

NOTE ECONOMIC DEVELOPMENTS CURAÇAO

JULY 2018

CENTRALE BANK VAN CURAÇAO EN
SINT MAARTEN



Centrale Bank van Curaçao en Sint Maarten

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July 2018

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GENERAL ECONOMIC DEVELOPMENTS

Following an economic contraction of 1.0% in 2016, Curacao's real GDP dropped further by 1.7% in 2017 because of a decline in both domestic demand and net foreign demand. Meanwhile, inflationary pressures increased to 1.6% in 2017 from zero inflation in 2016, due mainly to an increase in food and oil prices.

The expenditure side of GDP shows that the economy of Curacao contracted in 2017 as a result of decreases in net foreign demand and domestic demand. The contribution of net foreign demand to GDP growth was negative because of a drop in exports and a slight increase in imports. Exports declined because of lower foreign exchange earnings from stay-over tourism, air transportation services, and refining activities. Imports increased as a result of higher oil imports driven by the increase in international oil prices and more construction services imported for various ongoing investment projects. Meanwhile, domestic demand declined because of decreases in both private and public demand. The drop in private demand was caused by a decrease in private consumption, mitigated by higher investments. Private consumption dropped as a result of, among other things, a decline in disposable income because of higher inflationary pressures and a worsening labor market. The growth in private investment reflects large projects such as the second megapier,

the windmill park, the remodeling and expansion of the airport, and several hotel projects. In addition, public demand went down because the drop in government investments exceeded the increase in public consumption. Public investments dropped because the construction of the new hospital is reaching its final stages. Meanwhile, government consumption increased because of more spending on wages & salaries and goods & services.

An analysis of the GDP by production shows that lower activities in the private sector were the main reason for the economic contraction in 2017. The negative GDP growth was largely attributable to the wholesale & retail trade, restaurants & hotels, transport, storage, & communication, manufacturing, and financial intermediation sectors.

Real value added in the wholesale & retail trade sector dropped because of lower tourism and domestic spending, moderated by an increase in activities in the free zone. Despite a decline in the number of visitors, the free zone recorded a growth as reflected by an increase in the re-export of merchandise.

The restaurants & hotels sector contracted in 2017, although at a slower pace than in 2016, as the drop in the number of stay-over visitors was mitigated by an increase in the average length of stay. In

addition, the number of cruise tourists increased significantly. All stay-over visitor markets contracted, except the North American market. The South American market recorded the strongest decline in the number of visitors, primarily because of fewer visitors from Surinam and Venezuela, mitigated by an increase in number of visitors from Colombia. The increase in the number of visitors from Colombia can be ascribed to, among other things, the removal of visa requirement and stronger ties with the country. The Caribbean market recorded the second largest decline as a result of fewer visitors from Haiti, Jamaica, Trinidad & Tobago, and Aruba, mitigated by a slight increase in the number of visitors from the Dominican Republic. Similar to 2016, the Caribbean and South American markets performed poorly because of a drop in airlift from the local carrier InselAir. Furthermore, the European market contracted because the number of tourists from Belgium and Germany declined, mitigated by an increase in the number of Dutch visitors. The number of German visitors dropped as the main carrier, Air Berlin, cancelled all its flights to the Caribbean, including Curaçao, as of September 2017. The increase in the Dutch market largely explains the rise in the overall average length of stay. By contrast, the North American market improved as the number of visitors from both the United States and Canada increased. The significant increase in cruise tourism was in line with the rise in the number of cruise calls related mainly to the opening of the second mega pier and changes in itineraries by the cruise lines because of the devastation caused by hurricanes Irma and Maria in other popular cruise destinations in the Caribbean.

Similar to 2016, the transport, storage & communication sector performed poorly in 2017 due to fewer activities at both the airport and the harbor. Activities at the airport declined because total passenger traffic, notably transit passengers, and commercial landings contracted. The financial problems and downscaling of the operations by the local carrier InselAir had significant impact on the airport in terms of connectivity options, total passenger arrivals and departures, number of commercial flights, and available seats. Furthermore, harbor activities dropped because fewer ships were piloted into the port of Curaçao, particularly freighters and tankers. By contrast, increases in cargo movements, oil storage activities, and the number of cruise calls mitigated the contraction in harbor activities.

The financial intermediation sector shrank further in 2017, reflected by lower real value added in both the domestic and international financial services industries. Meanwhile, output in the manufacturing sector declined because the oil refining activities by the Isla refinery dropped.

Contrary to the other sectors, the construction and utilities sectors contributed positively to GDP growth in 2017. Activities in the construction sector expanded, although at a slower pace than in 2016, because of the ongoing construction of the second megapier, the hospital, hotel projects, and housing and apartments projects. Output rose in the utilities sector because of more production of both water and electricity.

DEVELOPMENTS IN THE PUBLIC FINANCES

The current budget deficit of the government of Curaçao widened from 2016 to 2017 by NAf.42.0 million, reaching NAf.80.2 million.¹ An analysis of the government's operations during 2017 reveals that the deterioration of its current budget was caused by an increase in government expenditures (NAf.32.9 million) combined with a decrease in government revenues (NAf.9.2 million). The rise in expenditures was primarily caused by a 76.2% increase in the category other expenditures, particularly due to additions to the buffer fund of the social security bank, SVB, to absorb funds deficits. Additionally, there were more outlays on goods & services (7.1%) reflecting higher spending on public housing, education, sports, social security, and public health. Meanwhile, revenues dropped because of a fall in nontax revenues (-3.9%) moderated by a rise in tax revenues (2.0%). The drop in nontax revenues was accounted for particularly by fewer dividends received by the government in 2017 compared to 2016. Also, transfers² received from the Netherlands dropped. On the other hand, tax revenues went up in every category except for wage tax and import duties,

reflecting, among other things, increased efforts by the government to improve tax compliance. The decline in the proceeds from wage tax was in line with the increase in the unemployment rate recorded in 2017.

Noteworthy is that the government still has additional expenditures of NAf.84.6 million and revenues of NAf.51.5 million that have not been processed yet in the accounts of 2017, which will result in a higher current budget deficit of NAf.113.3 million for 2017. The additional expenditures are related to contributions to the SVB to cover the costs related to assistant physicians and additional spending on goods & services and transfer & subsidies. The pending revenues concern dividend payments by government-owned companies.

The outstanding public debt of Curaçao amounted to NAf.2.806 billion at the end of 2017, an increase of NAf.260.2 million compared to the end of 2016. Both the domestic and foreign debt components contributed to the increase. The domestic debt component went up by NAf.202.1 million due mainly to higher liabilities towards the public pension fund, APC, and the social security bank, SVB. Furthermore, the foreign debt component rose by NAf.58.0 million to NAf.2.346 billion resulting from the issuance of a bond loan of NAf.60.0 million in November 2017 that was allocated entirely to the Dutch State

¹ Source: "Financiële Management Rapportage" of the government of Curaçao of December 2017.

² These transfers refer to contributions by the Dutch government to the government of Curaçao regarding payments for services provided, i.e., meteorological services and services by the Justitiële Jeugd Inrichting Curaçao, JJIC (formerly known as GOG).

Treasury Agency (DSTA), mitigated by an amortization of a sinking bond issued in January 2015 for the financing of the new hospital. Consequently, Curaçao's debt-to-GDP ratio increased from 45.6% at the end of 2016 to 50.3% at the end of 2017, well above the 40% benchmark considered prudent for a small open economy.

During the first quarter of 2018, the government recorded a surplus of NAf.88.3 million on its current budget, a 73.5% improvement compared to the surplus recorded in the first quarter of 2017.³ This improvement was caused by a 4.8% increase in revenues and a 1.2% decrease in expenditures. Revenues went up due to a 9.8% increase in nontax revenues and a 2.0% increase in tax revenues. More social security income contributed to the increase in nontax revenues while more proceeds from taxes on goods & services (2.8%), taxes on income & profits (1.8%) and import duties (0.7%) accounted for the increase in tax revenues. Meanwhile, expenditures dropped mainly due to fewer outlays on goods & services (-11.9%), transfers & subsidies (-3.6%) and wages & salaries (-0.2%).

The public debt of the Curaçao government dropped by NAf.22.6 million at the end of the first quarter of 2018 compared to the end of 2017. This drop was caused by a decline in both the foreign and domestic debt components. The foreign debt dropped by NAf.13.8 million due mainly to the amortization of a sinking bond issued in January 2015 for the financing of the new hospital. The domestic debt went down

by NAf.8.9 million primarily as a result of a drop in the government's outstanding liabilities towards the public pension fund, APC. Consequently, Curaçao's debt-to-GDP ratio dropped from 50.3% at the end of 2017 to 49.7% at the end of the first quarter of 2018.

³ Source: "Financiële Management Rapportage" of the government of Curaçao of March 2018.

DEVELOPMENTS IN THE BALANCE OF PAYMENTS

The deficit on the current account of the balance of payments widened by NAf.39.5 million in 2017 compared to 2016 as a result of a drop in the net export of goods and services. In contrast, both the income and current transfers balances improved. External financing into the monetary union rose. However, as the external financing was insufficient to cover the current account deficit, the gross official reserves of the Bank decreased by NAf.17.6 million in 2017, a turnaround compared to the NAf.187.5 million increase in 2016. The average import coverage remained practically unchanged, from 5.1 months in 2016 to 5.0 months in 2017, due to the drop in official reserves combined with a significant increase in imports.

In Curaçao, net foreign demand shrank by NAf.275.5 million as exports dropped, while imports grew. The contraction in exports can be attributed to, among other things, a drop in the foreign exchange earnings from transportation services provided to abroad. This drop can be explained by the discontinuation of several flights by the domestic airline, InselAir, caused by its ongoing financial problems. In addition, foreign exchange revenues from tourism activities went down because of a decline in the number of stay-over visitors, particularly from Venezuela in 2017 compared to 2016. However, cruise tourism revenues increased consistent with the rise in the number of cruise

tourists. Also, the refining fee dropped due to fewer refining activities. However, foreign exchange receipts from bunkering activities rose consistent with the higher international oil prices. Re-exports by the free-zone companies also increased.

The import growth resulted particularly from more oil imports in line with the higher international oil prices in 2017. Furthermore, construction services received from abroad rose related to the hospital, the second megapier, and the Isla refinery. In contrast, non-oil merchandise imports dropped reflecting lower private consumption.

The deficit on the income balance of the monetary union narrowed by NAf.93.9 million mainly because of an increase in interest income earned on foreign bonds and notes held by local institutional investors and a rise in labor income earned from abroad. However, higher dividend payments to foreign shareholders of local companies moderated the improvement in the income balance.

Meanwhile, the current transfers balance turned positive, recording a significant improvement of NAf.390.5 million mostly because of an increase in current transfers received from reinsurers abroad. The higher transfers from reinsurers reflected mainly the inflow of funds related to the claims by local insurance companies to

pay off their clients in Sint Maarten whose insured properties were damaged by Hurricane Irma. Sint Maarten received also in-kind support particularly from the Netherlands, which further contributed to the improvement of the current transfers balance.

External financing into the monetary union as reflected by a worsening of the direct investment, portfolio investment, and loans & credits balances. Net direct investments into the monetary union rose as a result of increased liabilities of domestic companies towards their foreign affiliates. Also, claims of domestic direct investors on their foreign subsidiaries dropped. The portfolio investment balance deteriorated largely because of matured foreign debt securities held by institutional investors that were only partly reinvested abroad. The latter included debt securities that were issued in the past by the Netherlands Antillean entities and taken over by the Dutch government under the debt relief program. Furthermore, the issuance of bonds by the governments of Curaçao and Sint Maarten purchased entirely by the Dutch State contributed to the deterioration of the portfolio investment balance. The worsening of the loans & credits balance was related to the repatriation of funds abroad by local companies, moderated by a decline in nonresident deposits in the monetary union, the repayment of foreign loans by local companies, and a deterioration of the net trade credit balance.

MONETARY DEVELOPMENTS

During the January – July period of 2017, the monetary policy instruments were not actively deployed by focusing only on the refinancing of maturing CDs during the bi-weekly auctions while the reserve requirement was maintained at 18.00%. Nevertheless, the amount of required reserves rose as a result of the higher base amount upon which it is calculated.

Furthermore, the Bank increased its official interest rate, the pledging rate, by 0.50 percentage point to 1.50% on March 20, 2017. After being kept at the historically low level of 1.00% since December 2008, the Bank took this step following the upward adjustments of the federal funds rate and its impact on the international interest rates and, hence, the domestic money market rates.

However, as of August 2017⁴, the Bank started gradually reducing the amount of CDs while keeping the reserve requirement percentage at 18.00%. Consequently, the amount of outstanding CDs dropped by NAf.66.6 million in the second half of 2017. Meanwhile, the amount of required reserves increased by NAf.79.6 million due to an increase in the base upon which it is calculated.

⁴ After an evaluation, the Bank concluded the auctioning of CDs is not an effective instrument during a prolonged period of excess liquidity.

At the end of the December 2017, the current account balances of the commercial banks with the Bank were NAf.316.6 million higher compared to December 2016. The increase in these balances occurred mostly in the second half of 2017 because of debt service payments on matured securities by the DSTA.⁵ Through its monetary instruments, the Bank mopped up NAf.59.8 million of liquidity during 2017.

Broad money expanded by 6.9% in 2017 due to an increase in net foreign assets while net domestic assets decreased slightly.

In 2017, loans to the private sector in the monetary union grew by 1.4%. Outstanding loans in Curaçao increased by 2.4% while Sint Maarten recorded a decline of 1.6%. The increase in Curaçao was the result of increases in business loans (7.6%) and consumer loans (4.5%) moderated by decreases in mortgages (-1.7%) and in the other loans category (-18.6%).

During the January – July period of 2018, the Bank continued to gradually reduce the amount of CDs. As a result, on July 20, 2018, the amount of outstanding CDs was NAf.118.5 million lower compared to the end of 2017. Meanwhile, the

⁵ Related to debt securities taken over by the Dutch government under the debt relief program.

reserve requirement was maintained at 18.00%. Nevertheless, the amount of required reserves rose due to the higher base amount upon which it is calculated. However, on July 20, 2018, the commercial banks' current account balances at the Bank were NAf.217.5 million higher compared to the end of December 2017.

Broad money grew by 0.9% between December 2017 and May 2018. This growth was due to an increase in net foreign assets of the banking system, mitigated by a contraction in net domestic assets.

Loans to the private sector in the monetary union dropped in the first five months of 2018 by 1.3% as outstanding loans in both Curaçao (-1.3%) and Sint Maarten (-1.0%) contracted. The contraction in Curaçao was the result of a drop in all loan components, i.e., business loans (-1.9%), mortgages (-0.9%), consumer loans (-0.4%) and other loans (-9.3%).

Monetary and liquidity conditions

- The current account balances of the commercial banks at the central bank are still high (see Table 1).

- Low international interest rates; Fed funds rate between 1.75 - 2.00%.
- On July 11, 2018, the 1M USD Libor rate stood at 1.72%, while the 3M USD Libor was 2.06%.
- Auctioning of CDs: the amount outstanding was NAf.42.3 million on July 20, 2018. The latest CD interest rates offered on the auction of July 16, 2018 was 1.24% for 4 weeks.
- For the July – August 2018 period, the reserve requirement percentage remained unchanged at 18.00% and the outstanding amount was NAf. 1,315.0 million.
- The pledging rate stands at 2.00% since March 27, 2018.

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

	Dec 31, 2013	Dec 31, 2014	Dec 28, 2015	Dec 30, 2016	Dec 31, 2017	Jul 20, 2018
Current account balance commercial banks	231.2	388.5	490.7	500.4	817.7	1,048.1

OUTLOOK FOR 2018

Global economic activity is projected to accelerate in 2018 (3.9%) because of increased output growth in the advanced economies as well as the emerging & developing economies.⁶ The global growth is supported by improved financial conditions, accommodative monetary policies, expansionary fiscal policies and increased commodity exports. However, risks to the medium-term global economic outlook are tilted to the downside as reflected by, among other things, escalating trade tensions, uncertainties about the outcome of the Brexit negotiations, and noneconomic factors such as geopolitical tensions. Real output for both the United States and the Netherlands, two of the main trading partners of Curaçao, is projected to grow in 2018. Similar to the previous three years, Venezuela - Curacao's third important trading partner- will remain in a deep economic crisis.

The economy of Curaçao is expected to remain in decay in 2018 (-1.6%), as both domestic demand and net foreign demand are projected to decline. The decline in domestic demand is attributable to lower private and public spending. Private demand will decrease due to lower private consumption. The decline in private consumption is related to a worsening labor market as several companies (particularly

in the telecommunication, transport, and hotel sectors) have announced cuts in personnel. Meanwhile, private investments will record zero-growth as the increase in investments in, particularly, the ship repair sector will be offset by the decline in investments in the transportation sector following the completion of the second megapier in 2017. Public demand is projected to contract as both public investment and consumption will drop. In addition, net foreign demand is expected to contribute negatively to real output growth because the increase in imports will exceed the higher exports. Imports will grow, reflecting investments in the ship repair sector and higher oil prices. The export growth reflects primarily higher foreign exchange earnings from tourism activities, mitigated by lower refining fee earnings. The projected development in tourism is related to a growth in the main stay-over markets of Curacao, particularly the United States and Europe. In addition, cruise tourism is expected to increase at a faster pace as a result of the opening of the second mega-pier in November 2017 and the changes of itineraries by the cruise lines because of the devastation caused by hurricanes Irma and Maria in popular destinations in the Caribbean. Furthermore, foreign exchange earnings from bunkering activities will rise in line with the projected increase in international oil prices.

⁶ IMF: *World Economic Outlook*, April 2018.

Meanwhile, consumer price inflation is projected to rise to 1.9% in 2018 caused mainly by the projected increases in food, oil, and electricity prices.

ATTACHMENT

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

	2014	2015	2016	2017
Real sector				
Real GDP growth (% change)	-1.1	0.3	-1.0	-1.7
Inflation (% change)	1.5	-0.5	0.0	1.6
Public finances				
Budget balance ¹	-11.4	4.8	-38.2	-80.2
Debt-to-GDP ratio (%)	38.6	44.2	45.6	50.3
Balance of payments of the monetary union				
Current account balance	-1,085.8	-887.4	-1,080.8	-1,120.3
Capital transfers	23.1	-7.1	3.0	-2.7
External financing	1,414.8	804.2	1,183.8	1,004.5
Direct investments	128.7	278.3	241.0	628.8
Loans and credits	498.4	-62.4	569.7	52.7
Portfolio investments	787.7	588.2	373.2	323.1
Change in reserves	-459.9	-27.8	-187.5	17.6
Net errors and omissions	107.7	118.1	81.5	100.9
Import coverage (months)	3.9	4.9	5.1	5.0

¹ Source 2017 figure: "Financiële Management Rapportage" of the government of Curaçao of December 2017.

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

	2014	2015	2016	2017
Monetary survey (monetary union)				
Net domestic credit	3,744.1	3,787.1	3,753.2	3,699.2
Net domestic credit to government	-429.3	-589.7	-670.2	-597.4
Net domestic credit to private sector	6,148.3	6,145.6	6,625.0	6,683.1
Miscellaneous	-1,974.8	-1,768.8	-2,201.6	-2,386.4
Net foreign assets	4,041.8	4,186.0	4,377.0	4,989.7
Money supply	7,785.9	7,973.1	8,130.2	8,689.0
Annual growth in private sector loans				
Mortgages	0.8%	-2.4%	-1.4%	-1.6%
Consumer loans	-1.0%	-3.0%	1.6%	4.5%
Business loans	-8.3%	1.3%	-2.9%	7.6%
Other	-	-	8.7%	-18.6%

Table 3 Economic key figures 2017

	Curaçao	Sint Maarten	Monetary Union
Real GDP growth (% change)	-1.7	-4.8	-2.5
Inflation (% change)	1.6	2.2	1.8

Table 4 Economic key figures 2018 (projection)

	Curaçao	Sint Maarten	Monetary Union
Real GDP growth (% change)	-1.6	-8.3	-3.3
Inflation (% change)	1.9	2.7	2.1

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

	Jan-18	Feb-18	Mar-18	Apr-18	May-18
Money supply (M2)	8,844.3	8,917.9	8,912.9	8,894.0	8,765.9
Money (M1)	4,488.4	4,553.8	4,552.7	4,519.8	4,404.3
Coins & notes with the public	368.5	367.6	375.6	379.7	366.8
Total demand deposits, of which:	4,120.0	4,186.2	4,177.1	4,140.1	4,037.6
Netherlands Antillean guilders	2,793.9	2,835.4	2,781.4	2,733.9	2,680.9
Foreign currency	1,326.1	1,350.7	1,395.8	1,406.2	1,356.7
Near money	4,355.9	4,364.2	4,360.2	4,374.2	4,361.5
Time deposits	1,985.2	1,955.0	1,902.8	1,922.4	1,978.9
Savings	2,370.7	2,409.2	2,457.4	2,451.7	2,382.6
Factors affecting the money supply					
Net domestic assets	3,592.3	3,620.0	3,542.5	3,574.6	3,571.9
Government sector	-556.7	-532.5	-626.7	-565.9	-532.9
Former central government	-11.6	-11.9	-12.0	-11.9	-12.0
Curaçao	-429.6	-418.2	-467.0	-414.0	-385.9
Sint Maarten	-115.5	-102.4	-147.8	-140.0	-135.0
Private sector	6,669.8	6,633.1	6,663.5	6,639.2	6,606.8
Memorandum items	-2,520.8	-2,480.6	-2,494.2	-2,498.7	-2,502.0
Net foreign assets	5,252.0	5,298.0	5,370.4	5,319.4	5,193.9
Central bank	3,327.8	3,427.4	3,379.2	3,360.4	3,366.3
Commercial banks	1,924.2	1,870.6	1,991.1	1,958.9	1,827.6

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

	Jan-18	Feb-18	Mar-18	Apr-18	May-18
Government loans by commercial banks	20.8	13.7	13.8	10.4	12.8
Government of Curaçao	6.7	0.3	0.1	0.4	0.3
Government of Sint Maarten	14.1	13.5	13.7	10.0	12.5

Private sector loans Curaçao	4,626.8	4,590.9	4,596.6	4,575.6	4,555.6
Mortgages	1,844.3	1,837.1	1,845.7	1,839.7	1,830.3
Consumer loans	902.3	894.3	894.3	896.6	896.8
Business loans	1,780.8	1,765.0	1,762.2	1,746.1	1,739.3
Other	99.5	94.5	94.4	93.1	89.3

Private sector loans Sint Maarten	1,493.6	1,499.2	1,496.2	1,497.0	1,487.8
Mortgages	880.2	875.8	864.2	867.6	868.6
Consumer loans	228.4	232.2	240.6	240.6	237.5
Business loans	378.4	383.8	384.7	383.3	376.1
Other	6.6	7.4	6.8	5.4	5.7

Table 6 Monetary sector growth rates

	2017-I	2017-II	2017-III	2017-IV	2018-I
Money supply (M2)	1.6%	0.3%	3.2%	1.6%	2.6%
Demand deposits					
N.A. guilders	0.9%	1.8%	10.2%	1.1%	4.6%
Foreign currency	11.0%	-1.0%	9.3%	8.6%	10.2%
Near money					
Time deposits	-0.8%	-2.4%	-3.2%	-6.5%	-5.7%
Saving deposits	1.2%	2.0%	-0.1%	6.1%	4.2%

