

NOTE ECONOMIC DEVELOPMENTS CURAÇAO

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CENTRALE BANK VAN CURAÇAO EN
SINT MAARTEN



Centrale Bank van Curaçao en Sint Maarten

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Curaçao

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GENERAL ECONOMIC DEVELOPMENTS

According to preliminary figures of the CBCS, Curacao's real GDP contracted further by 1.9% in 2018, following a decline of 1.7% in 2017. Meanwhile, consumer price inflation rose to 2.6% in 2018, reflecting mainly an increase in international oil and food prices.

An analysis of GDP by expenditure shows that the economic contraction in 2018 was caused by a decrease in both net foreign and domestic demand. Net foreign demand declined as the increase in imports surpassed the higher exports. In addition, domestic demand shrank as both private and public spending contracted. Private spending went down on the back of lower private consumption while private investment remained muted. Consumer spending dropped as a result of, among other things, a decline in disposable income because of the higher inflationary pressures and a worsened labor market. Furthermore, public spending dropped because of a decrease in both government investment and consumption. Public investment declined as the construction of the new hospital is reaching its final stages and because of fewer road infrastructure projects. The decrease in public consumption was caused by lower disbursements on goods & services and wages & salaries.

A review of GDP by sector shows that the decline in private sector activities

in the first nine months of 2018 was attributable mainly to the transport, storage, & communication, manufacturing, construction, and wholesale & retail trade sectors, mitigated by an increase in the activities in the utilities and restaurants & hotels sectors.

Real value added contracted in the transport, storage & communication sector during the first three quarters of 2018 as a result of a decline in both harbor and airport-related activities. The poor performance of the harbor was caused by a significant drop in the number of ships piloted into the port of Curaçao, notably tankers. The decline in the number of tankers was largely related to the headwinds the refinery was facing. However, more cruise ships, freighters and container movements moderated the contraction at the harbor. Meanwhile, airport-related activities dropped reflecting a decline in total passenger traffic and the number of commercial landings.

Real output in the manufacturing sector dropped significantly in the first nine months of 2018, primarily because of lower refining activities at the Isla refinery. The decline in crude oil supply from Venezuela, the seizure of PDVSA assets by the American oil company ConocoPhillips, and the limited steam deliveries by the CRU plant resulted in lower production activities at the refinery. The construction

sector also posted negative results because several large construction projects were finished or reached their final stages.

Furthermore, the wholesale & retail trade sector recorded a contraction in the first three quarters of 2018 due to fewer activities in the free zone and less domestic demand, moderated by an increase in tourism spending.

In contrast, the restaurants & hotels and utilities sectors contributed positively to GDP during the first nine months of 2018, while the financial intermediation sector remained muted.

The growth in the restaurants & hotels sector reflects an increase in the number of stay-over visitors, the number of visitor nights, the occupancy rate, and the number of cruise tourists. The number of stay-over visitors increased mainly because of more visitors from North America and Europe, specifically the United States and the Netherlands. Expansion in the seats capacity of American and Dutch air carriers facilitated this good performance. The South American and Caribbean markets declined mainly because of the lack of airlift to regional destinations due to the cancellation of flights by InselAir and the continued crisis in Venezuela. However, the significant increase in Colombian and Brazilian visitors mitigated the decline in the South American market. The buoyant performance of cruise tourism was related to the opening of the second mega pier and a change in itineraries by cruise lines because of the devastation caused by hurricanes Irma and Maria in popular cruise destinations in the Caribbean. The hotel occupancy rate rose also but probably reflected the increase in the number of

visitors combined with fewer available hotel rooms attributable to the closure or renovation of several hotels.¹ Real output increased in the utilities sector because of more water and electricity production in the first nine months of 2018.

Finally, real value added in the financial intermediation sector remained unchanged in 2018 compared to 2017 as the domestic financial services (as reflected by the net interest income of the commercial banks) and the international financial services (indicated by wages & salaries and other operational expenses) showed no growth.

¹ The Marriott Beach Resort & Casino has been temporary closed for renovation, while the Plaza Hotel Curaçao and the Howard Johnson Curaçao were closed.

DEVELOPMENTS IN THE PUBLIC FINANCES

During the first nine months of 2018, the deficit on the current budget of the government of Curaçao reached NAf.39.1 million,² compared to the NAf.57.0 million deficit recorded during the first nine months of 2017. The lower deficit was caused by a decline in government expenditures (NAf.619.1 million) that surpassed the decline in revenues (NAf.601.2 million). This development was related to the decision of the government of Curaçao to no longer include the income and expenditures of the social security bank, SVB, in the current budget.³ As a result of this correction, the outlays on transfer & subsidies dropped by NAf.615.4 million while nontax revenues declined by NAf.569.8 million.⁴

When the income and expenditures of the SVB are also excluded from 2017,

the government of Curaçao registered a budget deficit of NAf.52.1 million in the first nine months of 2017 compared to the NAf.39.1 million deficit in the first nine months of 2018. The improvement in 2018 was caused primarily by a decline in expenditures. Expenditures dropped by NAf.10.9 million due mainly to lower spending on transfers & subsidies (NAf.26.6 million) caused by fewer transfers to public companies and institutions. By contrast, government spending increased on “other expenditures” (NAf.7.4 million), wages & salaries (NAf.3.5 million), and goods & services (NAf.3.7 million). Meanwhile, revenues went up slightly by NAf.2.1 million due to more nontax revenues, mitigated by a fall in tax revenues. The rise in nontax revenues (NAf.29.9 million) reflected a windfall in withholding tax grants related to the BRNC⁵ tax arrangement between the Netherlands and Curaçao. Tax revenues dropped by NAf.27.8 million reflecting mostly fewer proceeds from taxes on goods & services (NAf.15.6 million), taxes on property (NAf.5.1 million), and profit tax (NAf.20.0 million).

The outstanding public debt of Curaçao amounted to NAf.2.874 billion at the end of September 2018, an increase of NAf.57.6 million compared to the end of June 2018. The higher public debt was

² Source: *Financiële Management Rapportage of the government of Curaçao of September 2018*.

³ Based on advice from the government's auditor (SOAB), the government of Curaçao decided to no longer consolidate the expenditures and income of the social security bank, SVB, in the government's current budget. In May 2018, the government excluded all income and expenditures of the SVB over the period January – April 2018 from its current budget. In addition, as of May 2018, SVB income and expenditures are no longer included in the budget.

⁴ According to the *Financiële Management Rapportage of the government of Curaçao of December 2018*, the government of Curaçao recorded a deficit of NAf.39.3 million on its current budget in 2018, an improvement compared to the deficit of NAf.116.8 million that was registered in 2017. The lower deficit was the result of a decline in government expenditures (NAf.105.4 million), moderated by a decline in revenues (NAf.27.9 million).

⁵ *Belasting Regeling Nederland en Curaçao*.

attributable to an increase in the domestic debt component (NAf.57.9 million) reflecting higher arrears towards the public pension fund, APC, and the social security bank, SVB. Meanwhile, the foreign debt component remained practically unchanged. Consequently, Curaçao's debt-to-GDP ratio increased from 50.2% at the end of June 2018 to 51.2% at the end of September 2018.

DEVELOPMENTS IN THE BALANCE OF PAYMENTS

The deficit on the current account of the balance of payments widened significantly from NAf.712.0 million in the first nine months of 2017 to NAf.1,146.3 million in the first nine months of 2018. The higher deficit was the result of a marked decline in the net export of goods and services and a worsening of the income balance, moderated by an improvement of the current transfers balance. Meanwhile, gross official reserves dropped considerably by NAf.393.7 million⁶ as the external financing was not sufficient to cover the current account deficit.

In Curaçao, the net export of goods and services shrank by NAf.337.3 million as the increase in imports (NAf.554.9 million) surpassed the growth in exports (NAf.217.6 million). The higher import bill was caused by increased oil and non-oil merchandise imports. Oil imports rose consistent with the higher average international oil prices in the January-September period of 2018. Furthermore, oil products were purchased at higher costs from other suppliers besides the Isla refinery.⁷ Meanwhile, the increase in non-oil merchandise imports was largely the result of more imports by

the wholesale & retail trade, construction, and utilities sectors. In addition, residents' tourism expenditures abroad increased. However, a decline in the import of construction services because the construction of the hospital is reaching its final stages, moderated the increase in the import bill.

The growth in exports stemmed from, among other things, increased foreign exchange earnings from bunkering activities reflecting the higher average international oil prices. In addition, revenues from legal, accounting and engineering services provided to abroad rose. The international financial services, ship repair, and tourism sectors also contributed positively to the growth in exports. Foreign exchange earnings by the international financial services sector increased mainly as a result of more banking services provided to abroad, while the gain in the tourism sector was supported by both stay-over and cruise tourism. However, the growth in exports was moderated by a decline in the refining fee caused by a drop in the production activities of the Isla refinery. Also, the foreign exchange earnings from harbor services dropped as a result of a significant decline in the number of tankers that visited the port of Curaçao, consistent with the marked drop in refining activities.

The income balance worsened by NAf.23.6

⁶ Net official reserves dropped by NAf.432.4 million while the net foreign assets of the commercial banks improved by NAf.409.9 million. As a result, the net foreign assets of the monetary union dropped by NAf.22.5 million.

⁷ Because of fewer oil products produced by the Isla refinery, Curoil N.V. purchased more oil products from suppliers abroad.

million as a result of a decline in dividend received on foreign equity securities and in interest earned on foreign debt securities. However, a drop in dividend and interest payments to foreign investors and an increase in labor income earned abroad moderated the worsening of the income balance.

Meanwhile, net current transfers into the monetary union rose by NAf.701.4 million due mainly to 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.

External financing into the monetary union rose by NAf.633.6 million as reflected by a worsening of the portfolio investment and loans & credits balances. The portfolio investment balance deteriorated largely because of funds received from matured foreign debt securities held by institutional investors that were only partly reinvested abroad. These debt securities were issued in the past by the former Netherlands Antillean entities and taken over by the Dutch State under the debt relief program. Furthermore, the zero-interest loan that the government of Sint Maarten received for liquidity support from the Dutch State contributed to the deterioration of the portfolio investment balance. The worsening of the loans & credits balance was related to a significant deterioration of the net trade credit balance and a decline in residents' foreign deposits, mitigated by a drop in nonresidents' foreign deposits. The direct investment balance, on the contrary, improved as a result of increased claims by domestic direct investors on their foreign subsidiaries. Also, liabilities of domestic companies towards their foreign

affiliates dropped.

Meanwhile, capital transfers into the monetary union rose by NAf.31.0 million due to the transfer of funds by the World Bank from the Sint Maarten Recovery, Reconstruction and Resilience Trust Fund towards the government of Sint Maarten to finance reconstruction projects.⁸

⁸ *The Sint Maarten Recovery, Reconstruction and Resilience Trust Fund supports recovery efforts, helps the government of Sint Maarten prepare projects with well-defined development objectives, and provides capacity support for effective, efficient and transparent project execution. The Dutch government has made €470 million (NAf.1.0 billion) available for the fund that is managed by the World Bank.*

MONETARY DEVELOPMENTS

During 2018, the Bank kept the reserve requirement, one of its monetary policy instruments, unchanged at 18.00%.⁹ Nevertheless, the amount of required reserves rose by NAf.11.7 million in 2018, 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 2.00% on March 27, 2018. After being kept at the historically low level of 1.00% since December 2008, the Bank adjusted the pledging rate earlier on March 20, 2017, also by 0.50 percentage point. The pledging rate was left unchanged at 2.00% during the rest of 2018. After three more upward adjustments of the federal funds rate (June 13th, September 26th and December 19th 2018) and the impact thereof on the international interest rates and, hence, the domestic money market rates, the Bank raised the pledging rate again to 2.50% effective January 1, 2019.

During 2018, the Bank continued¹⁰ to gradually reduce the amount of outstanding certificates of deposit (CDs)

by offering a lower amount of CDs than matured combined with a higher haircut on the interest rates offered. As a result, by the end of December 2018, there were no outstanding CDs anymore and the auctions were temporarily suspended.

Broad money remained practically unchanged in 2018 compared to 2017 as net foreign assets as well as net domestic assets remained about the same.

Private credit extension in the monetary union increased by 1.5% in 2018 compared to 2017. Outstanding loans in Curaçao increased by 2.5% while Sint Maarten recorded a decline of 1.4%. The expansion in Curaçao was the result of increases in business loans (8.4%), consumer loans (0.4%) and in the “other loans” category (14.9%). Outstanding mortgages, on the other hand, declined by 3.0%.

Monetary and liquidity conditions

- Despite the current account balances of the commercial banks at the Bank dropped by NAf.93.0 million during 2018, the outstanding balance is still high (see Table 1).
- Low international interest rates; Fed funds rate between 2.25 - 2.50% since December 19, 2018.
- On December 31, 2018, the 1M USD

⁹ The last adjustment of the reserve requirement percentage occurred in June 2014.

¹⁰ The policy of gradually reducing the outstanding amount of CDs was introduced in August 2017 after an evaluation concluded that the auctioning of CDs is not an effective instrument during a prolonged period of excess liquidity.

Libor rate stood at 2.50% while the 3M USD Libor was 2.81%. On February 26, 2019, the 1M USD Libor rate stood at 2.49% while the 3M USD Libor was 2.63%.

since January 1, 2019.

- Auctioning of CDs: the amount outstanding was Naf.5.4 million on December 3, 2018. The latest CD interest rate offered on the auction of December 3, 2018 was 0.18% for 4 weeks. No CD auctions were held after this date and maturing CDs were paid back.
- For the February – March 2019 period, the reserve requirement percentage remained unchanged at 18.00% and the outstanding amount was Naf.1,304.9 million.
- The pledging rate stands at 2.50%

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	Dec 31, 2018
Current account balance commercial banks	231.2	388.5	490.7	500.4	817.7	724.7

OUTLOOK FOR 2019

The global economic expansion is expected to continue in 2019 (3.5%), although at a somewhat weaker pace than in 2018. Nevertheless, risks to the medium-term global economic outlook are skewed to the downside as reflected by, among other things, policy uncertainties, rising trade barriers and tariff escalations, tightening financial conditions, uncertainty related to the outcome of the Brexit negotiations, an accelerated slowdown of the Chinese economy, and noneconomic factors such as geopolitical tensions. Both the United States and the Netherlands, two of the main trading partners of Curaçao, are projected to grow at a slower pace in 2019. Curaçao's third important trading partner Venezuela, is suffering from an economic crisis since 2014 which is expected to continue in 2019 and beyond.

The economy of Curaçao is projected to grow by 0.4% in 2019¹¹, as both domestic and net foreign demand are projected to contribute positively to GDP. The growth in domestic demand will be supported by increases in both private and public spending. Private spending will be driven by private investment growth while private consumption will drop. The growth in private investment is supported primarily

by investments in the tourism sector such as the renovation and expansion of the Marriott Hotel, and the Majestic and Corendon projects. Furthermore, investments in the utilities and wholesale & retail trade sectors will contribute to the rise in private investments. Private consumption will decline, albeit at a slower pace than in 2018, as a result of lower disposable income due to inflationary pressures. Also, the vulnerable labor market situation as reflected by layoff petitions of several companies, will affect private consumption. In addition, net foreign demand is projected to contribute positively to real output growth because of higher exports combined with lower imports. Exports will increase primarily as a result of higher foreign exchange earnings from tourism and ship repair activities, mitigated by lower earnings from refining and bunkering activities. The gain in foreign exchange earnings from tourism activities will be supported by a growth in both stay-over tourism, notably from the United States and Europe, and cruise tourism. Ship repair activities will rise as the investment in floating docks increased repair capacity. Despite higher private investments, imports will decline due to less construction material and services imported as the construction of the hospital is reaching its final stages. Also, the oil-import bill will drop due to lower international oil prices.

¹¹ This estimate is based on available data up to September 2018, continuation of the refinery operations on a minimum level, and does not include extra budget measures by the government.

Meanwhile, inflationary pressures are expected to reach 2.2% in 2019 due to a projected drop in international oil prices, mitigated by an increase in international food prices.¹²

¹² IMF World Economic Outlook, January 2019.

DOWNSIDE RISKS TO OUTLOOK 2019

There are a couple of risks that can affect the growth prospects of Curaçao in 2019. One of the main downside risks is the exposure to Venezuela, one of Curaçao's main trading partners. The crisis in Venezuela may further affect the activities in key economic sectors of the Curaçao economy such as the refinery, tourism, harbor, and financial services sectors. Furthermore, the continuing crisis may aggravate the inflow of refugees that Curaçao cannot handle on its own.

Another downside risk to the projection is the uncertain future of the refinery. Finding a new strategic partner is key for the near-term future of the refinery, given its importance to the economy in terms of value added and employment. Further delays in the process of finding such a partner can affect private consumption and investment. Consumption can be affected because financial institutions may become reluctant to provide loans and credits to workers of the refinery and related companies.

Furthermore, the loss of correspondent banking relations can put a drag on economic growth in 2019 as it affects cross-border transactions and, thereby, increases macroeconomic uncertainties.

Another risk to the outlook is delays in the execution of private investment projects due to lengthy administrative procedures and bureaucracy. Also, the pace of

implementation of structural measures, including labor and capital markets reforms and reducing administrative barriers, may hinder the resumption of growth. Finally, the implementation of measures by the government to achieve a balanced budget by increasing (tax) revenues and reducing expenditures may also put a drag on short-term growth.

ATTACHMENT

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

	2015	2016	2017	2018
Real sector				
Real GDP growth (% change)	0.3	-1.0	-1.7	-1.9
Inflation (% change)	-0.5	0.0	1.6	2.6
Public finances				
Budget balance ¹	-11.4	15.9	-116.8	-39.3
Debt-to-GDP ratio (%)	44.2	45.6	50.3	50.5
Balance of payments of the monetary union				
Current account balance	-887.4	-1,080.8	-1,120.3	-1,644.6
Capital transfers	-7.1	3.0	-2.7	28.5
External financing	804.2	1,183.8	1,004.5	1,203.7
Direct investments	278.3	241.0	628.8	45.2
Loans and credits	-62.4	569.7	52.7	971.9
Portfolio investments	588.2	373.2	323.1	186.6
Change in reserves	-27.8	-187.5	17.6	274.3
Net errors and omissions	118.1	81.5	100.9	138.1
Import coverage (months)	4.9	5.1	5.0	4.5

¹ Source 2017 figure: Financiële Management Rapportage of the government of Curaçao of September 2018. Source 2018 figure: Financiële Management Rapportage of the government of Curaçao of December 2018.

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

	2015	2016	2017	2018
Monetary survey (monetary union)				
Net domestic credit	3,744.1	3,753.2	3,699.2	3,678.9
Net domestic credit to government	-429.3	-670.2	-597.4	-304.5
Net domestic credit to private sector	6,148.3	6,625.0	6,683.1	6,684.4
Miscellaneous	-1,974.8	-2,201.6	-2,386.4	-2,701.1
Net foreign assets	4,041.8	4,377.0	4,989.7	5,006.4
Money supply	7,785.9	8,130.2	8,689.0	8,685.3
Annual growth in private sector loans ²	-1.3%	-1.1%	2.4%	2.5%
Mortgages	-2.4%	-1.4%	-1.7%	-3.0%
Consumer loans	-3.0%	1.6%	4.5%	0.5%
Business loans	1.3%	-2.9%	7.6%	8.4%
Other	-	8.7%	-18.6%	14.9%

² 2016 refers to July – December 2016.

Table 3 Economic key figures 2018

	Curaçao	Sint Maarten	Monetary Union
Real GDP growth (% change)	-1.9	-8.1	-3.5
Inflation (% change)	2.6	2.7	2.6

Table 4 Economic key figures 2019 (projection)

	Curaçao	Sint Maarten	Monetary Union
Real GDP growth (% change)	0.4	2.3	0.9
Inflation (% change)	2.2	2.5	2.3

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

	Aug-18	Sep-18	Oct-18	Nov-18	Dec-18
Money supply (M2)	8,685.5	8,660.7	8,622.3	8,651.3	8,685.3
Money (M1)	4,354.9	4,339.4	4,219.4	4,290.6	4,308.6
Coins & notes with the public	371.6	359.5	359.2	365.6	392.6
Total demand deposits, of which:	3,983.3	3,979.6	3,860.2	3,925.0	3,916.0
Netherlands Antillean guilders	2,628.5	2,608.0	2,608.2	2,662.4	2,628.0
Foreign currency	1,354.8	1,371.9	1,252.0	1,262.6	1,288.0
Near money	4,330.6	4,321.3	4,402.9	4,360.7	4,376.7
Time deposits	1,932.0	1,902.2	1,988.5	1,945.3	1,932.0
Savings	2,398.6	2,419.1	2,414.5	2,415.5	2,444.7
Factors affecting the money supply	-	-	-	-	-
Net domestic assets	3,504.1	3,571.8	3,591.6	3,621.5	3,678.9
Government sector	-460.0	-421.9	-357.1	-348.5	-304.5
Former central government	-13.5	-12.1	-12.1	-12.1	-12.1
Curaçao	-324.0	-313.2	-231.5	-235.2	-198.5
Sint Maarten	-122.5	-96.6	-113.4	-101.2	-93.8
Private sector	6,609.4	6,651.1	6,658.4	6,711.2	6,684.4
Memorandum items	-2,645.3	-2,657.4	-2,709.8	-2,741.3	-2,701.1
Net foreign assets	5,181.4	5,089.3	5,030.7	5,029.8	5,006.4
Central bank	2,958.9	2,841.3	2,808.3	2,919.9	2,984.8
Commercial banks	2,222.4	2,248.0	2,222.4	2,109.9	2,021.6

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

	Aug-18	Sep-18	Oct-18	Nov-18	Dec-18
Government loans by commercial banks	15.6	18.1	22.6	21.9	26.4
Government of Curaçao	1.6	3.5	0.5	0.0	4.8
Government of Sint Maarten	14.1	14.5	22.1	21.9	21.6

Private sector loans Curaçao	4,562.2	4,585.1	4,608.4	4,646.5	4,730.6
Mortgages	1,829.1	1,816.5	1,825.7	1,838.4	1,790.8
Consumer loans	903.1	916.7	899.7	902.1	905.3
Business loans	1,742.2	1,762.5	1,790.4	1,807.5	1,921.4
Other	87.9	89.3	92.5	98.5	113.1

Private sector loans Sint Maarten	1,487.8	1,494.2	1,484.3	1,478.1	1,481.2
Mortgages	879.0	876.7	879.2	871.5	869.6
Consumer loans	235.9	234.0	233.0	235.4	233.6
Business loans	367.5	378.2	366.4	367.4	374.3
Other	5.5	5.3	5.7	3.7	3.8

Table 6 Monetary sector growth rates

	2017-IV	2018-I	2018-II	2018-III	2018-IV
Money supply (M2)	1.6%	2.6%	0.1%	-2.9%	0.3%
Demand deposits					
N.A. guilders	1.0%	4.6%	1.8%	-7.9%	0.8%
Foreign currency	8.5%	10.2%	-3.9%	-3.9%	-2.8%
Near money					
Time deposits	-6.5%	-5.7%	2.8%	-2.7%	1.6%
Saving deposits	6.1%	4.2%	-1.9%	0.4%	1.1%

