçao (4.8%), moderated by a decrease in Sint Maarten (-1.1%).

[1] *The last adjustment of the reserve requirement percentage occurred in June 2014.*

Monetary and liquidity conditions

- The current account balances of the commercial banks at the central bank dropped by NAf.93.0 million during 2018. At the end of July 2019 they were NAf.328.8 million lower, but the outstanding balance is still high:

Table 1 Liquidity conditions in the monetary union (in millions NAf.)

(in millions NAf.)	Dec 28, 2015	Dec 30, 2016	Dec 31, 2017	Dec 31, 2018	July 26, 2019
Current account balance[1]	490.7	500.4	817.7	724.7	395.9

[1] *Source: condensed balance sheets CBCS*

- Low international interest rates; Fed funds rate between 2.00 - 2.25% since July 31, 2019.

- On December 31, 2018, the 1M USD Libor rate stood at 2.50% while the 3M USD Libor was 2.81%. On July 15, 2019, the 1M USD Libor rate stood at 2.31% while the 3M USD Libor was 2.30%.

- For the July – August 2019 period, the reserve requirement percentage remained unchanged at 18.00% and the outstanding amount was NAf.1,319.4 million.

- The pledging rate stands at 2.50% since January 1, 2019.

OUTLOOK FOR 2019

Global economic growth is projected to ease further to 3.2% in 2019 reflecting, among other things, softening global trade as a result of additional tariff increases enacted by the United States and China in 2018 and 2019. Increased policy uncertainty will further erode business and consumer confidence and, thereby, contribute to the projected slowdown of world economic growth. Risks to the global economic outlook are tilted to the downside including an escalation of the trade and technology tensions, geopolitical tensions (e.g., US sanctions on Iran), mounting disinflationary pressures and a worsening of financial market sentiment that could tighten financial conditions. The United States, which is the main trading partner of Sint Maarten, is projected to grow at a slower pace in 2019.

Real GDP in Sint Maarten is projected to grow by 3.1% in 2019. This positive economic turnaround is the result an increase in both domestic and net foreign demand. The higher domestic demand will be driven by both the private and public sectors. Private investments will increase reflecting primarily the rebuilding of the tourism sector and the the reconstruction of the airport. Private consumption will increase supported mainly by an increase in employment driven by the recovery of the tourism sector. Meanwhile, public investments will increase along with a rise in public consumption. Growth in public investments reflects capital spending on the modernization of the tax department and tax system and the structural improvement of the public financial management. Public consumption is estimated to increase because of higher disbursements on goods & services. The positive contribution of net foreign demand to growth will be driven by an increase in exports, moderated by higher imports. The improved export performance reflects primarily higher foreign exchange earnings from tourism activities. Additionally, imports will rise related to construction material and services for the continuing reconstruction of Sint Maarten.

Inflationary pressures are projected to ease during 2019, largely due to a projected drop in international oil prices.[2]

[2] *IMF World Economic Outlook, July 2019.*

DOWNSIDE RISKS TO OUTLOOK 2019

Following a natural disaster, resources should be channeled quickly, flexibly, and efficiently while ensuring that they reach those most severely affected. However, progress in the reconstruction of Sint Maarten has been rather slow. Further delays will hamper Sint Maarten's economic recovery. Furthermore, a lower than projected real GDP growth in Sint Maarten's main tourism markets will affect the recovery of Sint Maarten's tourism sector. In addition, insurance premiums will increase significantly because of Hurricane Irma, which could discourage businesses and individuals from insuring their property adequately and, hence, make the country even more vulnerable to future disasters.

ATTACHMENT

Table 2 Economic key figures of Sint Maarten (in millions NAf.)

	2015	2016	2017	2018
Real sector				
Real GDP growth (% change)	0.4	0.4	-4.8	-6.6
Inflation (% change)	0.3	0.1	2.2	2.7
Public finances				
Budget balance[1]	-18.4	26.4	-72.4	-90.3
Debt-to-GDP ratio (%)	36.3	34.0	32.6	43.1
Balance of payments of the monetary union				
Current account balance	-887.4	-1,080.8	-1,120.3	-1,507.4
Capital transfers	-7.1	3.0	-2.7	33.6
External financing	804.2	1,183.8	1,004.5	962.7
Direct investments	278.3	241.0	628.8	-191.9
Loans and credits	-62.4	569.7	52.7	814.5
Portfolio investments	588.2	373.2	323.1	340.1
Change in reserves	-27.8	-187.5	17.6	274.3
Net errors and omissions	118.1	81.5	100.9	236.7
Import coverage (months)	4.9	5.1	5.0	4.2

[1] *Source of the 2018 government figures is the Voorlopige Financiele Concernrapportage/Uitvoeringsrapportage, vierde kwartaal 2018 of the government of Sint Maarten.*

Table 2 Economic key figures of Sint Maarten (in millions NAf.) cont.

	2015	2016	2017	2018
Monetary survey (monetary union)				
Net domestic credit	3,787.1	3,753.2	3,699.2	3,673.8
Net domestic credit to government	-589.7	-670.2	-597.4	-304.5
Net domestic credit to private sector	6,145.6	6,625.0	6,683.1	6,679.8
Miscellaneous	-1,768.8	-2,201.6	-2,386.4	-2,701.5
Net foreign assets	4,186.0	4,377.0	4,989.7	5,011.5
Total money supply	7,973.1	8,130.2	8,689.0	8,685.3
Annual growth in private sector loans[2]	1.7%	1.3%	-1.6%	-1.7%
Mortgages	0.0%	0.9%	-1.7%	-1.7%
Consumer loans	-1.2%	7.0%	0.1%	4.9%
Business loans	6.2%	1.4%	-3.1%	-3.7%
Other	-	-51.4%	37.7%	-65.6%

[2] *2016 refers to July – December 2018.*

Table 3 Economic key figures 2018

	Curaçao	Sint Maarten	Monetary Union
Real GDP growth (% change)	-2.2	-6.6	-3.3
Inflation (% change)	2.6	2.7	2.6

Table 4 Economic key figures 2019 (projection)

	Curaçao	Sint Maarten	Monetary Union
Real GDP growth (% change)	-1.8	3.1	-0.6
Inflation (% change)	2.5	2.5	2.5

Table 5 Monetary survey monetary union (in millions NAf.)

	Jan-19	Feb-19	Mar-19	Apr-19	May-19
Money supply (M2)	8,655.5	8,846.3	8,839.8	8,873.3	8,840.3
Money (M1)	4,316.0	4,537.2	4,515.6	4,533.6	4,502.2
Coins & notes with the public	363.0	364.9	357.4	378.0	384.4
Total demand deposits, of which:	3,952.9	4,172.2	4,158.2	4,155.6	4,117.8
Netherlands Antillean guilders	2,627.5	2,784.3	2,791.9	2,804.7	2,810.2
Foreign currency	1,325.4	1,387.9	1,366.3	1,350.9	1,307.6
Near money	4,339.5	4,309.2	4,324.2	4,339.8	4,338.1
Time deposits	1,881.6	1,860.4	1,859.8	1,911.9	1,921.6
Savings	2,457.9	2,448.8	2,464.4	2,427.8	2,416.4
Factors affecting the money supply					
Net domestic assets	3,447.7	3,445.5	3,306.4	3,388.2	3,404.5
General government	-391.9	-379.4	-491.8	-466.5	-505.3
Central government	-12.2	-12.1	-12.2	-11.2	-11.2
Curaçao	-295.0	-288.8	-382.7	-354.8	-354.2
Sint Maarten	-84.7	-78.5	-96.9	-100.5	-139.9
Private sector	6,691.2	6,661.9	6,691.7	6,652.2	6,708.7
Memorandum items	-2,852.2	-2,837.0	-2,893.5	-2,797.5	-2,799.3
Net foreign assets	5,207.7	5,400.8	5,533.3	5,485.2	5,435.2
Central bank	3,019.9	3,176.8	3,230.2	3,093.6	3,047.2
Commercial banks	2,187.8	2,224.0	2,303.1	2,391.7	2,388.4

Table 5 Monetary survey monetary union (in millions NAf.) cont.

	Jan-19	Feb-19	Mar-19	Apr-19	May-19
Government loans by commercial banks	25.1	12.6	17.0	18.9	21.7
Government of Curaçao	1.8	0.0	0.8	1.8	1.4
Government of Sint Maarten	23.3	12.6	16.2	17.1	20.3
Private sector loans Curaçao	4,734.8	4,705.8	4,734.2	4,708.5	4,775.8
Mortgages	1,776.6	1,789.7	1,791.2	1,795.0	1,631.9
Consumer loans	915.1	908.0	905.7	903.5	903.1
Business loans	1,930.0	1,895.7	1,922.4	1,893.8	2,056.8
Other	113.1	112.4	115.0	116.1	184.0
Private sector loans Sint Maarten	1,486.6	1,488.7	1,476.4	1,470.5	1,471.3
Mortgages	871.5	875.7	870.0	870.4	870.1
Consumer loans	234.1	233.0	230.9	232.9	231.3
Business loans	377.2	376.1	371.9	363.5	366.2
Other	3.9	3.9	3.7	3.7	3.7

Table 6 Monetary sector growth rates (%)

	2018-I	2018-II	2018-III	2018-IV	2019-I
Money supply (M2)	2.6	0.1	-2.9	0.3	1.8
Demand deposits					
N.A. guilders	4.6	1.8	-7.9	0.8	6.2
Foreign currency	10.2	-3.9	2.3	-6.1	6.1
Near money					
Time deposits	-5.7	2.8	-2.7	1.6	-3.7
Saving deposits	4.2	-1.9	0.4	1.1	0.8