ANNUAL REPORT 2012

Centrale Bank van Curaçao
en Sint Maarten

1 REPORT OF THE PRESIDENT

1.1 General review

The year 2012 marked the fourth year since the outbreak of the global financial crisis. The pace of recovery from this crisis has been slow and is characterized by financial sector stress, high public debt burdens, and fiscal austerity measures. In 2012, world economic growth decelerated to 3.2%, reflecting weakened economic activities in the advanced, emerging, and developing countries.

Contrary to the global economic trend, the Sint Maarten economy rebounded from its weak performance in 2011, registering a real GDP expansion of 1.5% in 2012. Consumer price inflation eased to 4.0% in 2012 against 4.6% in 2011, caused mainly by a deceleration of international oil prices.

In Curaçao, real GDP contracted by 0.1% in 2012, following an expansion of 0.6% in 2011. The economic contraction was accompanied by a heightened inflation rate of 3.2%, up from 2.3% a year earlier. The increased inflationary pressures were primarily the result of the raise of the sales tax rate from 5.0% to 6.0% in 2012.

The fall in real GDP in Curaçao was driven by domestic demand. Both private and public demand contracted in 2012. Private demand shrank because of lower consumer spending. The increased inflationary pressures throughout 2012 eroded consumers' purchasing power, leading to a decline in private consumption. By contrast, private investment recorded a tepid growth supported by investments in among other things, the refinery and the utility sector. Meanwhile, public demand fell, as a result of declines in both government consumption and investment. The contribution of net foreign demand to growth was positive in 2012, as export growth outpaced the rise in imports.

The poor economic performance in Curaçao was largely the result of a contraction in the manufacturing and construction sectors combined with weakened activities in other sectors of the economy. In the manufacturing sector, real output contracted due mainly to a decline in production activities at the Isla refinery. The lower production was caused by maintenance work that took place during most of 2012 and delays in the start-up process of the cat cracker after completion of the maintenance work. In addition, ship repair activities shrank, as reflected by a decline in the number of man hours sold. Similar to the previous two years, activities in the construction sector declined in 2012, owing to a lack of major construction projects. Over the past years, the number of major private investment projects has been declining due to, among other things, difficulties in the financing of projects, a lack of investors' confidence and, the worsened economic conditions in the Netherlands, which is an important market for residential real estate in Curaçao.

Activities weakened in the wholesale and retail trade sector due to a decline in domestic spending. However, increased re-exports by the free-zone companies and positive developments in the tourism industry contributed positively to activity growth in the wholesale and retail trade sector. Activities weakened in the utilities sector because the increase in the production of electricity and water was less pronounced in 2012 compared to 2011.

Real output grew in the transport, storage & communication sector, although the pace of growth was less pronounced than in 2011. Air transportation and airport-related activities expanded in line with the growth in the number of stay-over tourists. Furthermore, the number of commercial landings increased in 2012 compared to 2011. The harbor also recorded positive results as the number of ships handled increased, cargo movements rose, and oil storage activities expanded.

Activities in the financial services sector weakened as well in 2012. Real value added by domestic financial services expanded because of an increase in net interest income. The higher net interest income was attributable to a decline in interest expenses. Developments in international financial services were, however, disappointing as activities contracted, owing to a decline in wages and salaries.

The positive development in the restaurants and hotels sector was ascribable to a growth in both stay-over and cruise tourism. The encouraging development in stay-over tourism throughout 2012 underscores the importance of more airlift. In 2012, airlift to South and Central America increased, as COPA airlines started regular flights between Curaçao and Panama. Also, Air Berlin introduced direct flight connections between Düsseldorf and Willemstad. An analysis of the several market segments reveals that the number of visitors from South and Central America, notably Venezuela, rose significantly in 2012. In addition, the number of European tourists increased, due mainly to a marked growth in the number of German visitors. However, a decline in the number of Dutch tourists, which is Curaçao's main tourism market, mitigated the growth in the number of European visitors. The expansion in stay-over tourism was dampened by declines in the number of visitors from North America and the Caribbean.

In Sint Maarten, 2012's real GDP expansion stemmed primarily from a growth in the restaurants & hotels and transport, storage & communication sectors. The restaurants & hotels sector performed well during 2012 as a result of an increase in both stay-over and cruise tourism. The increase in cruise tourism was the result of more cruise calls. However, cruise tourism increased at a slower pace than in 2011. Meanwhile, stay-over tourism grew thanks to a rise in the number of visitors from North America, which is traditionally the main tourism market for Sint Maarten. After a decline in 2011 because of, among other things, the cancellation of flights by American Eagle, airlift capacity to and from the United States was restored in 2012 after JetBlue initiated flight connections between Philipsburg and San Juan, supporting the growth in stay-over tourism from North America. Growth in the European and Caribbean market segments also contributed to the expansion in stay-over tourism.

Real value added in the transport, storage & communication sector rose due to increased activities in both the air and sea transport. Thanks to the growth in the number of stay-over arrivals, the number of passengers handled at the airport rose, contributing to the positive development in airport-related activities. Meanwhile, the harbor of Sint Maarten performed well because of an increase in the number of ships piloted into the port and a rise in cargo movements.

The wholesale and retail trade sector recorded a growth, due to the positive developments in the tourism industry, particularly stay-over tourism. However, a decline in domestic spending, reflecting largely a contraction in private consumption, mitigated the growth in the wholesale and retail trade sector.

The utilities and financial services sectors also contributed to Sint Maarten's real GDP expansion in 2012. Activities rose in the utilities sector as reflected by an increase in the production and consumption of water and electricity. Meanwhile, real output increased in the financial services sector as indicated by a rise in the net interest income of the domestic banks.

Growth in the construction sector of Sint Maarten was flat in 2012 as an increase in public construction projects, including a public housing project, was offset by a decline in private investments. The lower private investments were in line with the drop in business loans and mortgages extended in Sint Maarten. Meanwhile, the manufacturing sector contributed negatively

to growth due mainly to a decline in repair activities on yachts that visited Sint Maarten throughout 2012.

The developments in Curaçao's public finances were dominated by the official instruction of the Kingdom Council of Ministers to the Curaçao government. One of the conditions for the debt relief as agreed upon in the Kingdom Act Financial Supervision for Curacao and Sint Maarten, was the adherence to the balanced budget rule. However in 2012, it became clear that contrary to this rule, the Curacao government recorded a budget deficit in 2010 as well as 2011. Also, the developments in the public finances indicated that in the absence of proper and timely measures, the Curaçao government would be confronted with progressively increasing budget deficits in 2012 and beyond. Therefore, the instruction was given to take measures to prevent a budget deficit in 2012 and compensate for the deficits recorded in 2010 and 2011.

Nonetheless, Curacao was not able to comply with the instruction before the end of 2012. Consequently, the country posted a deficit on the budget's current account of NAf.110.3 million, down from the NAf.153.7 million deficit in 2011. The lower deficit was due to an increase in government revenues, mitigated by a rise in government expenditures. Government revenues increased, owing to a rise in both tax and nontax revenues. The rise in tax revenues was largely the result of an increase in the sales tax rate from 5.0% to 6.0%, mitigated by a decline in the proceeds from excises and import duties. Meanwhile, nontax revenues were up, due to grants received from the Netherlands related to the BRK tax arrangement. However, since the withholding tax assessments are being contested in court and the funds might have to be reimbursed to the Netherlands, the grants received were also booked on the expenditures side of the budget. The latter explains part of the increase in government expenditures. Increased outlays on wages & salaries and goods & services also contributed to the growth in government expenditures during 2012. A decline in subsidies and transfers, due to fewer disbursements made by the government to households, mitigated the growth in public expenditures.

Similar to the previous two years, presenting a balanced budget has been a challenge for the Sint Maarten government in 2012. Also, adherence to the limits of the approved balance was difficult for the Sint Maarten government.

Based on the available data, it can be concluded that the Sint Maarten government recorded a surplus on its current budget of NAf.27.9 million in 2012, up from the NAf.10.3 million surplus that was registered in 2011. This positive outcome was the result of an increase in government revenues that exceeded a rise in government expenditures. On the revenue side, tax proceeds increased due mainly to more sales tax revenues reflecting the economic expansion in 2012. Also revenues from room tax and wage tax were up compared to 2011. In contrast, proceeds from taxes on profit and property contracted. Unfortunately, no breakdown was available of the government expenditures.

The balance of payments of the monetary union recorded a deficit in 2012 since the current account deficit was not covered by external financing and net capital transfers. The balance of payments deficit was reflected by a decline in the gross reserves of the central bank. As a result, the average import coverage declined from 3.7 months in 2011 to 3.2 months in 2012.

The current account deficit narrowed in 2012 compared to 2011, due to an improvement in the net exports of goods and services. The improvement in net exports was the result of an increase in exports mitigated by a rise in imports. Exports rose because of more foreign exchange revenues from the tourism and transportation sectors, increased re-exports by the free-zone companies in Curaçao, and more trading activities by the Isla refinery. Meanwhile, imports expanded as a result

of among other things, more oil imports in Sint Maarten. Also, the free-zone companies in Curaçao imported more merchandise to meet foreign demand and replenish their inventories. More imports of construction material and increased payments for services provided abroad to local airlines added to the import bill. The income and current transfers balances deteriorated in 2012 compared to 2011. The worsening of the income balance was largely due to a decline of interest income earned on foreign assets, combined with an increase in dividend payments to foreign investors. Meanwhile, the current transfers balance worsened due to a decline in current transfers received from abroad.

The current account deficit was financed primarily by external financing as reflected by a worsening of the portfolio investment, direct investment, and loans and credits balances. The deterioration of the portfolio investment balance was to a great extent related to the debt relief program. In 2012, several debt securities issued in the past by the entities of the Netherlands Antilles and taken over by the Dutch government, matured. Many local institutional investors that held these securities in their portfolios did not reinvest the received funds abroad. Net direct investment into the monetary union expanded mainly because of an increase in liabilities of domestic companies with their foreign parents and more real estate purchased by nonresidents, both in Curaçao and Sint Maarten. Meanwhile, the loans and credits balance worsened mainly because of the net decline in domestic companies' foreign bank balances to finance part of their imports, more trade credits received on imports, and the net repayment of trade credit extended to foreign customers. Net capital transfers into the monetary union dropped in 2012, due mainly to a decline in development aid funds. The phasing out of the development aid from the Netherlands was one of the conditions of the debt relief program.

The monetary aggregates expanded slightly stronger in 2012 than in 2011. The expansion in 2012 was attributable entirely to a growth in net domestic assets. In contrast, net foreign assets dropped both at the commercial banks and the central bank. The growth in net domestic assets was caused primarily by an increase in credit extension to the private sector. All loan components in Curacao, except consumer loans, increased in 2012. Similar to 2011, Sint Maarten registered a drop in all private loan components. Net domestic assets grew also due to a rise in net credit to the government reflecting a drawdown of deposits.

Due to the high deficit on the current account of the balance of payments, the relatively rapid expansion in credit compared to GDP growth, and the declining trend in reserves, the Bank continued tightening its monetary policy throughout 2012. The percentage of the reserve requirement was increased gradually from 10.50% at the end of 2011 to 14.25% at the end of 2012. However, given the magnitude of the excess liquidity, increasing the reserve requirement percentage alone was not effective in containing credit growth. Therefore, the Bank introduced a temporary credit freeze for the period March – August 2012. As private credit growth decelerated towards June and the decline in international reserves slowed, the Bank eased the credit measure by allowing a maximum credit growth of 1% when it was prolonged for the period September 2012 – February 2013. In addition to the commercial banks, the Postspaarbank and the Centrale Hypotheekbank were also included in the second term of the credit measure.

The other monetary policy tool of the Bank, the auctioning of the Certificates of Deposit (CDs) was deployed in a neutral manner. During the biweekly auctions of CDs, the Bank aimed only at the refinancing of maturing CDs. Meanwhile, the pledging rate, which is the Bank's official lending rate, was kept unchanged at 1.00%.

1.2 Policy considerations

Over the past years, the economic performance of Curaçao and Sint Maarten has been weak compared to the region. It is estimated that real GDP in the Caribbean region expanded by approximately 3.0% on average during the period 2010 – 2012. By contrast, the Curacao economy registered a meager average growth rate of 0.2% while Sint Maarten's economic growth was on average flat. In other words, Curaçao and Sint Maarten are lagging behind the region.

It is noteworthy in this context that Curaçao and Sint Maarten, contrary to most countries in the region, do not face a high public debt burden. This favorable situation is attributable to the debt relief program that was agreed upon as part of the dismantling of the Netherlands Antilles. However, despite this unique fiscal situation, the two countries seem not to be able to achieve a higher steady growth path. One of the reasons behind this situation is the fact that private sector investment growth has been rather slow over the past years.

Investors' confidence has been negatively affected by several factors, including the sluggish economic recovery in our main trading partners, dampening the growth in net foreign direct investment in the two countries. Also, the frequent government changes, lack of policy consistency, and failure to address the weaknesses in the investment climate of Curaçao and Sint Maarten have affected investors' confidence negatively.

As mentioned on several occasions, the areas that need to be addressed considering the investment climate include the rigidities in the labor market, the red tape and administrative burden, and the high tax burden. Failure to address these weaknesses will deter growth in private investment and, consequently, a higher steady growth path.

In the case of Curaçao, the government had to address the budgetary situation in order to comply with the balanced budget rule as agreed upon in the debt relief program. Several measures have already been taken to reduce government expenditures. In the area of health care costs, a general public health insurance scheme was introduced. In order to reduce the deficit in the old-age pension fund (AOV), the government increased the retirement age to 65 years and raised the premiums for both employers and employees. Government revenues have also been addressed through, among other things, a differentiation of the sales tax rates.

However, the disproportionate emphasis placed on fiscal consolidation went at the expense of economic growth, resulting in a contraction of the economy and increasing social constraint. Therefore, in addition to further addressing the budgetary situation, the government should focus on starting public investment projects that will give a boost to economic growth and facilitating private investment initiatives. In this respect, the Bank welcomes the recently announced public investment program, including the improvement of Curaçao's road infrastructure, which could provide a major impulse to economic growth. Through public investments, together with adequately facilitating private investment projects, and consistency and transparency in government policies, a major step can be made in restoring investors' confidence and reaching a higher growth path. The recent stable rating of Curaçao by Standard and Poor's is a welcome support for this strategy.

Since its autonomous status within the Dutch Kingdom, Sint Maarten has been facing difficulties in presenting a balanced budget and adhering to the approved budget. Instead of addressing economic ills and stimulating economic growth, Sint Maarten had to focus primarily on financial and budget management. So far, progress has been made in the areas of statistical data gathering

and reporting. However, the timely provision of complete fiscal data is an important area that still needs to improve.

Sint Maarten's economic growth in 2012 was attributable primarily to the tourism and transportation sectors. However, an analysis of the tourism sector reveals that Sint Maarten needs to improve its tourism product to safeguard future growth. Also, growth in cruise tourism has been slowing down. Cruise visitors spend less on the island because the cruise ships nowadays offer a wide variety of retail products at competitive prices to their passengers. As the contribution of the cruise tourism sector to the economy might be declining over time, Sint Maarten needs to diversify its tourism product to grow stronger in other markets.

Meanwhile, competition from other Caribbean destinations has been increasing recently. For example, the marine trade sector, which traditionally contributes significantly to Sint Maarten's economy through ship repair activities and the provision of goods and services to yachts is facing increased competition from other islands that offer the same services at more competitive prices combined with less red tape. These challenges need to be addressed soon for a stable long-term growth of Sint Maarten's main economic pillar.

The balance of payments of the monetary union remains an area of concern. The deficit on the current account of the balance of payments is high according to international standards. Meanwhile, external financing and capital transfers from abroad have not been sufficient to cover the deficit. Consequently, we have been noticing a declining trend in our international reserves and import coverage.

Given the situation on the balance of payments, the Bank has continued its tight monetary policy stance. The reserve requirement percentage has been raised further to 16.00% as of June 17, 2013. In addition to increasing the reserve requirement, the Bank prolonged the credit measure for a third term until the end of August 2013. However, monetary policy tightening is only a short-term remedy for a structural problem.

To prevent that monetary policy will ultimately stifle economic recovery, the governments of Curaçao and Sint Maarten should take the lead with economic policy measures that will boost the economies in the short run and achieve a sustainable higher growth level in the future. A consistent implementation of such a growth strategy will contribute to the much-needed stable macroeconomic environment in which our young countries can prosper.

A higher growth path is also critical to improve the social environment for our citizens. It is well known that various public service areas, such as health care, education, public housing, public safety, public transportation, and the environment, currently do not meet our aspirations. To finance the necessary improvement in these areas, two percentage points of extra growth, for example, could generate NAf.30 million in additional tax income in Curaçao and NAf.7 million in Sint Maarten. However, to ensure that those extra revenues are indeed allocated for the implementation of such social program, subjecting expenditure growth to a ceiling is an indispensible condition.

E.D. Tromp
President

2 INTERNATIONAL ECONOMIC DEVELOPMENTS

In 2012, world economic growth decelerated to 3.2% after expanding by 4.0% in 2011. This deceleration reflected weakened activities in the advanced, emerging, and developing economies. In most advanced economies, growth was dampened by sluggish domestic demand because of fiscal austerity measures, high public debt burdens, and financial sector stress. As a result, labor market conditions continued to worsen, leading to higher unemployment rates. Output growth slowed down in the emerging and developing economies because of subdued external demand and fiscal tightening measures.

The recovery of the U.S. economy gained momentum in 2012, as real GDP expanded by 2.2% compared with 1.8% in 2011 (See Table 1). The economic expansion was driven primarily by private demand as both consumption and investment rose. Private consumption benefitted from rising consumer confidence, improvement in the housing market, and higher equity prices. In addition, positive developments in the labor market contributed to the gain in private consumer spending. After a contraction in 2011, residential fixed investment expanded in 2012, reflecting the improvement in the housing market. Despite uncertainties among businesses regarding fiscal tightening, both nonresidential investment and inventory accumulation contributed positively to economic growth. In contrast, public demand put a drag on output growth as both government investment and consumption shrank. The decrease in output growth was attributable largely to defense spending cuts. The contribution of net foreign demand to growth was neutral as the rise in exports was counterbalanced by an increase in imports. Nevertheless, the current account deficit widened by 2% reaching $465.9 billion because of a decline in net income received from abroad. In line with the economic expansion, conditions in the labor market showed signs of recovery in 2012, as the jobless rate fell from 8.5% in 2011 to 7.8% in 2012. Nevertheless, the U.S. labor market still faces several problems, including a historically high number of unemployed people who have been without work for 6 months or longer. Consumer price inflation decelerated to 2.1% in 2012, reflecting lower food and energy prices. However, sustained increases in the costs of housing, medical care, and clothing had an upward effect on inflation. As in previous years, the Federal Reserve kept the Fed funds rate close to zero throughout 2012.

Table 1 Key indicators of selected countries

	United States		Netherlands		Venezuela	
	2011	2012	2011	2012	2011	2012
Real GDP (% change)	1.8	2.2	1.0	-1.0	4.2	5.5
Consumer prices (%)	3.2	2.1	2.3	2.5	26.1	21.1
Unemployment rate (%)	8.5	7.8	4.4*	5.3*	6.5	5.9

Sources: US Bureau of Economic Analysis, US Bureau of Labor Statistics, Central Bureau of Statistics Netherlands, Banco Central de Venezuela, and Instituto Nacional de Estadistica Venezuela.
*International definition.

During the year 2012, economic activity contracted in the Euro area. Consequently, real GDP dropped by 0.6% after an expansion by 1.4% in 2011. The economic contraction was caused by a decline in domestic demand. Both private consumption and investment shrank as a result of weak consumer and investor sentiment, increasing unemployment, tight credit conditions, and fiscal consolidation measures. Net foreign demand moderated the economic contraction somewhat, as exports rose while imports dropped. The rise in exports was, however, less pronounced than in 2011 due to the weak global economic environment. Lower energy and food prices reduced inflationary pressures somewhat to 2.5% in 2012, down from 2.7% in 2011.

After two years of modest economic growth, the Netherlands recorded a real economic contraction of 1.0% in 2012, ascribable solely to a decline in domestic demand. In contrast, net foreign demand expanded as the growth in exports surpassed the rise in imports. Export growth was largely attributable to increased re-exports. Meanwhile, domestic demand declined, because both public and private spending shrank. During 2012, public investment contracted while government consumption remained muted. Meanwhile, private consumer spending dropped, caused by a decline in household income due to the drop in employment, and higher taxes and social premiums. In addition, the contractual wage increases lagged behind inflation. Private investment dropped as well, particularly in residential and nonresidential construction, reflecting the slump in the property market. An analysis by sector reveals that all economic sectors, except the public sector, contributed negatively to growth. The highest decline in economic activity was registered in the construction sector. The economic contraction was accompanied by a higher unemployment rate of 5.3%. Despite the economic downturn, inflation rose to 2.5%, due to, among other things, higher petrol prices and the delayed effects of oil price increases on electricity and gas prices. Also, the increase in the Value Added Tax rate contributed to additional inflationary pressures.

In Latin America and the Caribbean, real economic growth decelerated to 3.0% in 2012, down from 4.6% in 2011. During 2012, economic activities weakened in Latin America as the economic slowdown in the developed and emerging economies had a negative impact on export from the region. Brazil and Argentina, in particular, experienced a sharp deceleration in output growth. In other Latin American countries, growth was supported by strong domestic demand that compensated for the weakened net foreign demand. Meanwhile, the pace of economic expansion in the Caribbean countries moderated as a result of lower export growth, in particular tourism, and weak competitiveness. In addition, the high public debt burden in most Caribbean countries dampened economic growth. The region's annual inflation rate dropped from 6.6% in 2011 to 6.0% in 2012, reflecting mainly the weakening global environment and the (lagged) impact of monetary policy tightening in the region.

Real GDP in Venezuela expanded by 5.5% in 2012, an improvement over the 4.2% growth recorded in 2011. The economic expansion was driven solely by domestic demand, reflecting positive contributions from both private and public spending. Private spending rose due to investments in the housing sector. Also, private consumption increased, reflecting a rise in the minimum wage. Meanwhile, public spending grew sharply as government expenditures on infrastructure and public housing soared in the presidential election year. By contrast, net foreign demand contracted because the rise in imports offset the export growth. Oil export growth, Venezuela's main source of foreign exchange revenues, remained contained in 2012 as crude oil production and refinery activities decreased. The drop in refinery activities was due mainly to an explosion and fire in Venezuela's largest refinery, Amuay, which caused extensive damage. As a consequence, Venezuela had to import refined oil products to meet domestic demand. Also, the increased domestic demand and the relaxation of currency restrictions fueled the import bill. All economic sectors, except mining, contributed positively to Venezuela's economic growth in 2012. However, growth was more pronounced in the construction, trade, and financial services sectors. Venezuela's inflation eased to 21.1% in 2012 due to, among other things, the government's efforts to increase the supply of goods through direct imports via state-run entities. Moreover, the government relaxed the currency restrictions by permitting more foreign currency sales and, hence, allowing more imports and to contain price increases due to shortages. In addition, price controls were tightened on a number of products. The labor market improved as a result of the economic growth, reflected by a drop in the unemployment rate to 5.9%.

3 GENERAL ECONOMIC DEVELOPMENTS IN THE MONETARY UNION

3.1 General economic developments in Curaçao

3.1.1 Introduction

Real GDP in Curaçao contracted by 0.1% in 2012, following an expansion by 0.6% in 2011. The economic contraction was the result of a decline in private sector activities. The public sector's contribution to GDP growth was neutral in 2012 after a negative impact in 2011. Consumer price inflation rose to 3.2% in 2012, due mainly to the increase in the sales tax rate from 5% to 6%. Also, higher energy prices added to inflationary pressures.

An analysis of the GDP by expenditure reveals that the economic contraction in 2012 was caused by a decline in domestic demand, mitigated by an increase in net foreign demand (see Table 2). Domestic demand shrank as a result of a fall in both public and private spending. Public spending contracted due to declines in both government consumption and investments. The decline in private demand stemmed from lower consumer spending. The contraction in private consumption was caused by the increased inflation that eroded consumer purchasing power. Also, the decline in the extension of consumer loans contributed to the drop in consumer spending. Similar to 2011, private investment recorded a slight increase in 2012 due to, among other things, investments in the manufacturing and utility sectors.

Table 2 GDP growth by expenditures[a] (real percentage changes)

	2011	2012
Domestic expenditures, of which:	-0.2	-1.0
Private sector	1.8	-0.3
- Investment	0.4	0.2
- Consumption	1.4	-0.5
Government	-2.0	-0.7
- Investment	0.0	-0.6
- Consumption	-2.0	-0.1
Changes in inventory	-1.2	0.1
Foreign net expenditures, of which:	2.0	0.7
Export of goods and services	8.6	3.8
Import of goods and services	6.6	3.0
GDP by expenditures	0.6	-0.1
Net primary income	0.6	-0.7
Gross national income	1.3	-0.8
Net current transfers from abroad	-4.6	-0.2
Gross national disposable income	-3.4	-1.0

Source: Estimates by the Central Bank of Curaçao and Sint Maarten.
[a] Expenditure categories data are weighted contributors to GDP growth.

Net foreign demand increased in 2012 compared to 2011, as the rise in exports outweighed the increase in imports. However, the contribution of net foreign demand to real GDP growth was less pronounced in 2012 than in 2011. Higher foreign exchange revenues from the tourism and transportation sectors, increased re-exports by the free-zone companies, and a rise in the refining fee were the main drivers of the gain in exports. Imports increased owing to, among other things,

more merchandise imports by the free-zone companies to meet export demand and replenish their inventories. Also, the import of construction materials picked up, due to more nonresidential investments. Import growth was mitigated, however, by a decline in imports by the retail trade sector, in line with the decline in private consumer spending.

3.1.2 Domestic production

From a sectoral perspective, real GDP dropped slightly in 2012 compared to 2011, due primarily to a contraction in the manufacturing and construction sectors (see Table 3). Also, activities weakened in the wholesale & retail trade sector. The unfavorable performance of the manufacturing sector was related largely to a decline in the real output of both the "Isla" refinery and the ship repair industry. During most of 2012, the refinery was only partially operational due to maintenance work on the plants. Delays in the start-up process of the cat cracker caused a further decline in the refinery's real output. This decline was, however, mitigated by increased trading activities by the refinery. Meanwhile, activities in the ship repair industry shrank, reflecting a drop in the number of man-hours sold. Similar to 2011, activities dropped in the construction sector in 2012 because of a lack of major construction projects.

Real value-added growth in the wholesale & retail trade sector slowed to 1.6% in 2012 because of the decline in domestic demand, particularly private consumer spending. Nevertheless, the decline in private demand was compensated by more activities in the tourism industry and more re-exports by the free-zone companies. Despite the increased activities in the free zone, the number of free-zone visitors dropped, in particular from the Caribbean region.

The transport, storage, & communication sector contributed positively to private sector growth in 2012. However, the pace of growth was somewhat slower than in 2011. Real value added expanded in the air transportation and airport-related activities, due mainly to an increase in the number of commercial landings and a rise in total passenger traffic. The rise in passenger traffic was due to the growth in stay-over tourism. Moreover, the harbor performed well, due to an increase in the number of ships piloted into the port, more cargo movements and oil storage activities. The growth in oil storage activities was ascribable mainly to the upgrading and expansion of the tank facilities in the port of Bullenbaai. Activities in the utilities sector weakened in 2012 as the production of water and electricity increased at a slower pace than in 2011.

Real value added in the financial services sector increased by 0.3%, a slight deceleration compared to the growth of 0.5% that was registered in 2011. The increase in 2012 was a result of a rise in domestic financial services, mitigated by a decline in the international financial services. The increase in domestic financial services was due to a growth in net interest income of the commercial banks, albeit at a slower pace compared to 2011. Similar to 2011, the international financial services contracted as reflected by a decline in wages and salaries.

The restaurants & hotels sector continued to perform well in 2012 as both stay-over and cruise tourism expanded. Despite a decline in the number of cruise calls, the number of cruise ship visitors was up by 8.1% because larger cruise ships visited Curaçao. Meanwhile, stay-over arrivals grew by 7.5%. The positive outcome in stay-over tourism was driven mainly by a marked increase in the number of visitors from South and Central America (26.2%). Similar to 2011, the number of Venezuelan tourists rose significantly (34.0%) in 2012 reflecting, among other things, increased marketing efforts among the higher income groups. The introduction of direct flights between Panama City and Curaçao in June 2012 also contributed to the growth in the number of visitors from South and Central America. The number of European visitors rose by 2.3%, led by a strong growth in the number of arrivals from Germany. The increase from Germany was the result of

weekly flights from Düsseldorf by Air Berlin combined with promotional activities in Germany. However, growth in the European market segment was mitigated by a decline (3.2%) in the number of Dutch tourists due to, among other things, the economic downturn in the Netherlands. Also, Dutch tourists have increasingly been choosing other, less expensive destinations in or near Europe. The number of visitors from the United States also declined (3.0%) in 2012. This decline can be ascribed to, among other things, the temporary discontinuation of the biweekly flights by Continental Airlines from Newark, New Jersey. The Caribbean market segment contracted by 4.2% in 2012, due mainly to fewer visitors from Jamaica and Trinidad & Tobago. (See Table 11 in the appendix for more details.) The growth in the number of stay-over tourists was accompanied by more time spent on the island. Hence, the number of visitor nights increased by 15.2%. However, the hotel occupancy rate dropped from 76.0% in 2011 to 71.0% in 2012 as an increased number of tourists chose to stay in apartments instead of hotels.

Table 3 GDP by sector (real percentage changes)

Sector	2011	2012
Agriculture, fishery, & mining	-1.0	-1.0
Manufacturing	10.4	-2.4
Electricity, gas, & water	1.6	1.0
Construction	-0.4	-1.1
Wholesale & retail trade	4.0	1.6
Restaurants & hotels	3.5	3.5
Transport, storage, & communication	4.0	3.6
Financial intermediation	0.5	0.3
Real estate, renting, & business activities	-2.5	-3.1
Other community, social, & personal services	0.1	-3.6
Private households	1.0	1.0
Total private sector	1.5	-0.1
Public sector	0.0	-0.2
Taxes minus subsidies	-0.8	0.2
GDP	0.6	-0.1

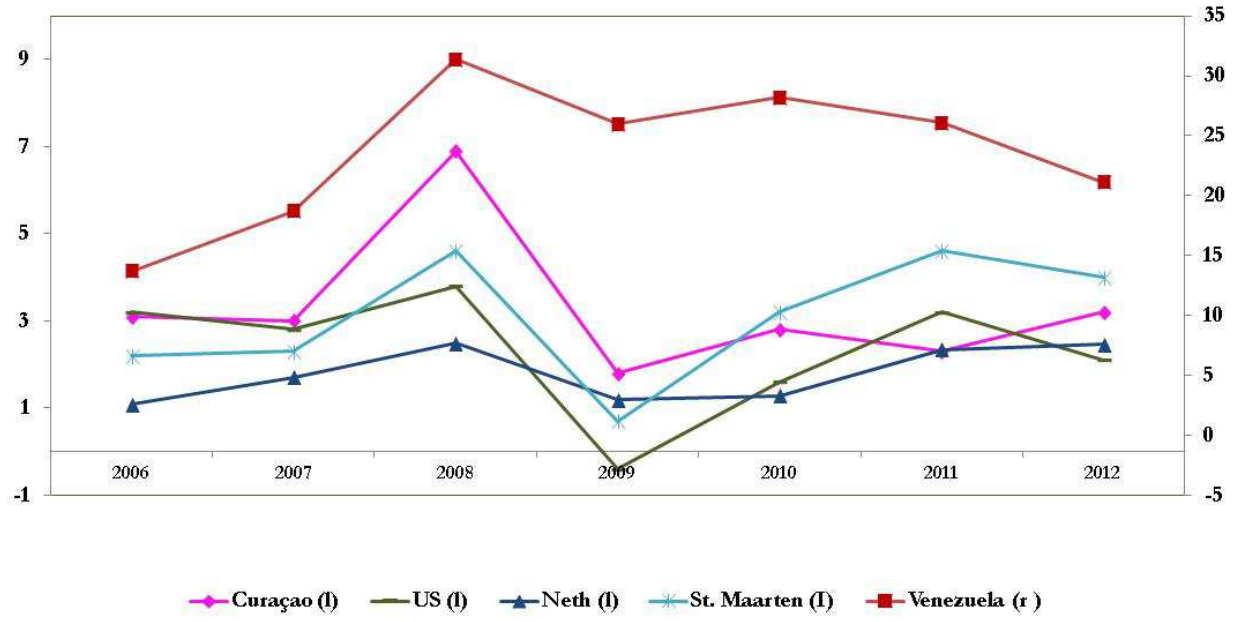
Source: Estimates by the Central Bank of Curaçao and Sint Maarten.

3.1.3 Inflation

Consumer price inflation in Curaçao climbed to 3.2% in 2012, up from 2.3% in 2011. The higher inflationary pressures stemmed primarily from the increase in the sales tax rate from 5% to 6% in January 2012. Increased international oil and food prices also contributed to the inflationary pressures in 2012, albeit to a lesser extent than in 2011. On average, the increase of international oil prices decelerated in 2012. The pace of acceleration of domestic energy prices did not slow in line with the international prices because in Curaçao, energy prices are adjusted monthly but with a lag of two months.

Since Curaçao's inflation in 2012 was caused primarily by internal factors, the higher inflation rate did not correspond with the decline in inflation in the United States and Venezuela (see Graph 1).

Graph 1 Developments in consumer prices (annual percentage change)



An analysis of the inflation rate by components shows that all components increased in 2012. The categories "Food," "Beverages & tobacco," "Housing," "Housekeeping & furnishings," and "Transport & communication" recorded significant increases in 2012. The increase in the category "Food" was less pronounced in 2012 than in 2011, due mainly to a deceleration in the prices of "potatoes, vegetables & fruits" and "meat & fish". The gain in the category "Housing" was caused primarily by higher electricity prices. Price increases in gasoline and new automobiles led to the increase in the category "Transport & communication". (See Table 12A in the appendix for more details.)

3.2 General economic developments in Sint Maarten

3.2.1 Domestic production

In 2012, Sint Maarten's real GDP expanded by 1.5%. The output growth was accompanied by an inflation rate of 4.0%. An analysis by sector shows that the restaurants & hotels and transport, storage & communication sectors contributed primarily to Sint Maarten's real economic growth in 2012 (see Table 4).

Real value added in the restaurants & hotels sector rose as a result of an increase in both stay-over and cruise tourism. The number of stay-over arrivals increased by 7.6% in 2012 compared to a 4.2% decline in 2011, with the most significant growth in the North American market, accounting for 10.5% of the stay-over arrivals in 2012. The positive development in the North American market segment was related to an improvement in the airlift capacity. In response to the decline in airlift capacity in 2011, Jet Blue flights replaced the discontinued American Eagle flight connections between San Juan and Philipsburg in 2012, resulting in more stay-over arrivals from North America. The number of visitors from the Caribbean also rose (4.0%), after registering a contraction in 2011 (2.0%). The performance of the European market segment improved in 2012 with an increase by 3.4%. However, growth in this market segment was mitigated by a decline in the number of Dutch tourists (see Table 11 in the appendix for more details). Coinciding with the increase in stay-over arrivals, the hotel occupancy rate improved from 56% in 2011 to 63% in 2012, further solidifying the growth in stay-over tourism. Cruise tourism continued to grow but at

a slower pace in 2012, because the rise in the number of cruise visitors and cruise calls was less pronounced compared to 2011. In addition, cruise tourists are spending less during their visit to Sint Maarten as the cruise ships nowadays offer retail products at competitive prices.

The transport, storage & communication sector expanded in 2012, led mainly by increased airport-related activities. In line with the growth in stay-over arrivals, the number of passengers handled at the Princess Juliana International Airport rose by 6.6% in 2012. By contrast, the number of commercial flights that landed at the airport dropped by 0.9%. Meanwhile, activities in the harbor expanded as reflected by an increase in the number of ships that visited the port, notably cruise ships and tankers. Additionally, total container movement increased by 4.5% from 2011.

Real output increased also in the wholesale and retail trade sector, supported by the positive outcome in the tourism industry. However, a contraction in domestic spending, particularly private consumption, mitigated the growth in the wholesale and retail trade sector.

Developments in the utilities sector were also positive as the production of water and electricity continued to rise from 2011 to 2012. Also, water consumption increased by 3.5% while electricity consumption rose by 0.8% compared to 2011. The financial intermediation sector contributed positively to growth due to an increase in net interest income. The latter increase was related to a decline in interest expenses mitigated slightly by a drop in interest income.

Activities in the construction sector of Sint Maarten remained muted in 2012. On the one hand, public sector investments in, among other things, a public housing project in Belvedere contributed positively to growth in 2012. However, a decline in private sector investments, in line with the registered drop in business loans and mortgages extended in 2012, counterbalanced the positive stimulus of the government investments. Meanwhile, the developments in the manufacturing sector put a drag on economic growth in 2012 due mainly to a decline in repair activities on yachts that visited the harbor of Sint Maarten.

Table 4 GDP by sector (real percentage changes)

Sector	2012
Agriculture, fishery, & mining	0.0
Manufacturing	-5.4
Electricity, gas, & water	0.9
Construction	0.0
Wholesale & retail trade	0.3
Restaurants & hotels	3.8
Transport, storage, & communication	1.5
Financial intermediation	0.1
Real estate, renting, & business activities	1.0
Other community, social, & personal services	-4.4
Private households	-5.0
Total private sector	0.5
Public sector	0.5
Taxes minus subsidies	0.5
GDP	1.5

Source: Estimates by the Central Bank of Curaçao and Sint Maarten.

3.2.2 Inflation

Sint Maarten's consumer price inflation decelerated from 4.6% in 2011 to 4.0% in 2012. Consumer prices rose at a slower pace due mainly to the deceleration in international oil prices. An analysis of the development by category reveals that the lower inflation in 2012 is attributed mainly to a deceleration in the categories "Transportation & communication," "Housing," and "Beverages & tobacco." The category "Transport & communication" impacted the overall index the most with a strong deceleration in the average prices from 4.7% in 2011 to 1.8% in 2012 caused by the slowdown in international crude oil prices. Furthermore, the "Housing" category registered a deceleration from 4.6% in 2011 to 2.4% in 2012 due to a decline in energy prices. The decline in inflationary pressures was mitigated primarily by surges in the categories "Food," "Clothing & footwear," and "Housekeeping & furnishings." The acceleration in the prices of "Clothing & footwear" and "Housekeeping & furnishings" might be a result of a temporary absorption of the turnover tax increase in 2011 by businesses dampening 2011's price increases. Food prices increased from 9.1% in 2011 to 11.4% in 2012. The latter increase was caused mainly by a rise in the prices of meat and fish products from 11.2% in 2011 to 14.4% in 2012. The development in Sint Maarten's 2012 inflation rate corresponds with the decline in inflation of its main trading partner, the United States. (See Table 12B in the appendix for more details.)

3.3 Public finances

3.3.1 Public finances Curaçao

Cash overview and financing

The year 2012 can be classified as a turbulent year for Curaçao in the area of public finances. During the second quarter of 2012, the Curaçao government published the first draft of its annual account for 2011, revealing a budget deficit of about 2.8% of GDP (NAf.153.7 million). Not only was the government deficit at odds with the budgetary norms in the Kingdom Act Financial Supervision Curaçao and Sint Maarten (Kingdom Act), but also the magnitude of this deficit was unanticipated. According to the Kingdom Act, the government of Curaçao is not allowed to run a deficit on the current account of its budget in any year. However, both the short fiscal year running from October 10, 2010[1] to the end of 2010, and the year 2011 were concluded with a deficit on the current account of the government budget. Additionally, these developments made it evident that in the absence of any fiscal policy changes, the new country of Curaçao would be confronted with progressively increasing budget deficits in 2012 and beyond.

In view of these alarming projections, the board supervising Curaçao's public finances, the College Financieel Toezicht (CFT),[2] repeatedly advised the Curaçao government to balance its 2012 budget and multiannual forecast. However, since the government was making little headway, the CFT recommended that the Kingdom Council of Ministers give Curaçao an instruction. Consequently, on July 13, 2012, the Kingdom Council of Ministers gave the government of Curaçao an official instruction which included, among other things, to bring its 2012 budget back in line with the norms laid down in the Kingdom Act.[3] The instruction also included an admonishment to the Curaçao government to compensate for its previous budget deficits, as the Kingdom Act dictates.

[1] Curaçao acquired the status of autonomous country within the Kingdom of the Netherlands on October 10, 2010, following the disbanding of the federation of the Netherlands Antilles.
[2] The CFT was established to temporarily assess and provide council on the public finances of Curaçao, Sint Maarten, and the other islands that used to form the Netherlands Antilles.
[3] For more details on the instruction, consult the Box in Quarterly Bulletin 2012-3.

The government of Curaçao subsequently filed an appeal with the Dutch Council of State,[4] but the instruction was essentially upheld. Despite this ruling, Curaçao's government did not manage to bring an end to its budget woes and comply with the instruction before the end of 2012. The current account of the government budget registered a deficit of NAf.110.3 million by the end of the year,[5] while the passing and implementation of several contractionary measures were deferred to 2013.

In 2012, the Curaçao government's primary balance, defined as the budget balance excluding interest payments, amounted to -1.1% of GDP (see Table 5). Although still negative, the primary balance improved somewhat compared to 2011, when it registered at -1.9% of GDP. Total interest payments remained at about the same level in both years, as the government of Curaçao did not issue any new securities after October 2010.[6]

Table 5 Selected key variables of the government of Curaçao (in millions NAf.)

	2011	2012
Revenues	1,563.5	1,654.7
% of GDP	28.7%	29.5%
Tax revenues	1,423.0	1,445.8
Nontax and other revenues	140.5	208.9
Expenditures	1,717.2	1,765.0
% of GDP	31.6%	31.5%
Interest payments	49.8	50.0
Budget balance	-153.7	-110.3
% of GDP	-2.8%	-2.0%
Primary balance	-104.0	-60.2
% of GDP	-1.9%	-1.1%

Developments in Curaçao's public sector in 2012 were influenced largely by the instruction the government received from the Kingdom Council of Ministers. The government of Curaçao was compelled to devise and implement several measures to curb its expenditures and boost its revenues in an attempt to balance its budget by the end of 2012. In combination with the higher inflation in 2012, the overall contraction in public spending resulted in a real-term decline in both government investment and consumption. Public investments financed from the budget in 2012 were almost halved in comparison to 2011, as funds originally set aside for investments were reallocated to compensate for the government's deficits. The investments financed by USONA[7] in 2012 also dropped relative to 2011, as the development aid-financed projects are gradually phasing out. By contrast, public consumption grew moderately in nominal terms during 2012, owing to higher outlays on goods & services and wages & salaries. However, the more elevated prices in 2012 eroded any real income gains resulting from the increased public consumption.

A review of the Curaçao government's operations in 2012 reveals that total revenues and expenditures grew by 5.8% and 2.8%, respectively. The growth in total income was ascribable to a

[4] The Dutch Council of State is a constitutionally established advisory body on legislation and an administrative court.
[5] Based on the draft of the Curaçao government's 2012 annual account.
[6] The takeover of all Netherlands Antillean securities by the Netherlands to finalize the debt relief program on October 10, 2010, caused the actual amount of debt relief provided to Curaçao to exceed the agreed-upon amount. On October 15, 2010, Curaçao issued NAf.1,667.4 million in new bonds to settle its resulting liability to the Netherlands.
[7] The foundation in charge of approving and funding development projects in Curaçao, Sint Maarten, and the other islands that used to form the Netherlands Antilles.

rise in tax revenues, complemented by higher nontax revenues. Tax revenues increased due primarily to the upward adjustment of the sales tax rate from 5% to 6% as of January 1, 2012. However, the upturn in sales tax revenues was mitigated by fewer proceeds from gasoline excise and import duties. Excise on gasoline fell sharply compared to 2011, mainly because the applicable excise was reduced by 25% starting July 5, 2011, and by a further 12.5% starting July 2, 2012. The decline in import duties during 2012 was in line with the overall slowdown in domestic demand. Over the course of 2012, the Curaçao government received NAf.44.9 million in withholding tax grants from the Netherlands related to the BRK tax arrangement.[8] The rise in total nontax revenues compared to 2011 can largely be explained by this transaction. However, the withholding tax assessments are being contested in court so the funds might have to be reimbursed to the Netherlands. To reflect this possibility, these funds were also administered on the expenditure side of the Curaçao government's financial reports, under the item "Other expenditures". This item consequently recorded an upturn in 2012, complementing the rise in outlays on goods & services and wages & salaries. However, the growth in these expenditures was mitigated by a decline in transfers and subsidies, reflecting fewer disbursements made by the government in behalf of households. (See Table 13A and Table 13B in the appendix for more details.)

Table 6 Financing of the budget balance of Curaçao (in millions NAf.)

	2011	2012
Monetary financing	14.1	152.8
Central bank	34.3	176.7
Commercial banks	-20.2	-23.9
Nonmonetary financing	139.7	-42.6
Government securities with the public	0.0	0.0
Other	139.7	-42.6
Budget balance	-153.7	-110.3

Over the course of 2012, the net borrowing of the government of Curaçao was positive again for the second consecutive year following the end of the debt relief program. To cover its budget deficit incurred during 2012, the Curaçao government drew down its deposits with the central bank. A portion of these funds also was used to settle outstanding liabilities with creditors and replenish the government's accounts with the commercial banking sector (see Table 6).

Public sector debt

According to the available data, Curaçao's public debt-to-GDP ratio increased from an estimated 34.6% in 2010 to about 40.6% in 2011. This rise was due largely to the deficits incurred in the social security funds during 2011, deficits for which the Curaçao government is ultimately responsible. Unfortunately, incomplete government debt statistics made it impossible to determine Curaçao's public debt-to-GDP ratio as of December 31, 2012. As of this date, Curaçao's government still had NAf.1,667.4 million in outstanding bonds as no additional securities emissions have taken place since October 2010. The outstanding government securities alone constituted 29.7% of Curaçao's GDP at the end of 2012.

[8]As part of the BRK tax arrangement, all withholding tax collected on dividends paid by Dutch companies to their parent company in the former Netherlands Antilles is transferred to the government of the island where the parent company is located.

3.3.2 Public finances Sint Maarten

Cash overview and financing

Public sector developments in Sint Maarten during 2012 are a reflection of the continued focus on developing into a full-fledged government administration.[9] However, the financial constraints the Sint Maarten government has been facing can be considered a steep hurdle in this process. The norms laid down in the Kingdom Act Financial Supervision Curaçao en Sint Maarten (Kingdom Act) require the Sint Maarten government to run a balanced budget every year, and to compensate for any budget deficit with a surplus in the following year(s). An implication of these requirements is that Sint Maarten's government has had little room to raise its expenditure level, as this calls for a higher level of revenues also. The last few years, presenting a balanced budget while staying within the limits of its approved budgets, has proven to be a challenge for the government of Sint Maarten. According to the independent board supervising the public finances of Sint Maarten, College Financieel Toezicht (CFT)[10], the drafts of the government annual accounts for 2010 and 2011 both show a budget deficit. Moreover, the CFT estimates that although the quarterly reports published by the government in 2012 show a budget surplus, the 2012 annual account might end up revealing a less positive result.[11]

Since the draft of the 2011 annual account of the government of Sint Maarten has not been made available to the Bank as yet, this analysis is derived from the quarterly reports published by the Sint Maarten government in 2011 and 2012. Based on these reports, the government ran a year-end budget surplus in both years, amounting to NAf.10.3 million and NAf.27.9 million, respectively. Unfortunately, the quarterly government reports do not contain any detailed information about the various expenditures categories, which limits the scope of this analysis, and allows only for a rough estimate of the contribution of the public sector to the GDP growth of Sint Maarten in 2012.

Table 7 Selected key variables of the government of Sint Maarten (in millions NAf.)

	2011	2012
Revenues	413.8	435.8
% of GDP	27.8%	27.8%
Tax revenues	322.3	344.6
Expenditures	403.5	407.9
% of GDP	27.1%	26.0%
Interest payments	11.9	10.9
Budget balance	10.3	27.9
% of GDP	0.7%	1.8%
Primary balance	22.1	38.8
% of GDP	1.5%	2.5%

The Sint Maarten government's primary balance, defined as the budget balance exclusive of interest payments, rose from 1.5% of GDP in 2011 to 2.5% of GDP in 2012. This improvement was largely attributable to the upturn in revenues over the course of 2012. Meanwhile, total interest

[9] Sint Maarten acquired the status of autonomous country within the Kingdom of the Netherlands on October 10, 2010, following the disbanding of the federation of the Netherlands Antilles.
[10] The CFT was established to temporarily assess the public finances of the five islands of the former Netherlands Antilles and provide counsel.
[11] Source: CFT Advice on the Sint Maarten government progress report 2012-4.

payments declined during 2012, due mainly to the refinancing of some government loans at a more favorable rate in late 2011 (see Table 7).

Over the course of 2012, the growth in Sint Maarten's total revenues (5.5%) outpaced the increase in total expenditures (1.1%). Government revenues grew primarily due to an upturn in turnover tax proceeds, which coincided with the economic activity increment during 2012. Income from room tax and wage tax also rose compared to 2011, contrasting with the drop in taxes on profit and property. Meanwhile, the nontax revenues of the Sint Maarten government showed a decline relative to 2011, owing mainly to less concession fees received from public enterprises in 2012. (See Table 14A and Table 14B in the appendix for more details).

Table 8 Financing of the budget balance of Sint Maarten (in millions NAf.)

	2011	2012
Monetary financing	63.8	49.7
Central bank	-0.1	0.0
Commercial banks	63.9	49.7
Nonmonetary financing	-74.1	-77.6
Government securities with the public	26.0	-.-
Other	-100.0	-77.6
Budget balance	10.3	27.9

In 2012, the net borrowing of Sint Maarten's government was negative. The government used its budget surplus and a fraction of its commercial bank deposits to reduce its outstanding liabilities with creditors (see Table 8).

Public sector debt

The total outstanding public debt of Sint Maarten at the end of 2012 could not be determined due to incomplete government debt statistics. The currently available data does not include any outstanding debt of the Sint Maarten government to the social security bank, the government pension fund, and other companies. Therefore, it was only possible to calculate a partial debt-to-GDP ratio of 22.5% for Sint Maarten as of December 31, 2012. This ratio is based on the documented debt of the Sint Maarten government (NAf.352.7 million), which consisted of NAf.328.1 million in outstanding government bonds and NAf.24.6 million in other liabilities.

3.4 Developments in the balance of payments

3.4.1 Introduction

In 2012, the deficit on the current account of the balance of payments of the monetary union narrowed by NAf.84.4 million compared to 2011. The lower deficit was caused entirely by a significant improvement of the services balance, offset only partly by a deterioration in the trade, income, and current transfers balances. Since the current account deficit dropped, the combined capital and financial account worsened at a slower pace than in 2011(see Table 9).

Table 9 Balance of payments summary (in millions NAf.)

	2010	2011	2012
Current account	-1,427.8	-1,466.5	-1,382.1
Capital transfers	1,200.8	123.1	69.8
External financing of the government	1.5	28.6	53.7
External financing of the private sector	153.9	1,318.2	893.7
- Direct investment	228.6	88.4	112.1
- Loans and credits	1,454.6	1,047.6	207.9
- Portfolio investments	-1,529.3	182.2	573.7
Change in gross reserves of the central bank *)	-27.6	-48.4	277.4
- Foreign exchange	35.7	-160.2	197.1
- held at foreign central banks	-359.6	-41.1	128.4
- held at foreign commercial banks	395.4	-119.1	68.7
- Other claims	-63.3	111.8	80.3
Statistical discrepancies	99.0	45.0	87.5

*) A minus sign implies an increase.

3.4.2 Current account

Net exports of goods and services in the monetary union increased by NAf.152.2 million during 2012 compared 2011, as a result of an increase in exports (NAf.624.9 million) mitigated by a growth in imports (NAf.472.7 million). Below is an analysis of the development in net exports of goods and services in Curaçao and in Sint Maarten.[12]

Developments in the net exports of goods and services in Curaçao

In Curaçao, net exports of goods and services increased slightly in 2012 compared to 2011 because of an increase in exports (NAf.382.7 million) mitigated by a growth in imports (NAf.371.9 million). The growth in exports was related to, among other things, an increase in foreign exchange revenues from the tourism industry (NAf.160.3 million), a small acceleration compared to 2011. Foreign exchange earnings from both stay-over tourism and cruise tourism rose in 2012, by 20.4% and 12.2%, respectively. The increased tourism revenues were accompanied by a growth in foreign exchange receipts from the air transportation sector (NAf. 74.9 million). In line with increased harbor activities, revenues from sea transportation grew accordingly (NAf.9.2 million). Besides higher revenues from the tourism and transportation sectors, the refining fee increased as well (NAf.72.8 million), despite the shutdown of the refinery for several months, reflecting more trading activities. Furthermore, re-exports by the free-zone companies registered a growth compared to 2011 (NAf.77.1 million).

In comparison to 2011, international oil prices remained fairly stable in 2012. In spite of this price stabilization, foreign exchange revenues from bunkering activities dropped slightly (NAf.17.0 million) due to less fuel purchased by cruise ships. A more significant drop in revenues was registered in foreign exchange revenues from ship repair activities (NAf.89.5 million). In contrast to the considerable declines registered in the previous years, foreign exchange revenues from the international financial & business sector stabilized in 2012.

[12] The current account of the monetary union is not equal to the sum of the current accounts of Curaçao and Sint Maarten due to the transactions between the two countries.

The increase in imports of goods and services was largely the result of more merchandise imports by the free-zone companies (NAf.172.4 million). As their exports did not increase to the same extent, the difference reflects an increase in stock building. In addition, the investments in nonresidential construction projects, among other things, contributed to a rise in imports of construction materials (NAf.14.8 million). Furthermore, imports by the transportation sector increased (NAf.46.9 million) due in part to more cargo flights. In addition, due to increased airlift by local airline companies, commissions and costs increased, which caused a rise in the import of transportation services. Also, more services for, among other things, the development of USONA projects were contracted. In contrast, merchandise imports by the retail trade sector declined by NAf.14.0 million, reflecting the drop in consumer spending.

Developments in the net exports of goods and services in Sint Maarten

In Sint Maarten, net foreign demand rose strongly by NAf.150.1 million in 2012 compared to 2011, as the rise in exports (NAf.250.9 million) was significantly higher than the increase in imports (NAf.100.8 million). The expansion of net foreign demand was reflected by a surplus on the combined trade and services balances. The growth in exports was almost entirely related to increased foreign exchange revenues from the tourism sector. The latter grew by NAf.219.3 million, largely as a result of the increase in revenues from stay-over tourism (NAf.166.2 million). In addition, revenues from cruise tourism increased by NAf.53.1 million in 2012 compared to 2011.

Imports of goods and services increased as a result of a strong rise in imported oil products, reflecting better reporting, more oil re-exports to Saba and St. Eustatius, and advance payments for future oil imports reflecting a hedge for a rise in future oil prices. Furthermore, a growth in the import of construction materials was registered. The latter increase was related to construction projects, including public housing and investments in the harbor of Sint Maarten.

Developments in the income balance and current transfers balance

The income balance of the monetary union deteriorated by NAf.37.9 million, due mainly to less interest income earned on foreign assets by resident companies. In addition, dividend payments to foreign investors increased. Similar to the development in the income balance, the current transfers balance deteriorated by NAf.29.9 million, reflecting a strong decline in current transfers received from abroad offset partly by a decline in current transfers paid to abroad. (For a detailed overview, see Table 15 in the appendix.)

3.4.3 Financing of the current account balance

In line with the deficit on the current account, the net foreign wealth of the private sector dropped by NAf.893.7 million in 2012. This change in the external financing of the private sector was due mainly to a deterioration of the portfolio investments balance.

The portfolio investments balance deteriorated by NAf.573.7 million in 2012, largely as a result of received funds from matured foreign debt securities held by institutional investors, which were not reinvested abroad. The bulk of these matured debt securities was issued in the past by the entities of the Netherlands Antilles and taken over by the Dutch government in October 2010 as part of the debt relief program.

The loans and credits balance deteriorated by NAf.207.9 million in 2012 as domestic companies withdrew funds from their foreign bank accounts to finance part of their imports. Also, the net

trade credit balance worsened because of more trade credits received on imports combined with higher payments received on previously extended trade credit.

Net direct investments into the monetary union expanded by NAf.112.1 million in 2012, an acceleration compared to the increase of NAf.88.4 million registered in 2011. The expansion in 2012 was due mainly to increased claims of foreign direct investors on their subsidiaries in Curaçao and Sint Maarten and the purchase of real estate in both countries by nonresidents.

Meanwhile, capital transfers declined to NAf.69.8 million in 2012 compared to NAf.123.1 million in 2011 as a result of less development aid funds received. Due to the diminishing inflow from capital transfers and the slower pace of growth in external financing of the private sector, gross reserve assets declined by NAf.277.4 million to cover the current account deficit. (See Table 16 in the appendix for a detailed overview.)

3.5 Monetary developments

3.5.1 Monetary policy and money supply

The tightening of the monetary stance initiated in 2011 in light of balance of payment pressures and reflected by a growing deficit on the current account and a declining trend in the level of the foreign exchange reserves continued during 2012. First, the percentage of the reserve requirement, the Bank's main instrument, was raised from 10.50% at the end of December 2011 to 14.25% at the end of December 2012. Second, to complement the mopping-up of excess liquidity through the reserve requirement, a credit freeze was introduced to directly impact the level of domestic credit extension. The credit freeze measure was introduced in March 2012 for a period of six months. For the period August 2012 - February 2013, the credit measure was prolonged and eased somewhat by allowing a maximum credit growth of 1.00%.

The Bank's other monetary policy tool, the auctioning of certificates of deposit (CDs), was deployed in a neutral manner in 2012 as the Bank aimed only at refinancing maturing CDs at the biweekly auctions. However, due to shortfalls in subscriptions in the second half of 2012, the outstanding amount of CDs dropped slightly from NAf.30.3 million to NAf.29.0 million at the end of December 2012.

In line with the very low central bank policy rates in the major advanced economies, particularly the Fed funds rate, the Bank kept the official interest rate, i.e., the pledging rate, unchanged at the historically low level of 1.00% during 2012.

3.5.2 Monetary aggregates

Broad money (M2) expanded by 1.8% in 2012, up from 1.3% in 2011. (See Table 15 in the appendix for more details.) The expansion in M2 in 2012 was the result of a surge of 6.9% in the narrow money component (M1) mitigated by a drop of 2.0% in the near money component. The increase in M1 (NAf.216.5 million) was caused by increases in both demand deposits and coins and notes with the public and reflected a continuing shift into more liquid monetary assets observed throughout the year. The rise in demand deposits was driven largely by households and private nonfinancial companies that increased their outstanding balances both in domestic and foreign currency. Near money, on the other hand, declined by 2.0%, the result of a drop in private sector time deposits offset by higher savings deposits.

3.5.3 Factors affecting the money supply

An expansion of NAf.313.8 million (9.7%) in net domestic assets caused the growth in the money supply in 2012. In contrast, net foreign assets dropped by NAf.180.7 million (4.4%). The increase in net domestic assets reflected an expansion in net credit to both the private sector and the government sector. Net credit to the private sector expanded by 3.5% in 2012, a substantial moderation compared to the 11.0% growth in 2011. The expansion in 2012 was attributable entirely to the 4.8% growth in loans extended. An analysis by country shows that only Curaçao contributed to the growth in loans. Private sector loans in Curaçao expanded by 8.6% in 2012, slightly less than the 8.9% growth in 2011, due to the expansion in business loans (14.9%) and mortgages (9.5%). In contrast, consumer loans declined (1.0%).

The relatively high growth rate in private loans seems contradictory to the credit measure that became effective in March 2012. This contradiction can be explained primarily by the exemptions on the credit measure agreed upon with the banks. These exemptions comprise the take-up of the undisbursed part of credit commitments agreed upon before the measure became effective and loans for projects that will strengthen the foreign exchange reserves and economic development.

Sint Maarten recorded a negative development in private sector loans for the second consecutive year. The contraction in total loans worsened from 2.4% in 2011 to 4.7% in 2012, underpinned by declines in outstanding mortgages (5.2%), consumer loans (8.2%), and business loans (1.3%).

The expansionary impact of the government sector in 2012 was accounted for by a drawdown of deposits by both the government of Curaçao (NAf.152.9 million) and Sint Maarten (NAf.49.7 million) to finance their budget deficits.

Net foreign assets of the banking system amounted to NAf.3,899.9 million at the end of 2012, a drop of 4.4% compared to 2011. Nevertheless, this drop was less pronounced than in 2011 (9.7%). The decline in net foreign assets in 2012 was reflected largely by a drop in the net foreign assets held by the commercial banks, which declined by NAf.139.7 million to NAf.1,054.6 million at the end of 2012. The net foreign assets of the Central Bank of Curaçao and Sint Maarten dropped by a smaller amount, namely NAf.41.1 million reaching NAf.2,845.3 at the end of 2012. (See Table 17 in the appendix for a detailed overview.)

3.5.4 Developments in domestic interest rates

Throughout 2012, the official lending rate of the Bank remained unchanged at 1.00%. The rates offered at the auctions of certificates of deposit varied in line with the international interest rates. At the first auction in January 2012, the highest rate (0.20%) was accepted, while the lowest rate accepted was in December 2012 (0.12%).

The drop in excess liquidity in the domestic money market, a result of the monetary tightening and increased competition among the financial institutions, resulted in a decline in commercial bank lending rates in 2012. First, the increase by 0.6 percentage point in the average mortgage rate that occurred in 2011 was reversed. At the end of December 2012, the rate stood again at 6.7%, the same rate as at the end of 2010. Second, the average interest rate on the more risky time loans dropped by 0.4 percentage point to 7.9%. A mixed development occurred in borrowing rates in 2012. While the average interest rate on savings deposits increased by 0.1 percentage point to 1.2% at the end of 2012, the average rate paid on 12-month time deposits dropped by 0.5 percentage point to 1.6%.

The indicative yields on government securities in Curaçao and Sint Maarten are based on the relatively lower effective yield of Dutch State loans with similar maturities, as the Dutch State Treasury Agency (DSTA) participates in the local tender of government securities (i.e., the standing subscription). The average effective yield of 5-year government bonds dropped from 1.4% at the end of 2011 to 0.6% at end-December 2012. A similar development occurred in Treasury bill rates. The 12-month treasury bills rate dropped from 0.15% at the end of December 2011 to 0.01% at the end of 2012. (See Table 18 in the appendix for a detailed overview.)

3.6 Developments in the commercial banking sector

3.6.1 Balance sheet and income statement

Total assets of the domestic commercial banks expanded by 4.0% during 2012 compared to a marginal increase of 0.1% in 2011. The expansion in assets in 2012 was due mostly to the growth on the loan portfolio (3.9%) and interest-bearing cash (11.1%). (See Table 19 in the appendix for more details.)

Total liabilities of the domestic banks increased by 3.7% in 2012 compared to a 0.6% decline in 2011. The increase in 2012 was attributable primarily to the 3.8% expansion in the deposit base, almost entirely the result of the growth in demand deposits (8.7%). Savings deposits increased also (2.5%,) while time deposits declined (4.6%). These developments contributed to a change in the composition of total deposits. The share of interest-bearing deposits, i.e., time and savings deposits, dropped from 54.3% in 2011 to 52.1% at the end of 2012. Consequently, the share of non-interest-bearing demand deposits increased to 47.9% of total deposits at end-December 2012, up from 45.7% in 2011. Furthermore, the domestic banks continued to strengthen their capital buffer. Total capital increased by 6.1% in 2012, about the same pace as in 2011 (6.0%).

Total operational income of the domestic commercial banking sector rose by 2.9% in 2012, a deceleration compared to the 5.5% growth registered in 2011. In 2012, both net interest income (3.6%) and other income (1.5%) increased. The increase in net interest income was due largely to a decline in interest expenses (13.6%), mainly because of the drop in both the average rate and the outstanding amount of time deposits.

Operational expenses rose by 7.6% in 2012, an acceleration compared to the 3.1% growth in 2011. The growth in expenses occurred in all categories, with the net addition to general provisions (51.4%) and other operating expenses (9.8%) contributing most to the increase. The growth in operating expenses outweighed that of operating income, resulting in a decline in net operating income (9.0%) in 2012. As a consequence, net income after taxes declined by 7.4% to NAf.226.5 million in 2012. The total expenses-to-total assets ratio increased from 4.3% in 2011 to 4.4% in 2012, implying a slight deterioration in cost efficiency. Furthermore, the rather flat growth in interest income combined with an increase in nonperforming loans and provisioning contributed to a decrease in the profitability of the commercial banks in 2012. (See Table 20 in the appendix for more details.)

3.6.2 Financial soundness indicators

The Bank analyzes the general performance of the banking sector on a regular basis through the monitoring of financial soundness indicators (FSIs), i.e., aggregates of microprudential indicators used to assess the soundness of individual banks. Since these microeconomic indicators consider only the exposure of individual banking institutions, macroeconomic factors are not really taken into account. The Bank has started to consider macroeconomic factors by developing stress tests.

Stress testing helps to monitor and anticipate potential vulnerabilities in the financial system. These stress tests together with the FSIs enhance a macroprudential approach for a better assessment of the vulnerability of the banking system to shocks and the extent of systemic risk.

The ratio of total capital-to-total assets increased from 11.3% in 2011 to 11.5% in 2012, indicating more regulatory capital to absorb possible shocks from financial risk. The increase in the capital adequacy ratio was due to stronger growth in qualifying Tier 1 capital (6.1%) than in total assets (3.6%). The capital assets ratio exceeded the internationally acknowledged Basel benchmark of 8.0%, meaning that capitalization of the domestic banks is relatively strong (see Table 10).

A higher increase in nonperforming loans than in provisions caused the ratio of provisions for loan losses-to-nonperforming loans to drop from 45.9% in 2011 to 38.9% in 2012. The quality of the commercial banks' credit portfolio deteriorated further in 2012 as the ratio of nonperforming loans-to-total loans reached 8.1% at the end 2012, up from 6.8% at the end of 2011. The deterioration in asset quality in 2012 resulted from an accelerated growth of 22.8% in nonperforming loans, while the growth in total loans decelerated (3.3%).

An expansion in average earning assets (1.0%) and a slight decline in the interest earned on these assets (0.3%) caused the gross earning assets yield to decline from 5.6% in 2011 to 5.5% in 2012. The return on assets ratio declined from 1.9% in 2011 to 1.7% in 2012, caused by a decline in net income (7.1%) and an increase in average total assets (3.6%). The net interest margin improved to 4.6% in 2012, up from 4.5% in 2011, the result of a 2.9% increase in net interest income and a 1.0% growth in the average earning assets.

Finally, the ratio of total loans-to-total deposits, an indicator of the liquidity of the domestic banking sector, remained unchanged at 68.7% at the end of 2012 compared to the end of 2011.

Table 10 Macroprudential indicators (in %, end of period)

	2010	2011	2012
Capital adequacy			
Total capital/total assets	10.8	11.3	11.5
Asset quality			
Nonperforming loans/total loans	5.9	6.8	8.1
Provisions for loan losses/nonperforming loans	53.4	45.9	38.9
Earnings			
Gross earning assets yield	5.6	5.6	5.5
Net interest margin	4.3	4.5	4.6
Return on assets	1.7	1.9	1.7
Liquidity			
Total loans/total deposits	65.3	68.7	68.7

APPENDIX

Table 11 Developments in stay-over tourism per island (% change) [a]

	Curaçao				Sint Maarten			
	2011		2012		2011		2012	
North America, of which:	26.3	(4.9)	-1.4	(-0.2)	-6.5	(-3.8)	10.5	(6.4)
-U.S.A.	28.0	(4.5)	-3.0	(-0.4)	-7.3	(-3.8)	8.8	(4.6)
Europe, of which:	3.2	(1.4)	2.3	(0.9)	0.6	(0.1)	3.4	(0.8)
-The Netherlands	1.0	(0.4)	-3.2	(-1.1)	0.7	(0.0)	-1.2	(0.0)
South & Central America, of which:	28.7	(7.1)	26.2	(7.6)	12.3	(0.5)	-2.0	(-0.1)
-Venezuela	38.8	(6.1)	34.0	(6.7)	-0.6	(0.0)	20.4	(0.2)
-Brazil	9.0	(0.2)	4.3	(0.1)	-4.7	(-0.1)	-15.9	(-0.2)
-Other	16.0	(1.1)	15.4	(1.1)	38.5	(0.7)	0.1	(0.0)
Caribbean, of which:	7.1	(0.7)	-4.2	(-0.4)	-2.0	(-0.1)	4.0	(0.2)
-Aruba	8.6	(0.5)	5.4	(0.3)	---	--	---	--
-Dominican Republic	39.9	(0.4)	-0.5	(0.0)	14.7	(0.1)	10.0	(0.1)
-Other	-0.5	(0.0)	-16.9	(-0.6)	-4.2	(-0.2)	3.0	(0.1)
Total	14.2	--	7.5	--	-4.2	--	7.6	--

Source: Curaçao Tourist Board and Sint Maarten Tourist Bureau.
[a] Weighted growth rates between brackets.

Table 12A Curaçao consumer prices (annual percentage change)

	2009	2010	2011	2012
Food	9.9	4.6	7.7	6.1
Beverages & tobacco	5.5	3.5	2.5	4.9
Clothing & footwear	2.0	-1.1	0.6	1.2
Housing	-1.1	4.0	0.8	2.4
Housekeeping & furnishings	5.2	0.9	1.4	2.5
Health	1.9	2.2	0.9	0.7
Transport & communication	-1.9	2.5	2.7	3.9
Recreation & education	1.8	-0.1	-0.1	1.4
Other	3.7	2.2	1.3	2.0
General inflation rate	1.7	1.8	2.3	3.2

Source: Central Bureau of Statistics

Table 12B Sint Maarten consumer prices (annual percentage change)

	2009	2010	2011	2012
Food	9.3	3.0	9.1	11.4
Beverages & tobacco	6.1	2.1	9.8	7.9
Clothing & footwear	1.6	0.4	1.5	6.2
Housing	-1.9	5.8	4.6	2.4
Housekeeping & furnishings	4.5	1.1	3.6	6.0
Health	1.4	0.7	1.5	1.4
Transport & communication	-1.3	1.3	4.7	1.8
Recreation & education	0.3	0.8	1.4	3.9
Other	2.8	1.9	3.1	2.7
General inflation rate	4.6	3.2	4.6	4.0

Source: Department of Statistics, Sint Maarten

Table 13A Budgetary overview of Curaçao (in millions NAf.)

	2011	2012
Revenues	1,563.5	1,654.7
Tax revenues, of which:	1,423.0	1,445.8
Taxes on income and profits	701.3	712.9
Taxes on goods and services	487.2	516.4
Taxes on property	47.7	43.9
Taxes on international trade and transactions	181.3	166.4
Nontax and other revenues	140.5	208.9
Expenditures	1,717.2	1,765.0
Wages and salaries	720.1	737.2
Goods and services	371.6	391.3
Transfers and subsidies	528.7	497.1
Interest payments	49.8	50.0
Other expenditures	47.0	89.4
Budget balance	-153.7	-110.3

Table 13B Overview of selected tax revenues of Curaçao (in millions NAf.)

	2011	2012
Taxes on income and profits, of which:	701.3	712.9
Profit tax	198.5	202.9
Wage tax	504.4	499.8
Taxes on property, of which:	47.7	43.9
Land tax	26.1	26.1
Property transfer tax	18.3	16.9
Taxes on goods and services, of which:	487.2	516.4
Sales tax	311.9	367.2
Excises, of which:	101.1	79.2
Excise on gasoline	67.0	40.9
Motor vehicle tax	39.3	34.7
Taxes on international trade and transactions, of which:	181.3	166.4
Import duties	180.4	165.2

Table 14A Budgetary overview of Sint Maarten (in millions NAf.)

	2011	2012
Revenues	413.8	435.8
Tax revenues, of which:	322.3	344.6
Taxes on income and profits	149.1	148.1
Taxes on property	18.9	14.5
Taxes on goods and services	154.4	182.0
Social contributions	17.0	19.7
Nontax and other revenues	74.4	71.5
Expenditures	403.5	407.9
Budget balance	10.3	27.9

Table 14B Overview of selected tax revenues of Sint Maarten (in millions NAf.)

	2011	2012
Taxes on income and profits, of which:	149.1	148.1
Profit tax	27.1	22.2
Wage tax	124.9	128.9
Taxes on property, of which:	18.9	14.5
Land tax	4.1	3.2
Property transfer tax	14.7	11.3
Taxes on goods and services, of which:	154.4	182.0
Turnover tax	111.7	134.6
Vehicle tax	8.5	8.5
Excise on gasoline	9.8	9.6

Table 15 Detailed overview of balance of payments (in millions NAf.)

	2010	2011	2012
Trade balance	-3,359.0	-3,236.6	-3,478.9
-Exports	1,451.3	1,888.6	1,931.2
-Imports	4,810.2	5,125.2	5,410.0
Services balance	1,767.6	1,993.3	2,387.8
Receipts, of which:	3,457.3	3,850.7	4,433.0
-Travel	2,024.7	2,098.7	2,478.3
-Transportation	324.2	317.6	398.0
-Other services, of which:	1,108.4	1,434.4	1,556.7
-Int. fin & bus. services sector	256.3	191.7	181.3
Expenses, of which:	1,689.8	1,857.4	2,045.2
-Travel	558.6	637.3	661.2
-Transportation	304.0	305.8	362.1
-Other services, of which:	827.2	914.3	1,021.9
-Int. fin & bus. services sector	126.1	106.7	90.4
Income balance[1)]	-95.3	-88.4	-126.3
Current transfers balance[2)]	258.9	-134.8	-164.7
Current account balance	**-1,427.8**	**-1,466.5**	**-1,382.1**
Capital & financial account balance	**1,328.8**	**1,421.5**	**1,294.6**
Capital account balance	1,200.8	123.1	69.8
Financial account balance	128.0	1,298.5	1,224.8
Net errors & omissions	**99.0**	**45.0**	**87.5**

1) Labor and investment income.
2) Public and private transfers.

Table 16 Breakdown of net changes in the financial account [1] (in millions NAf.)

	2010	2011	2012
Direct investment	228.6	88.4	112.1
- Abroad [2]	-32.8	52.0	-14.1
- In Curaçao and Sint Maarten [3]	261.4	36.4	126.2
Portfolio investment [3]	-1,529.3	182.2	573.7
Other investment, of which:	1,167.4	913.9	224.6
- Assets [3]	810.8	1,086.6	643.9
- Liabilities [3]	356.6	-172.8	-419.3
Net lending/borrowing, of which:	288.7	162.4	37.0
- Assets [2]	40.9	65.4	-18.0
- Liabilities [3]	247.8	97.0	55.0
Reserves [4]	-27.6	-48.4	277.4
Total assets [2]	-738.0	1,337.8	1,462.9
Total liabilities [3]	865.8	-39.4	-238.1
Balance	127.8	1,298.5	1,224.8

1) Transaction basis
2) A minus sign means an increase in assets.
3) A minus sign means a decrease in liabilities.
4) A minus sign means an increase in reserves.

Table 17 Monetary survey (in millions NAf.)

	2010 [1]	2011	2012
Money supply (M2)	7,216.5	7,308.1	7,441.2
Money (M1)	3,131.2	3,148.8	3,365.3
Coins & notes with the public	320.6	301.3	331.8
Total demand deposits, of which:	2,810.6	2,847.5	3,033.5
- Netherlands Antillean guilders	2,218.6	2,174.7	2,292.3
- Foreign currency	592.0	672.8	741.2
Near money	4,085.3	4,159.3	4,075.9
Time deposits	2,186.6	2,266.4	2,149.5
Savings	1,898.7	1,893.0	1,926.4
Factors affecting the money supply	7,216.5	7,308.1	7,441.2
Net domestic assets	2,696.0	3,227.5	3,541.3
Government sector	-705.2	-621.6	-425.7
- Former Central government	-112.2	-106.4	-113.1
- Curacao	-347.6	-333.6	-180.7
- Sint Maarten	-245.4	-181.6	-131.9
Private sector	5,545.9	6,155.7	6,373.8
Memorandum items	-2,144.8	-2,306.6	-2,406.8
Net foreign assets	4,520.5	4,080.6	3,899.9
Central bank	2,906.4	2,886.4	2,845.3
Commercial banks	1,614.1	1,194.2	1,054.6
Government loans by commercial banks	0.2	0.1	0.1
Government of Curaçao	0.0	0.0	0.0
Government of Sint Maarten	0.2	0.1	0.1
Private sector loans Curacao	3,524.0	3,839.3	4,170.6
- Mortgages	1,394.1	1,628.2	1,782.4
- Consumer loans	943.9	954.9	945.3
- Business loans	1,186.0	1,256.3	1,442.9
Private sector loans Sint Maarten	1,581.8	1,544.0	1,471.9
- Mortgages	661.7	648.2	614.2
- Consumer loans	391.5	379.4	348.2
- Business loans	528.6	516.4	509.5

[1] Excluding the BES islands (i.e., Bonaire, Sint Eustatius, and Saba).

Table 18 Developments in domestic interest rates (in %)

	2010	2011	2012
Central bank			
- Pledging rate	1.0	1.0	1.0
- Maximum CD rate (1 month)	0.15	0.17	0.20
Commercial bank borrowing rates			
- Passbook savings	1.1	1.1	1.2
- Time deposit (12 months)	1.7	2.1	1.6
Commercial bank lending rates			
- Mortgages	6.7	7.3	6.7
- Time loans	8.8	8.3	7.9
Government securities			
- 5-year government bonds (effective yield)	2.35	1.43	0.57
- Treasury bills (12 months)	1.50	0.15	0.01

Table 19 Aggregate balance sheet for domestic commercial banks (in millions NAf.)

	2010 [1]	2011	2012
Assets			
Non-interest-bearing cash	1,441.7	1,506.3	1,447.4
Interest-bearing cash	2,884.8	2,426.9	2,697.3
Investments	1,461.9	1,540.1	1,434.3
Loans	8,106.2	8,451.4	8,784.8
Investments in unconsolidated subsidiaries and affiliates	123.6	69.7	94.7
Fixed assets	333.8	355.5	393.0
Other assets	295.5	307.8	385.9
Total assets	14,647.6	14,657.8	15,237.5
Liabilities			
Demand deposits	5,215.6	5,673.1	6,168.8
Savings deposits	4,211.8	4,016.1	4,117.3
Time deposits	3,105.8	2,724.1	2,598.1
Total deposits	12,533.2	12,413.3	12,884.2
Borrowings	99.5	31.1	20.0
Other liabilities	427.6	531.6	549.4
Total liabilities	13,060.3	12,976.1	13,453.6
Minority interest	9.3	10.2	10.2
Subordinated debentures	0.0	0.0	0.0
General provisions	266.4	282.1	297.8
Capital & reserves	1,311.5	1,389.3	1,475.9
Total capital	1,587.2	1,681.7	1,783.9
Total liabilities and capital	14,647.6	14,657.8	15,237.5

1) Excluding the BES islands (i.e., Bonaire, Sint Eustatius, and Saba)

Table 20 Aggregate income statement for domestic commercial banks (in millions NAf.)

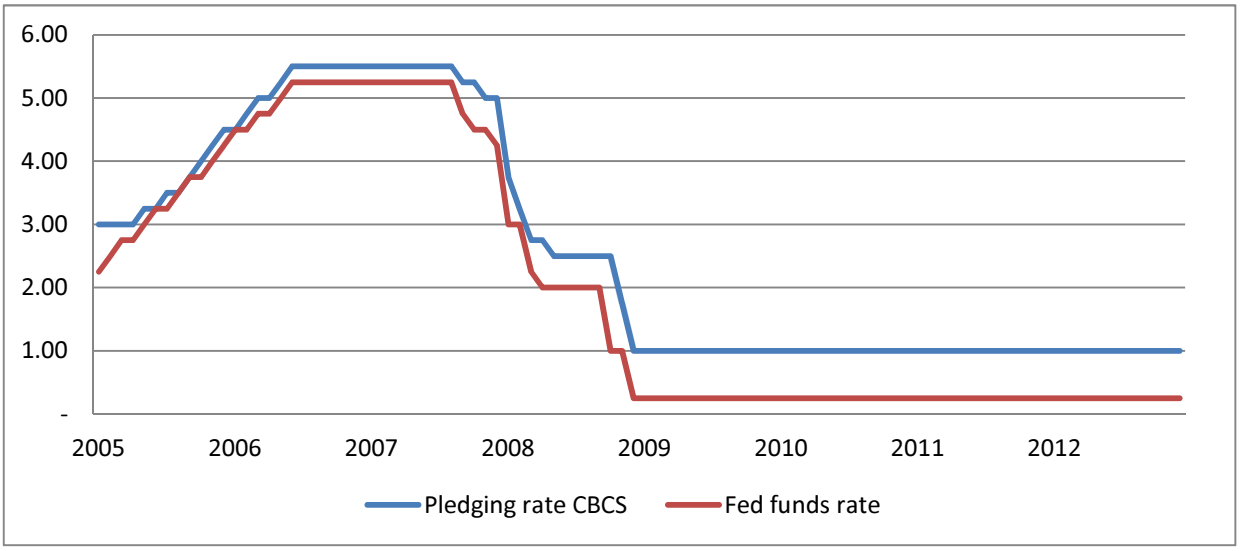
	2010	2011	2012
Interest income	713.9	712.2	713.8
Interest expenses	164.0	140.2	121.2
Net interest income	549.9	572.0	592.6
Other income	274.2	297.8	302.3
Total operational income	824.2	869.7	894.9
Salaries & other employee expenses	308.6	335.8	343.7
Occupancy expenses	95.1	99.9	100.3
Other operating expenses	132.2	138.8	152.4
Net addition to general provisions	69.6	49.8	75.3
Total operational expenses	605.6	624.3	671.7
Net operating income	218.6	245.4	223.2
Net extraordinary items	36.0	42.3	44.0
Applicable profit taxes	42.4	43.1	40.7
Net income after taxes	212.2	244.6	226.5

4 DOMESTIC FINANCIAL MARKET DEVELOPMENTS

4.1 Introduction

Towards the end of 2007, the Fed funds rate started to decline, dropping from 5.25% to a range of 0% - 0.25%, and it remained within that range from 2009 through 2012. Given the close ties between the United States and domestic financial markets in Curaçao and Sint Maarten, due to the peg of the Netherlands Antillean guilder to the dollar, the Bank's official lending rate was reduced from 1.75% to 1.00% at the end of 2008 and remained at this historically low level during 2009-2012 (see Graph 2).

Graph 2 Development in pledging rate CBCS and Fed funds rate (%)



In addition to international developments, local financial market developments were dominated by the debt relief offered by the Dutch government as part of the constitutional changes. The subscription possibility of the Dutch State Treasury Agency in local government securities put rates under pressure. The Agency subscribes at rates prevailing in the Netherlands, which are considerably lower than those common in Curaçao and Sint Maarten. Local investors usually use the US Treasury or US agency rates as references for AAA investments. The subscription possibility of the State of the Netherlands through the Dutch State Treasury Agency will be in effect for 5 years after October 10, 2010, the date of the constitutional changes. The governments of Curaçao and Sint Maarten did not issue any debt securities in 2012.

4.2 Financial instruments and the money market

Certificates of deposit (CDs) issued by the Bank are the only tradable nongovernmental instruments available in the local money market. CDs are a monetary tool the Bank uses to control the liquidity in the local money market through bimonthly auctions held according to a set schedule. Commercial banks did not trade in CDs in the secondary market in 2012, preferring to use uncollateralized interbank instruments.

As indicated in Table 21, the average balance of outstanding CDs decreased throughout 2012 to NAf.30.0 million, NAf.17.2 million (36.4%) lower than in 2011. Nevertheless, the auctions were oversubscribed during most of 2012 because the money market remained very liquid.

The average outstanding balance of the non-interest-bearing reserve requirement increased by NAf.228.1 million (42.2%) to NAf.768.8 million in 2012. The base amount on which the reserve requirement is calculated equals the commercial banks' domestic debt excluding interbank and long-term deposits. The reserve requirement percentage had been raised during 2012 from 10.50% to 14.25% due to the tightening of the Bank's monetary policy.

The increase in the reserve requirement percentage contributed to a reduction in commercial banks' liquidity in 2012, reflected by the lower average outstanding balance of demand deposits with the central bank. The average balance in 2012 was 22.0% lower than in 2011.

Table 21 Average outstanding balances of certificates of deposit, non-interest-bearing reserve requirement, and demand deposits of commercial banks with the central bank (in millions NAf.)

	2010	2011	2012	% change 2011-2012
Certificates of deposit	66.0	47.2	30.0	-36.4
Non-interest-bearing reserve requirement	573.6	540.7	768.8	42.2
Demand deposits	402.8	511.3	398.9	-22.0
Total	1,042.4	1,099.2	1,197.7	9.0

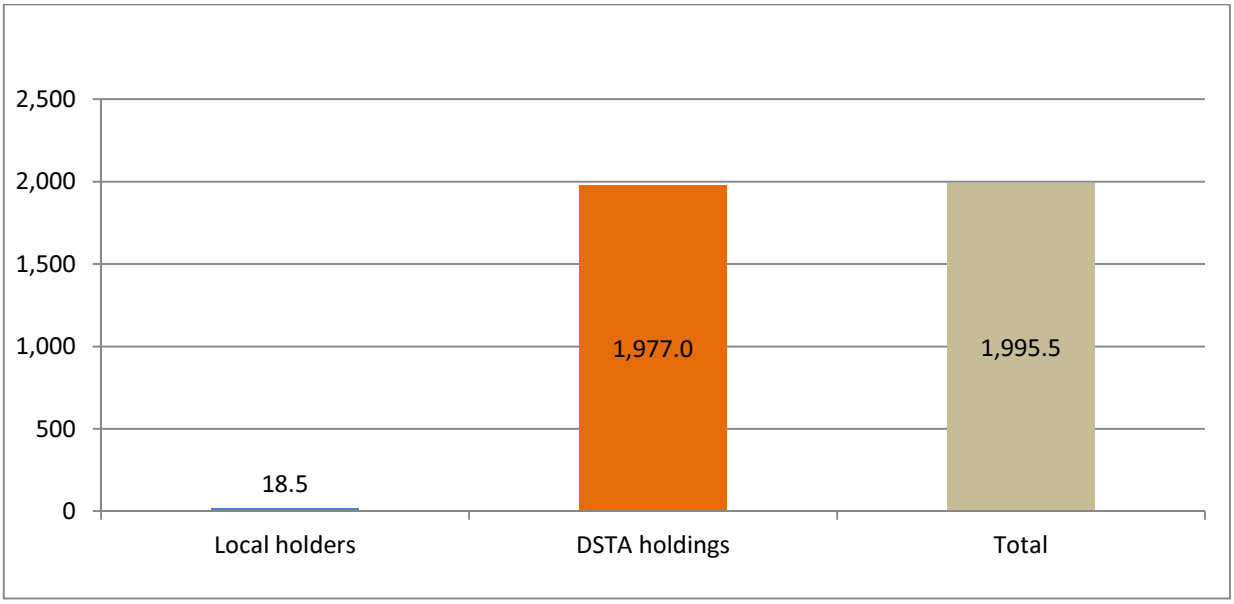
4.3 The market for government securities

During 2012, the indicative yield in the local government securities market remained very low, similar to the yield in the Netherlands. A 1-year bond had an average yield of 0.10%, and a 3-year bond 0.44%. The average yields for 5-, 10-, 15-, and 20-year bonds were 1.01%, 1.98%, 2.39%, and 2.48%, respectively.

4.4 Composition of issued debt securities

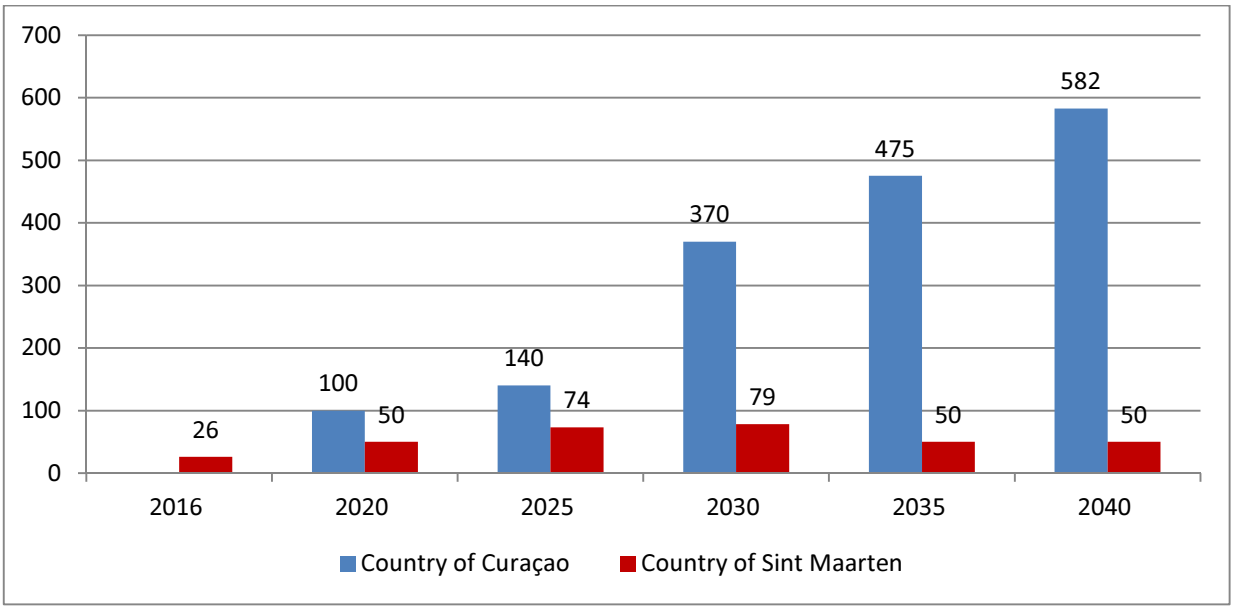
As indicated in graph 3, the outstanding securities issued by Curacao and Sint Maarten were almost entirely in the portfolio of the Dutch State Treasury Agency (99%). Local investors considered the coupons and yields too low for their investment appetite. Most institutional investors demand a return of at least 4% on their investments. However, because of the subscription of the Dutch State Treasury Agency, the bonds carried the prevailing yield in the Dutch capital market.

Graph 3 Government bond holdings as per December 31, 2012 (in millions NAf.)



Graph 4 provides an overview of the amounts of outstanding bonds of the governments of Curaçao and Sint Maarten that will mature up to 2040.

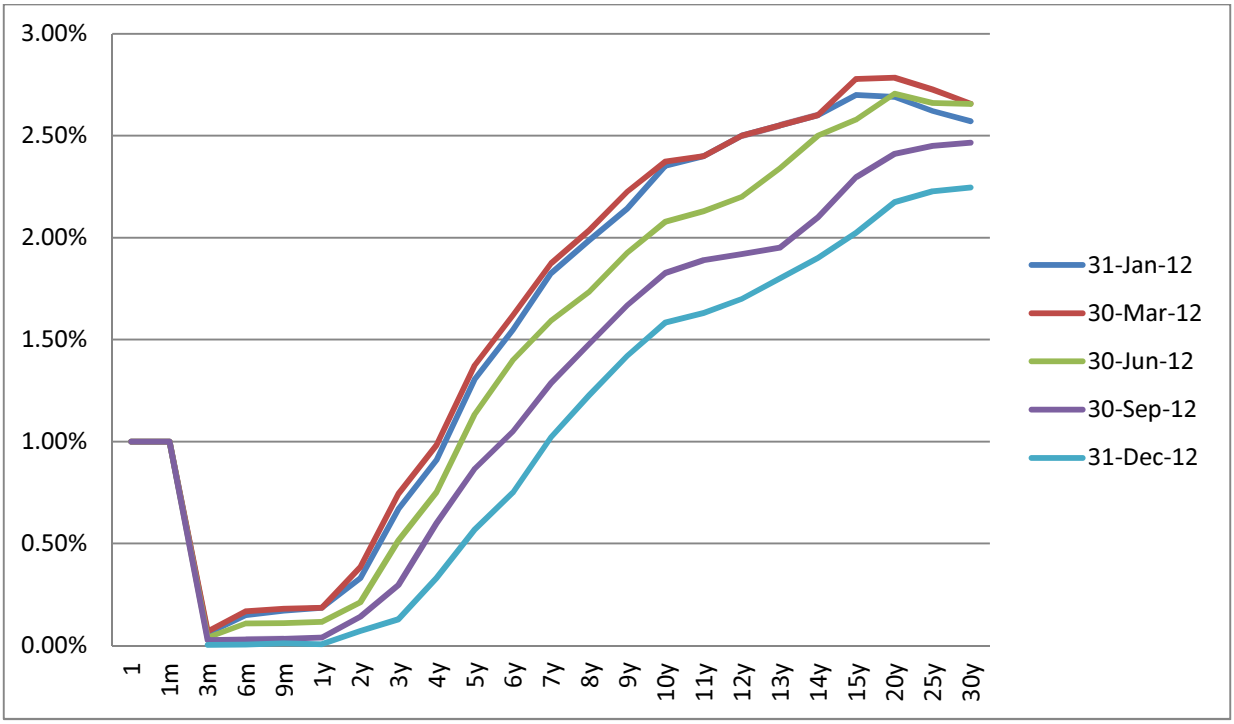
Graph 4 Maturity schedule for government bonds (in millions NAf.)



4.5 Domestic yield curve developments

The local yield curve experienced a downward shift during 2012 (see Graph 5). The decline in interest rates in the Netherlands and the excess liquidity in the local financial market due to the debt relief by the Dutch government contributed to the lower yields.

Graph 5 Development in the yield curve for local government securities



5 INSTITUTIONAL INVESTORS

5.1 Introduction

In 2012, the Bank continued working on its new supervisory approach, whereby supervision will be done based on a risk-based approach in the insurance industry. Using this new approach, the Bank will carry out periodic risk-focused onsite examinations, during which the Bank will evaluate the insurer's corporate governance, management oversight, and financial strength.

The examinations contain procedures to identify and assess risk and to assess the adequacy and effectiveness of strategies/controls used to mitigate risk. During the examination, the Bank will evaluate the insurer's current strengths and weaknesses (e.g., board of directors, board of supervisory directors, risk-management processes, audit function, information technology, and compliance with applicable laws and regulations) and prospective risk indications (e.g., business growth, earnings, capital, management competency and succession, and future challenges). The Bank will document the results of the examination in a report, including required corrective actions and recommendations.

For the insurers under its supervision, the Bank will develop a supervisory plan using the results of recent examinations and the annual financial reporting analysis to determine the type of surveillance and the necessary resources to be dedicated to the oversight. The Bank also will document appropriate future supervisory plans for each insurer (e.g., frequency of reporting, key areas for financial monitoring, and additional examinations).

The National Ordinance on Insurance Supervision (N.G. 1990, no. 77) requires that all insurance companies doing business in or through Curaçao and Sint Maarten file annual statements with the Bank. These statements must provide a clear picture of the insurance business that was conducted by the insurer and its financial position. In 2012, the Bank continued working on the valuation guidelines for the annual statements for the life and nonlife insurers. The insurers will have to apply these valuation guidelines in the reporting of their 2013 financial figures.

In 2012, the Bank also continued working on the development of new reporting forms for the pension funds under its supervision. The new reporting forms will be discussed with the pension industry prior to introducing them formally.

5.2 The institutional investors' sector

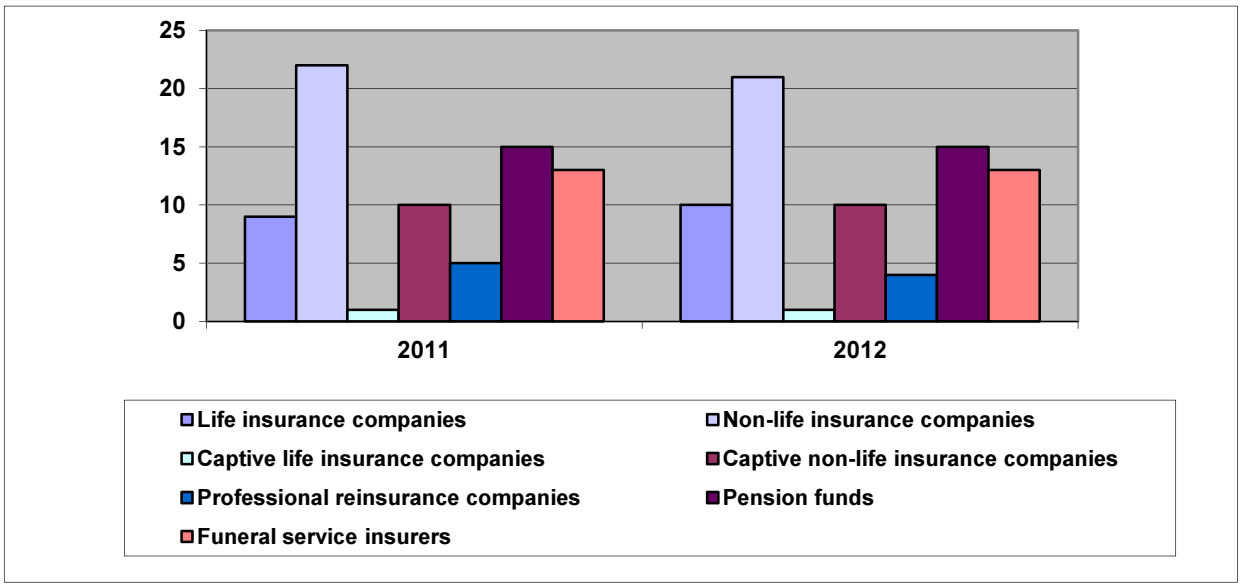
The number of institutional investors operating in Curaçao and Sint Maarten at the end of 2012 was 59 (2011: 59): 10 life insurance companies (2011: 9), 21 non-life insurance companies (2011: 22), 13 funeral service insurers (2011: 13), and 15 pension funds (2011: 15).

The number of insurance companies servicing the international market was 15 at the end of 2012 (2011: 16): one was involved in the life insurance business, 10 in the non-life business, and 4 were professional reinsurers (see Graph 6).

Graph 6 does not include insurance companies and pension funds in the process of liquidation. However, these institutions remain subject to the Bank's supervision until they are completely liquidated.

At the end of 2012, the number of insurance intermediaries registered with the Bank was 61, and one application was in process.

Graph 6 Composition of the institutional investors' sector (number of companies)



5.3 Life insurance industry

5.3.1 Balance sheet

According to Table 22, the total assets of the local life insurance sector increased by NAf.118.7 million (5.3%) in 2011, reaching over NAf.2.3 billion. The equity position of the local life insurance companies, consisting of capital, surplus, and subordinated instruments increased by NAf.29.4 million (11.3%) in 2011. This increase was driven mainly by the sector's net profit of NAf.36.8 million in 2011 (see Table 23).

In 2011, the solvency requirement of the local life insurance sector on a consolidated basis was NAf.61.3 million, while the equity available to cover the solvency requirement amounted to NAf.288.8 million. Based on these figures, the sector had a solvency surplus of NAf.227.5 million. In 2011, all local life insurance companies complied with the solvency requirement stipulated in the National Ordinance Insurance Supervision.

The total assets of the international life insurance companies (i.e., captive insurance companies and professional reinsurers) decreased significantly by NAf.68.7 million (68.2%) in 2011. This decrease was due to the termination of the reinsurance activities by a professional reinsurer. The solvency requirement of the international life insurance sector on a consolidated basis amounted to NAf.1.4 million in 2011. The equity available to cover the solvency requirement was NAf.12.3 million, resulting in a solvency surplus of NAf.10.9 million.

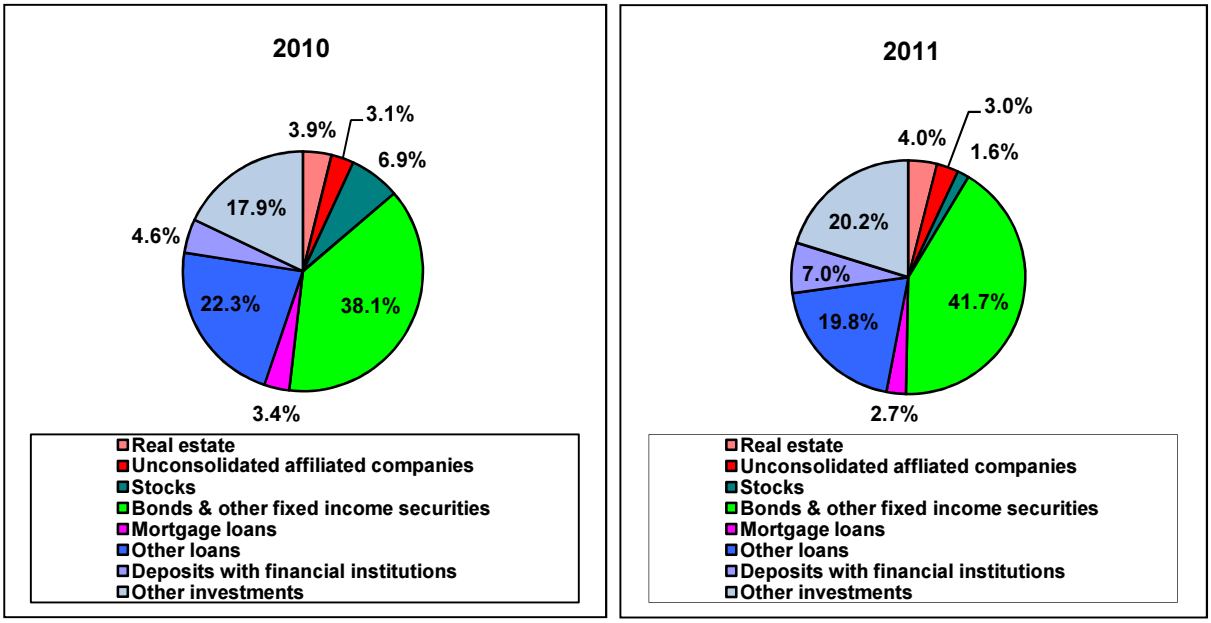
Table 22 Consolidated balance sheet of the life insurance sector (in millions NAf.)

	2009		2010		2011	
	Local	Int'l	Local	Int'l	Local	Int'l
ASSETS						
Intangibles	1.2	-	1.2	-	1.0	-
Total investments	1,653.1	82.4	1,774.3	95.1	2,007.0	24.7
Current assets	183.8	9.4	190.7	5.6	244.2	7.3
Other assets	44.2	-	50.1	-	55.3	-
From separate accounts statement	199.1	-	212.5	-	40.0	-
Total admissible assets	2,081.4	91.8	2,228.8	100.7	2,347.5	32.0
EQUITY, PROVISIONS, AND LIABILITIES						
Capital	80.9	1.0	80.9	1.0	86.1	0.5
Surplus	155.7	8.7	179.1	17.0	203.3	11.9
Subordinated instruments	0.4	-	0.4	-	0.4	-
Technical provisions	1,574.3	80.1	1,684.1	82.1	1,946.5	17.3
Current liabilities	55.0	3.6	51.3	2.6	57.6	2.3
Other liabilities	6.1	-1.6	9.7	-2.0	4.4	-
Contingent liabilities	9.9	-	10.8	-	9.2	-
From separate accounts statement	199.1	-	212.5	-	40.0	-
Total equity, provisions, and liabilities	2,081.4	91.8	2,228.8	100.7	2,347.5	32.0

5.3.2 Investments

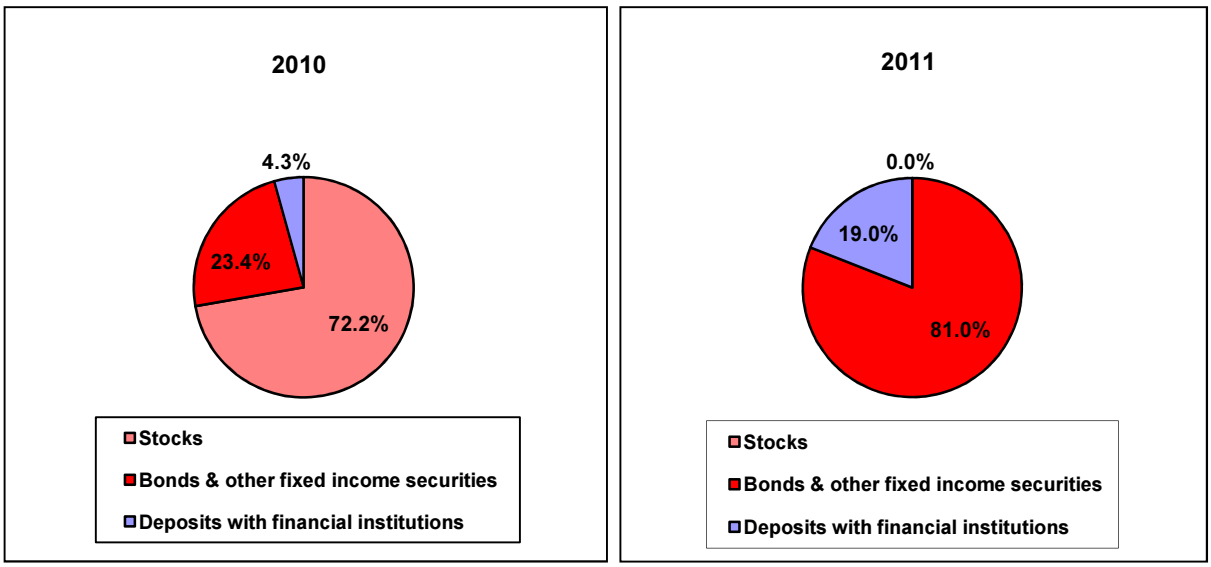
Total investments of the local life insurance sector increased by NAf.232.7 million (13.1%) in 2011. The composition of the consolidated 2010 and 2011 investment portfolios of the local life insurance companies is presented in Graph 7. This graph indicates that major changes took place in the shares of stocks, bonds & other fixed income securities, other loans, deposits with financial institutions, and other investments from 2010 to 2011. The proportion of stocks and other loans decreased by 5.3 and 2.5 percentage points, respectively, to the benefit of investments in bonds & other fixed income securities, deposits with financial institutions, and other investments, which increased by 3.6, 2.4, and 2.3 percentage points, respectively.

Graph 7 Composition of the investment portfolio of the local life insurance sector



The composition of the consolidated 2010 and 2011 investment portfolios of the international life insurance companies is presented in Graph 8. This investment portfolio is not as diversified as that of the local life insurance companies. In 2011, it consisted only of bonds & other fixed income securities and deposits with financial institutions.

Graph 8 Composition of the investment portfolio of the international life insurance sector



5.3.3 Profit and loss statement

The operating results of the life insurance industry are presented in Table 23. As can be seen, total net premium income of the local life insurance companies increased by NAf.37.5 million (19.6%), contributing mainly to the higher operational income of NAf.351.5 million in 2011. Operational expenditures increased also, by NAf.47.7 million (17.4%) to NAf.321.3 million in 2011. The sector ended 2011 with a net profit of NAf.36.8 million, NAf.1.5 million (3.9%) less than in 2010.

As fewer international life insurance companies were operational in 2011, total net premium income of this sector decreased by NAf.4.9 million (47.1%). On the other hand, operational expenditures decreased by only NAf.0.4 million. The international life insurance sector ended with a net loss of NAf.0.3 million in 2011, a substantial deterioration compared to 2010's net profit of NAf.9.4 million.

Table 23 Consolidated profit and loss statement of the life insurance sector (in millions NAf.)

	2009		2010		2011	
	Local	Int'l	Local	Int'l	Local	Int'l
INCOME						
Total net premium income	176.2	8.2	191.4	10.4	228.9	5.5
Net investment income and realized capital gains and losses	118.5	1.6	112.5	-0.3	118.8	1.1
Net other operational income	0.2	0.1	5.8	0.1	3.8	-
Total operational income	294.9	9.9	309.7	10.2	351.5	6.6
EXPENSES						
Net benefits incurred	99.9	4.9	103.4	4.3	116.8	4.3
Changes in net technical provisions	101.2	4.5	97.5	5.8	140.4	-
Net operational expenditures	53.3	0.8	58.1	0.8	52.7	0.7
Net other operational expenditures	0.9	0.1	1.1	0.1	1.1	-
Other changes affecting net results	-	-0.1	0.8	-0.1	0.1	-
Profit-sharing to policyholders	9.2	0.8	12.7	-3.8	10.2	1.7
Total operational expenditures	264.5	11.0	273.6	7.1	321.3	6.7
Extraordinary results	-0.8	-	2.3	-	-1.2	-
Net operational result before corporate taxes and before net results from separate accounts	29.6	-1.1	38.4	3.1	29.0	-0.1
Corporate taxes	8.0	0.1	10.6	0.2	2.9	0.2
Net operational result after corporate taxes and before net results from separate accounts	21.6	-1.2	27.8	2.9	26.1	-0.3
Net result from separate accounts	-2.1	-	4.5	-	0.7	-
Net operational result	19.5	-1.2	32.3	2.9	26.8	-0.3
Net unrealized gains or losses	9.4	10.3	6.0	6.5	10.0	-
Net profit or loss	28.8	9.1	38.3	9.4	36.8	-0.3

Graph 9 presents an overview of the consolidated net profit and loss (net results) of the local life insurance companies during the period 2002-2011. As shown in the graph, 2010 was a record year for the sector's profitability, followed by 2011.

Graph 9 Net results after corporate taxes of the local life insurance sector (in millions NAf.)

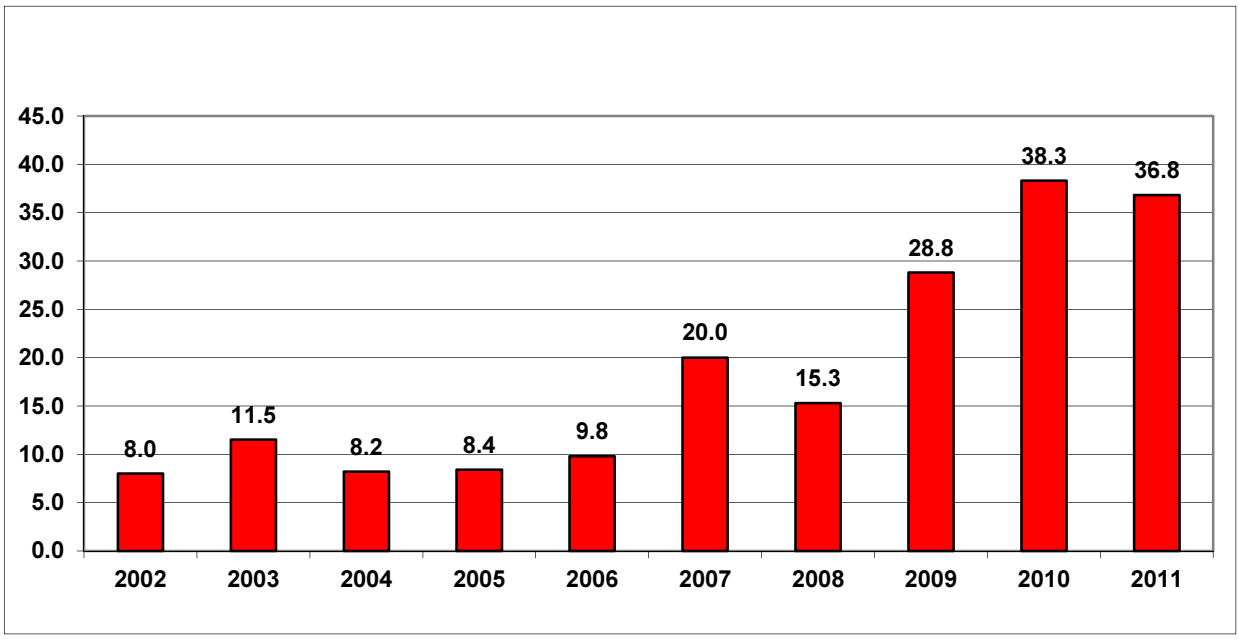


Table 24 shows the distribution of the operational result by line of business of the local life insurance companies in 2011. The individual life insurance business was the biggest contributor to the consolidated net operational result of NAf.26.8 million in 2011. Even though the group life insurance business reported the highest operational income compared to the other two lines of business, it ended up with a net operational loss in 2011 because a major part of total income was allocated to the technical provisions.

Table 24 Consolidated operational result by line of business of the local life insurance companies (in millions NAf.)

	Life insurance		Accident & sickness	Total
	Individual	Group		
INCOME				
Total net premium income	120.1	102.3	6.5	228.9
Net investment income and realized capital gains or losses	46.5	72.3	-	118.8
Net other operational income	1.7	2.1	-	3.8
Total operational income	168.3	176.7	6.5	351.5
EXPENSES				
Net benefits incurred	71.3	42.6	2.9	116.8
Changes in technical provisions	30.2	110.5	-0.3	140.4
Net operational expenditures	34.4	16.2	2.1	52.7
Net other operational expenditures	0.6	0.5	-	1.1
Other changes affecting net results	0.1	-	-	0.1
Profit sharing to policyholders	3.0	7.2	-	10.2
Total operational expenditures	139.6	177.0	4.7	321.3
Extraordinary results	-0.4	-0.8	-	-1.2
Net operational results before corporate taxes and net results from separate accounts	28.3	-1.1	1.8	29.0
Corporate taxes incurred	0.6	2.2	0.1	2.9
Net operational results after corporate taxes and before net results from separate accounts	27.7	-3.3	1.7	26.1
Net result from separate accounts	1.9	-1.2	-	0.7
Net operational results	29.6	-4.5	1.7	26.8

5.4 The non-life insurance industry

5.4.1 Balance sheet

Table 25 reveals that in 2011, the aggregated balance sheet total of the local non-life insurance companies increased by NAf.77.8 million (15.9%) compared to 2010. The equity position, consisting of capital, surplus, and subordinated instruments increased by NAf.45.7 million (26.5%) in 2011. This increase was driven mainly by the sector's net profit of NAf.35.3 million and an additional paid-in capital by a non-life insurance company in 2011 (see Table 25).

The solvency requirement of the local non-life insurance sector on a consolidated basis was NAf.49.6 million in 2011, while the equity available to cover the solvency requirement was NAf.218.0 million. Based on these figures, the sector reported a solvency surplus of NAf.168.4 million. In 2011, with the exception of one company, all local non-life insurance companies complied with the solvency requirement as stipulated in the National Ordinance Insurance Supervision.

The non-life insurance companies servicing the international market (captive insurance companies and professional reinsurers) reported total assets of NAf.3,687.8 million in 2011, an increase of NAf.222.7 million (6.4%) compared to 2010. Equity, consisting of capital and surplus, increased by NAf.99.5 million (5.3%) in 2011. This increase was driven mainly by the sector's net profit of NAf.194.9 million in 2011 (see Table 25).

The international non-life insurance sector reported a solvency surplus of NAf.1.9 billion in 2011, an increase of NAf.100 million compared to the solvency surplus in 2010.

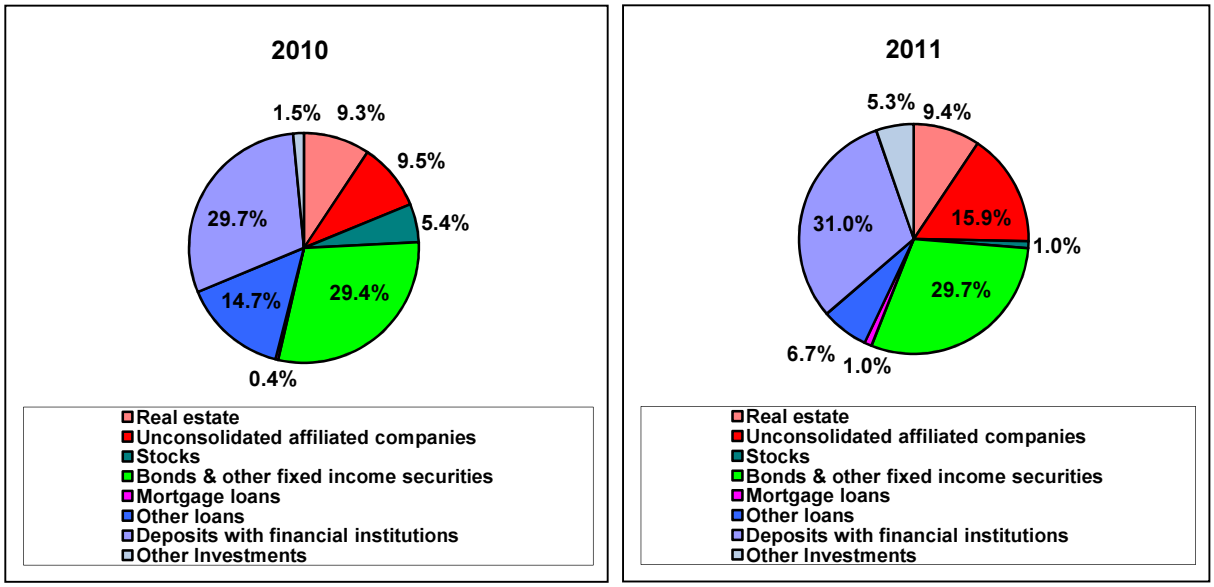
Table 25 Consolidated balance sheet of the non-life insurance industry (in millions NAf.)

	2009		2010		2011	
	Local	**Int'l**	**Local**	**Int'l**	**Local**	**Int'l**
ASSETS						
Intangibles	0.9	-	0.2	-	0.1	-
Total investments	293.2	3,535.6	295.2	2,957.2	328.4	2,812.8
Current assets	130.0	458.0	155.3	507.9	182.5	823.0
Other assets	8.8	-	39.4	-	57.0	52.0
Total admissible assets	433.0	3,993.6	490.1	3,465.1	567.9	3,687.8
EQUITY, PROVISIONS, AND LIABILITIES						
Capital	98.3	392.8	99.1	434.0	116.4	436.6
Surplus	68.8	2,120.0	71.8	1,457.5	100.1	1,554.4
Subordinated instruments	1.4	-	1.5	-	1.6	-
Technical provisions	174.4	1,424.5	193.5	1,524.8	189.0	1,634.6
Other provisions & liabilities	19.3	8.4	17.1	1.5	11.8	6.1
Current liabilities	70.7	47.8	107.0	47.3	149.0	56.1
Contingent liabilities	0.1	-	0.1	-	-	-
Total equity, provisions, and liabilities	433.0	3,993.6	490.1	3,465.1	567.9	3,687.8

5.4.2 Investments

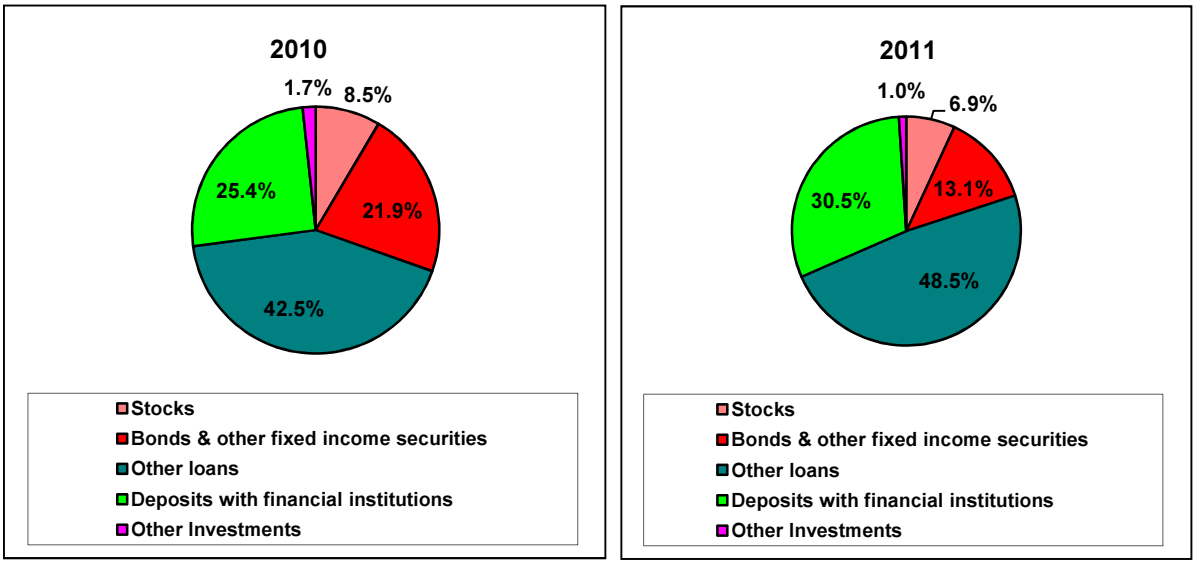
The composition of the investment portfolio of the local non-life insurance companies is presented in Graph 10. This graph indicates that the major changes took place in the shares of unconsolidated affiliated companies, stocks, other loans, and other investments from 2010 to 2011. The proportion of stocks and other loans decreased by 4.4 and 8.0 percentage points, respectively, to the benefit of investments in unconsolidated affiliated companies and other investments, which increased by 6.4 and 3.8 percentage points, respectively.

Graph 10 Composition of the investment portfolio of the local non-life insurance companies



The composition of the investment portfolio of the international non-life insurance companies is illustrated in Graph 11. This graph indicates that a shift took place from investments in bonds & other fixed income securities to investments in other loans and deposits with financial institutions. The proportion of investments in bonds & other fixed income securities decreased by 8.8 percentage points, while the proportion of investments in other loans and deposits with financial institutions increased by 6.0 and 5.1 percentage points, respectively, from 2010 to 2011.

Graph 11 Composition of the investment portfolio of the international non-life insurance companies



5.4.3 Profit and loss statement

Table 26 presents the operational results for the non-life insurance industry. The net earned premium of the local non-life insurance industry decreased marginally by NAf.3.3 million in 2011. On the other hand, operational expenditures decreased significantly by NAf.29.2 million (10.8%) primarily due to fewer claims incurred in 2011 compared to 2010. In 2011, the local non-life insurance sector was not confronted with major claims from catastrophes. The sector reported a positive underwriting result of NAf.16.3 million. Together with the investment income and other results, a net profit of NAf.35.3 million for the industry was recorded in 2011.

The international non-life insurance companies reported a net profit of NAf.194.9 million in 2011, a decrease of NAf.133.8 million (40.7%) compared to 2010. The lower profit resulted mainly from an increase of NAf.95.1 million in operational expenditures and a turnaround in net unrealized gains or losses.

Table 26 Consolidated profit and loss statement of the non-life insurance industry (in millions NAf.)

	2009		2010		2011	
	Local	Int'l	Local	Int'l	Local	Int'l
INCOME						
Total net earned premium	258.1	609.4	259.7	504.4	256.4	608.6
Net other underwriting income	1.9	5.1	-3.2	8.2	1.1	13.3
Total operational income	260.0	614.5	256.5	512.6	257.5	621.9
EXPENSES						
Net claims incurred	124.8	275.9	143.2	286.5	123.3	334.4
Claim adjustment expenses	5.6	2.5	6.9	1.2	6.8	1.6
Changes in various provisions	1.7	-10.3	1.8	3.6	1.9	34.0
Underwriting expenses incurred	111.6	31.8	116.3	27.4	110.0	63.5
Net other operational expenditures	1.1	7.1	2.2	7.8	-0.8	-11.9
Total operational expenditures	244.8	307.0	270.4	326.5	241.2	421.6
Underwriting result	15.2	307.5	-13.9	186.1	16.3	200.3
Net investment income	15.4	135.1	15.2	75.5	15.8	54.2
Other results	-3.9	4.5	0.9	19.2	5.8	-7.7
Extraordinary results	-	0.3	17.6	2.6	0.3	6.6
Net result before corporate taxes	26.7	447.4	19.8	283.4	38.2	253.4
Corporate taxes incurred	4.4	10.6	1.7	12.6	3.4	15.1
Net unrealized gains or losses	-0.3	91.7	-	57.9	0.5	-43.4
Net profit or loss	22.0	528.5	18.1	328.7	35.3	194.9

Graph 12 presents an overview of the consolidated net results of the local non-life insurance companies from 2002 to 2011 and indicates that 2011 was a record year for the sector's profitability.

Graph 12 Net results after corporate taxes of the local non-life insurance sector (in millions NAf.)

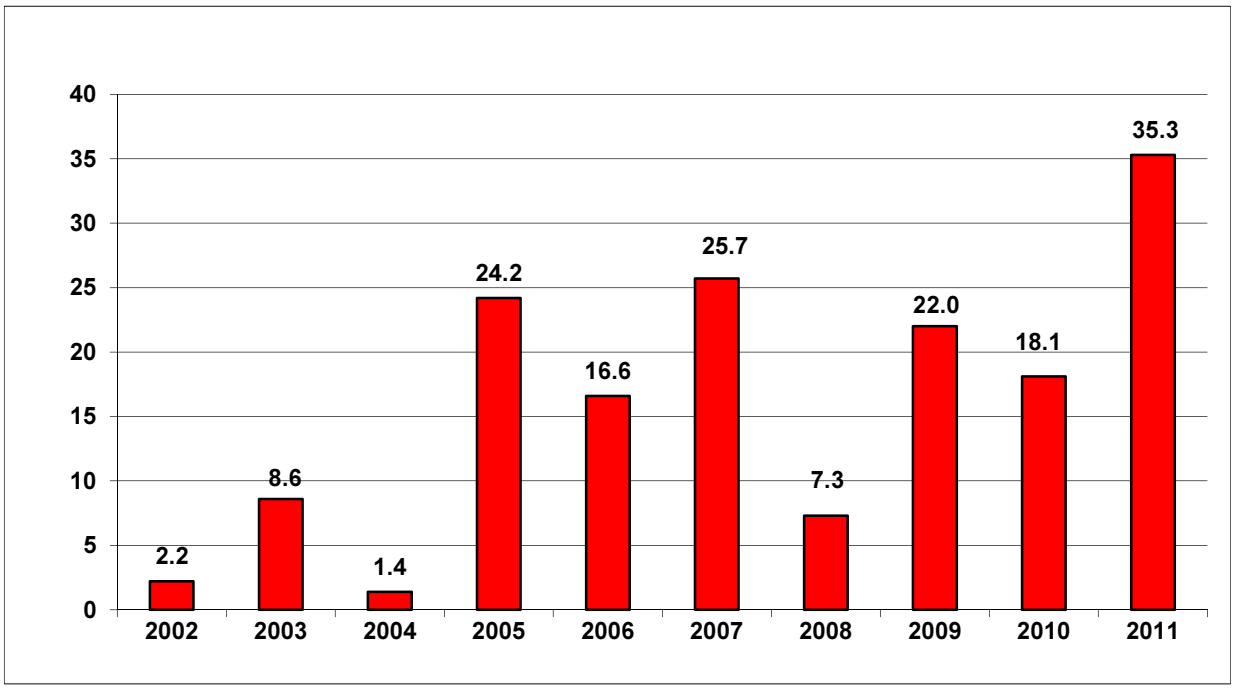


Table 27 shows the distribution of the operational results of the locally operating non-life insurance companies by indemnity group for the year 2011. While the motor vehicle line of business reported the highest operational income compared to the other four lines of business, it ended with a net loss of NAf.0.5 million, due mainly to the relatively high level of claims incurred and underwriting expenses.

Table 27 Consolidated operational result by indemnity groups of the local non-life insurance industry (in millions NAf.)

	Accident & sickness	Motor vehicle	Marine, transit & aviation	Property	Others	Total
INCOME						
Net earned premium	84.4	87.0	3.8	76.3	4.9	256.4
Net other underwriting income	-	-	-	0.1	1.0	1.1
Total operational income	84.4	87.0	3.8	76.4	5.9	257.5
EXPENSES						
Net claims incurred	56.0	51.9	0.6	13.6	1.2	123.3
Claim adjustment expenses	2.2	2.2	0.1	2.1	0.2	6.8
Changes in various provisions	1.9	-	-	-	-	1.9
Underwriting expenses incurred	26.6	38.7	1.9	40.0	2.8	110.0
Net other operational expenditures	-0.1	-0.4	-	-0.2	-0.1	-0.8
Total operational expenditures	86.6	92.4	2.6	55.5	4.1	241.2
Underwriting result	-2.2	-5.4	1.2	20.9	1.8	16.3
Net investment income	7.2	3.1	-	5.4	0.1	15.8
Other results	2.2	2.2	0.1	1.2	0.1	5.8
Extraordinary results	0.2	0.1	-	-	-	0.3
Net result before corporate taxes	7.4	-	1.3	27.5	2.0	38.2
Corporate taxes incurred	1.6	0.5	-	1.0	0.3	3.4
Net operational results after taxes	5.8	-0.5	1.3	26.5	1.7	34.8

5.5 Overview of developments in the pension industry

5.5.1 Balance sheet

The 2011 consolidated financial figures for the pension industry show a coverage ratio of 95% (investments-to-provisions for pension obligations), which is below the required minimum of 100%. This ratio may differ from fund to fund depending on the specific circumstances of each fund, such as the average age of the participants in the fund and the financial strength of the sponsor and, therefore, may or may not be reason for supervisory concern or for the Bank to take measures. Nevertheless, the coverage ratio improved by 7 percentage points in 2011 compared to 2010. This improvement was due to an increase of NAf.534.0 million (9.6%), in investments while the provisions for pension obligations increased by only NAf.116.2 million (1.8%) in 2011. The Bank closely monitors the pension funds with a coverage ratio below the 100% threshold. (See Table 28)

Table 28 Consolidated balance sheet of the pension industry (in millions NAf.)

	2009	2010	2011
Assets			
Total investments	5,471.4	5,568.1	6,102.1
Current assets	920.7	1,221.2	518.6
Other assets	17.3	14.1	267.6
Total	**6,409.4**	**6,803.4**	**6,888.3**
Equity, provisions, and liabilities			
Equity	223.6	276.3	178.7
Provisions for pension obligations	6,010.7	6,337.6	6,453.8
Current liabilities	175.1	189.5	255.8
Total	**6,409.4**	**6,803.4**	**6,888.3**

5.5.2 Profit and loss statement

The pension industry reported a net investment income and capital gains & losses of NAf. 345.9 million in 2011, which is equal to 5.4% of the provisions for pension obligations (see Table 29). The objective of most pension funds is to realize an investment return of at least 4% of the provisions for pension obligations to meet their future financial obligations.

The pension industry reported a loss of NAf.55.1 million for the year 2011, due mainly to lower net investment income and higher pension benefits incurred and allocations to technical provisions.

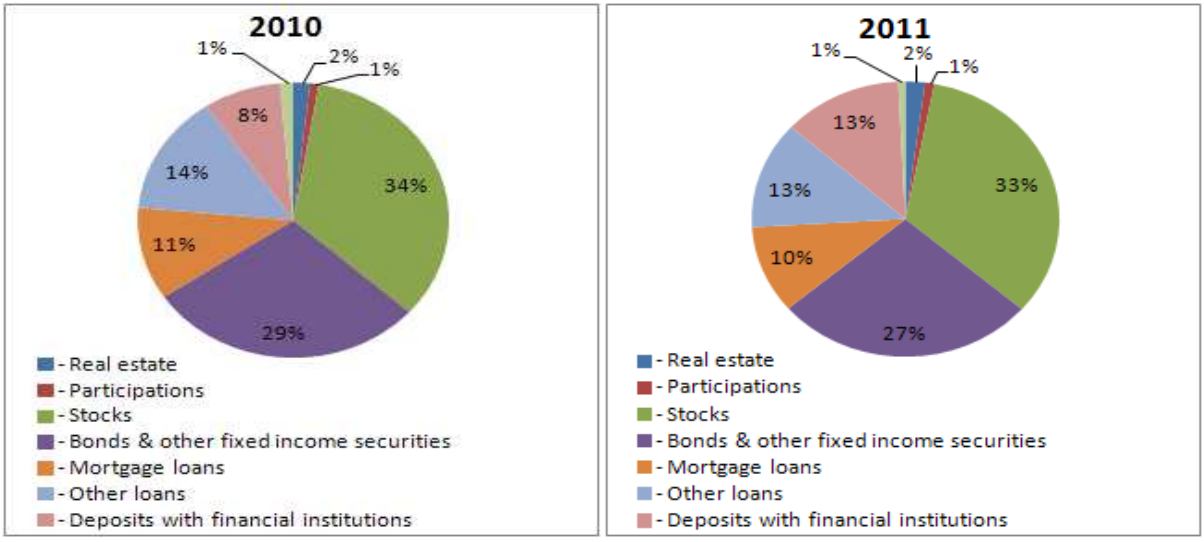
Table 29 Consolidated profit and loss statement of the pension industry (in millions NAf.)

	2009	2010	2011
Income			
Contributions	224.2	193.7	250.1
Net investment income and capital gains and losses	523.3	429.9	345.9
Other income	30.5	19.5	42.3
Total income	**778.0**	**643.1**	**638.3**
Expenses			
Pension benefits incurred	227.4	206.6	280.0
Change in net technical provisions	308.3	338.7	360.4
Operational expenses incurred	27.9	25.5	39.9
Other expenses incurred	9.5	4.3	13.0
Total expenses	**573.1**	**575.1**	**693.3**
Extraordinary results	-	2.1	-0.1
Net profit or loss	**204.9**	**70.1**	**-55.1**

5.5.3 Investments

The composition of the investment portfolio of the pension funds is presented in Graph 12. The graph indicates that only minor changes took place in the investment portfolio of the pension industry in 2011 compared to 2010.

Graph 13 Composition of the investment portfolio of the pension industry



6 SUPERVISORY POLICIES AND ACTIVITIES OF THE BANK

6.1 Supervision of trust service providers

The Bank has been entrusted with the supervision of the trust sector since the beginning of 2004. In 2012, the number of trust service providers with a license was 88, down slightly from 94 in 2011. The number of trust service providers with a dispensation remained stable at 118. As a result, the Bank had a total of 206 approved trust service providers under its supervision at the end of 2012.

In 2012, the bank maintained its high qualitative and quantitative risk-based selection criteria to perform supervision. The Bank made 19 formal visits to entities within the sector: 9 onsite investigations and 10 management meetings. Of those 19 visits, 16 were at trust service providers. In addition, the department held 60 meetings with stakeholders from within the sector at the Bank itself; about 20 of them were with trust service providers.

6.2 Supervision of investment institutions and administrators

Investment institutions and administrators have been subject to supervision by the Bank since the beginning of 2003. The number of supervised investment institutions and administrators dropped slightly to 32 entities in 2012. The Bank conducted 3 visits at investment institutions and administrators during 2012, 1 onsite investigation and 2 management meetings.

6.3 Supervision of securities exchange

The supervision of the securities exchange started in March 2010 when the exchange received its license. The exchange had reached 14 listings and one trading in 2012. During 2012, 3 formal meetings were held with the securities exchange: one onsite visit and two meetings.

6.4 Supervision of banks and credit institutions

In 2012, the draft legislation to harmonize and to update prevailing supervision laws and the draft legislation on the supervision of money transfer companies continued in the legislative process.

The possibility of imposing fines and penalties on banks for noncompliance with laws, regulations, and requirements was included in the draft Harmonization and Actualization of Supervision Ordinances of Curaçao and Sint Maarten. This addition comes on top of the already existing possibility for the imposition of fines for the late submission of prudential reports and the violation of the AML/CFT legislation and provisions & guidelines.

The draft harmonization and actualization legislation addresses some of the comments made by the IMF in its OFC Assessment of the Supervision and Regulation of the Financial Sector. This law, when executed, will enable the Bank to more effectively execute its supervisory tasks.

The Bank is concluding a new Chart of Accounts reporting system (NCOA) for credit institutions based on comments received from the banking sector and from internal reviews. Plans are for the NCOA to be implemented on January 1, 2015. In principle, the NCOA will be based on IFRS and the Basel II framework, while reporting will be on a gross basis. The NCOA will apply to both locally operating and internationally operating banks. The development of the software is being done in cooperation with the Centrale Bank van Aruba.

A proposal for the introduction of a Dutch Caribbean Deposit Insurance System for the local banking sector of Curaçao, Sint Maarten, and the BES islands13 was presented to the respective bankers' associations on October 1, 2009. Extensive deliberations within the working group resulted in a Memorandum of Understanding on the Implementation of a Dutch Caribbean Deposit Insurance System, which was signed in the first quarter of 2011 by the CBCS as the supervisory authority for Curaçao and Sint Maarten, the Dutch central bank as the supervisory authority for the BES islands, and the bankers' associations of the locally active banks in Curaçao, Sint Maarten, and the BES islands.

A proposal for the introduction of a Deposit Insurance System for the credit unions of Curaçao and Sint Maarten was presented to the association of credit unions on November 9, 2009, for comments. Since no comments were provided by October 31, 2012, the Ministers of Finance of both Curaçao and Sint Maarten were informed accordingly. They now will have to proceed to introduce a deposit insurance system for the credit unions of Curaçao and Sint Maarten pursuant to article 39, paragraph 2 of the Banking Supervision Act.

The banking supervision department continued to refine its risk-based supervision approach, which will allow the examiners to focus on the higher risk areas. Furthermore, the department continued to monitor closely the way the international banks coped with the effects of the global financial crisis.

In 2012, 22 onsite examinations were conducted at institutions operating with either a license or a dispensation from the Bank. Ten limited reviews were conducted: one at a local general bank, one at a subsidiary of a foreign bank, one at a specialized credit institution, three at non-consolidated international banks, and four at consolidated international banks. Three targeted examinations were conducted: two at money transfer companies and one at a nonconsolidated international bank. One full-scope examination was performed at a credit union. The banking supervision department also conducted four quick-scan examinations: two at institutions that recently obtained a license from the Bank, one at a credit union, and one at a saving and credit fund. Furthermore, four follow-up reviews were conducted: two at credit unions, one at a specialized credit institution, and one at a nonconsolidated international bank.

On December 29, 2011, the Bank issued a license to PSB Bank N.V. The institution is registered as a savings bank. Furthermore, the emergency measure on SFT Bank N.V was released on February 3, 2012 and the Bank subsequently issued a new license to SFT Bank N.V. on February 6, 2012. SFT Bank N.V. is registered as a local general bank.

6.5 Supervision of institutional investors and insurance intermediaries

An important objective of the Bank's supervision of the financial sector is to promote the stability of the financial system of Curacao and Sint Maarten. The Bank deems it imperative that its supervisory regime be conducive to the application of the risk-based approach to achieve this objective. Staff training and customizing of the software to support the risk-based supervision process continued in 2012. The Bank intends to fully apply the risk-based supervision approach at the end of 2013 or early 2014.

The Bank presented the sector with draft valuation guidelines for the completion of the Annual Reporting Automated System (ARAS) for the insurance industry. Based on comments received from the sector, a committee consisting of representatives of both the Bank and the sector was

[13] Bonaire, Sint Eustatius, and Saba.

established to further discuss the draft guidelines. The committee met several times and its recommendations led to changes in both the guidelines and the ARAS. It is expected that these new valuation guidelines together with the adjusted ARAS system will be used to complete the 2013 financial figures. In the meantime, a pilot group of insurers will be selected to use the new guidelines for their 2012 reporting to the Bank.

Currently, insurance companies and pension funds are legally required to report on an annual basis. The Bank is evaluating the possibility of increasing the frequency of reporting in the future, a move that may require legislative changes.

The Bank has been working to develop a new reporting format for the pension industry. This new format allows for the reporting of more financial information by the pension funds to the Bank and provides a uniform method for calculating the coverage ratio. The intention is to send the statements in the new format to the pension funds in the second half of 2013 for their comments. Once finalized, the new statements must be used for future reporting to the Bank. The reporting for the financial year 2013 is intended to serve as a pilot.

In 2012, 18 onsite examinations were conducted at supervised institutions, 3 of them at general insurance companies, 2 at funeral insurers, and 13 at insurance intermediaries.

Compliance with the Anti-Money Laundering and Combating Terrorist Financing (AML/CTF) regulations and guidelines and also with the National Ordinance Identification when Rendering Financial Services (LIF) continued to be an important part of the examinations conducted. The Bank will keep devoting its attention to this compliance in its future examinations.

To promote a closer relationship between the Bank and the institutions under its supervision, the Bank initiated regular supervisory meetings with the Board of Directors of these institutions. These meetings included discussions on various issues, some of which led to new supervisory measures by the Bank. Issues discussed focused on, for example, the financial position and financial strength of the supervised institution, the quality of corporate governance within an institution, the reinsurance program, and the investment policy.

In anticipation of the harmonized legislation, the Bank will develop new guidelines, including among other things, in the area of market conduct. To promote a level playing field between the countries within the Dutch Kingdom, the Bank will develop guidelines in line with the supervision of market conduct exercised by the Dutch financial markets authority (AFM) in Bonaire, Sint Eustatius, and Saba (BES islands). In this context, some of the Bank's examiners participated in market conduct examinations performed by the AFM on the BES islands in 2012. Furthermore, the Bank will focus primarily on the following aspects of market conduct by the financial institutions under its supervision:

- to provide adequate information to customers;
- to grant responsible credit arrangements;
- to provide appropriate advice on services;
- to prohibit tied selling; and
- to provide for adequate handling of complaints.

In 2012, the Bank drafted two sets of guidelines: "Provisions on Preventing Overextension of Credit" and "Provisions on the Disclosure of Pricing Information on Consumer Credit". These provisions will soon be submitted to the financial sector for comments. The Bank will address all other aspects of issues regarding market conduct at a later time.

The Bank is an active member of international standard-setting bodies such as the International Association of Insurance Supervisors (IAIS), the Offshore Group of Insurance Supervisors (OGIS), the Financial Action Task Force (FATF), and the Organization for Economic Co-operation and Development (OECD). These organizations play an important role in developing supervisory standards that their members must comply with in order to enhance their supervisory regimes.

6.6 Integrity aspects of financial sector supervision

The number of (co-)policymakers and holders of qualifying interests recorded in the Integrity Financial Sector Register increased further from 3,100 in 2011 to about 3,300 subjects in 2012.

The Bank made 10 international information requests and received, as part of the integrity testing, 49 information requests in 2012, all but 6 of which came from the supervisory authorities in the Netherlands regarding their supervised institutions on the BES islands. The Bank further registered 41 reported incidents eroding integrity: 12 cases were reported internally and 29 externally. The external incidents were pursuant mainly to the Policy Rule for Sound Business Operations in the Event of Incidents and Integrity-sensitive Positions.

In 2012, 24 accumulated cases with underlying reported incidents and accompanying integrity doubts were officially disclosed and dealt with by the Integrity Commission of the Bank. Two cases resulted in a negative test result because of serious doubts. In accordance with the Policy Rule on Integrity Testing and in the opinion of the Bank, these persons formed an impediment to discharging the position of (co)policymaker holding a qualifying interest, or obtaining a dispensation in pursuance of the Supervision Act. Two persons were in serious conflict with their employer and dismissed because of irregularities. After close consideration, five cases were settled with a positive test result, one of them after company consultations and corrective measures imposed by the Bank. Two cases remained in consideration for an eventual disqualification, but with increased risk monitoring and supervision by the Bank. The thirteen other cases remained, pending further investigation for a disqualification later on. The Bank made a specific information request to international authorities for additional information with respect to one case.

The Working Group HIT (Harmonization Integrity Supervision) presented its second report to the Technical Committee (TC) of Kingdom Supervisors at the end of 2012, containing specific recommendations to the central banks of Aruba, Curaçao and Sint Maarten, and the BES islands on how to harmonize (regulate) the integrity supervision in the Caribbean part of the Kingdom of the Netherlands. These findings cover the following areas: reporting obligations, sanctions, enforcement tools, confidentiality/information sharing, and rules for wire transfers. In accordance with the agreements made in the 2nd Technical Consultation Committee in October 2012, further steps will be taken to continue with the implementation of the previous recommendations of the Working Group, including risk-based supervision, methods of risk identification, standardization of procedures related to integrity testing, customer due diligence, sound and controlled business operations, and compliance with regulations to prevent money laundering and terrorist financing. The Working Group will pay specific attention to the elaboration of the suggestions contained in two constituent reports, the evaluation of their implementation, the FATF trends (typologies, experiences regarding evaluations), and cooperation regarding risk-based supervision and methods of risk identification. Meanwhile, a start has been made for further arrangements on information exchange with respect to the integrity testing on the BES islands.

In September 2012, the renewed "CBCS Regulation concerning the number of permitted (co-)

policymaking positions per person" went into effect. This regulation is supplementary to the CBCS Policy Regulation & Integrity Testing Questionnaire, and the CBCS Corporate Governance Guidance Notes (October 2001) and the Statement of Best Practices (November 2006), as issued in pursuance of the Supervision Act. This regulation includes an additional specific ruling regarding eventual conflict of interest when combining (co-)policymaking positions in the sector of investment companies, administrators, and trust service providers.

6.7 IT aspects of financial sector supervision

During 2012, the Bank performed regular IT examinations at 3 trust companies and 1 insurance company. In its continuous effort to promote and ensure safe and sound banking practices, the Bank also started with a special "Payment Systems Examination" at all institutions offering electronic payment services to retail and corporate customers. The objective of this IT examination was to identify and measure controls that mitigate information technology risks affecting the integrity of these payment services. In 2012, the examination was performed at 2 banks and 1 credit union.

One of the payment services included in this examination was the service offered to clients at gas stations. The Bank, therefore, also performed an examination at a gas station to inspect the physical and other security measures at the location and the security awareness of the personnel operating at the location.

In the first half of 2012, one IT auditor was assigned full-time to the task of customizing the risk-based software acquired by the Bank for the execution of IT examinations. The Payments Systems Examinations were used to test the application.

In June 2011, the Simplified version of the Supervised Institutions IT Questionnaire was introduced and institutions were required to report one of the questionnaires based on the scale of the institution. Until the end of 2012, completed questionnaires were received from 9 banks, 2 credit unions, 6 international banks, 2 specialized credit institutions, 5 insurance companies, 4 international insurance companies, 2 pension funds, and 24 trust companies.

Furthermore, meetings were conducted and correspondence was exchanged with different institutions with regard to the status of their implementation of the "Provisions and Guidelines for Information Security Management (ISM) and Business Continuity Management (BCM)."

6.8 International financial sector policy developments

Curaçao, as a member of the Financial Action Task Force (FATF) and the Caribbean Financial Action Task Force (CFATF), continued its efforts to implement the in February 2012 revised FATF recommendations to combat money laundering and the financing of terrorism and proliferation.[14] During 2012, both the National Committee on Money Laundering and Terrorist Financing (CIWG) and the Bank continued to implement the international standards set by the FATF. The Bank carries the presidency and the secretariat of the CIWG.

From August 22 to September 2, 2011, the CFATF conducted a Mutual Evaluation Assessment (MEA) to assess the anti-money laundering and the combating of financing of terrorism (AML/CFT) framework of Curaçao. The resulting draft Mutual Evaluation Report (MER) was discussed and adopted in the CFATF plenary meeting of May 2012 in San Salvador, El Salvador.

[14] Included in 2012.

The final MER was published on the CFATF website on June 25, 2012. The report's findings did not lead to Curacao's referral to the International Cooperation Review Group (ICRG). Curaçao complied with its first follow-up reporting requirements, and the CFATF Secretariat finished its first follow-up report on Curaçao on October 30, 2012. This first follow-up report was then adopted in the CFATF plenary meeting of November 2012 in Tortola, British Virgin Islands.

Furthermore, the CFATF conducted a MEA of the AML/CFT framework of Sint Maarten during March 19-30, 2012. The resulting draft MEA report was discussed and adopted in the CFATF plenary meeting of November 2012 in Tortola, British Virgin Islands. The findings in the MER led to Sint Maarten's referral to the ICRG for the preparation and monitoring of an action plan to accomplish a smooth remediation of the identified shortcomings.

The Bank has also placed FATF warnings on its website identifying countries that are not compliant with the international standards.

Finally, staff members of the Bank were actively involved in FATF and CFATF activities in 2012, underscoring the Bank's commitment to keep up with the latest AML/CFT developments.

7 FOREIGN EXCHANGE REGULATIONS AND THE LICENSE FEE

7.1 Introduction

The foreign exchange regulations in Curaçao and Sint Maarten are based on the Foreign Exchange Regulation of Curaçao and Sint Maarten (2010). Effective October 10, 2010, these two autonomous countries within the Kingdom of the Netherlands formed a monetary union with a common currency and central bank.

According to the foreign exchange regulation, current transactions are free in principle, while capital transactions require a license. Although capital transactions are bound by a license, the Bank has issued several foreign exchange notifications that have liberalized most capital transactions. The Bank applies a liberal licensing system with respect to capital transactions, i.e., licenses normally are granted upon request.

The main objectives of the foreign exchange regulation are to:

1. promote international financial activities in Curaçao and Sint Maarten; for this reason, the ordinance contains special provisions for companies engaged in international financial and business transactions;

2. gather the necessary information and data essential for compiling the balance of payments;

3. support the monetary and economic policy efforts of the monetary authorities whereby the maintenance and safeguarding of the monetary reserves and thus exchange rate stability are considered of primary importance; and

4. prevent the use of Antillean guilders as a means of payment in the international payment system.

The general foreign exchange policy is vested with the governments of Curaçao and Sint Maarten. The Bank is charged with executing the foreign exchange regulations and managing the available foreign exchange reserves for account and risk of both governments. Therefore, the Bank is empowered to grant licenses and exemptions by virtue of the Foreign Exchange Regulation of Curaçao and Sint Maarten (2010).

7.2 Foreign exchange licenses

In 2012, the number of foreign exchange licenses issued by the Bank dropped by 140 (12%) to 982 (see Table 30). This drop can be attributed primarily to fewer foreign exchange exemptions granted to international financial and business companies (109). In line with the fewer licenses issued, the total capital related to the granted licenses decreased by NAf.171.7 million (17%) to NAf.810.5 million. The decline in the value of licenses granted for intercompany financing was most pronounced (74%), followed by the category "Borrowing abroad" (29%). The value of licenses granted for portfolio investments abroad by institutional investors dropped slightly (3%) to the benefit of the purchase of local bonds[15] settled through foreign banks.

[15] Primarily a bond issued by the harbor of Sint Maarten.

Table 30 Overview of foreign exchange licenses issued (in numbers and millions NAf.)

	2011		2012	
Description	**Number**	**Amount**	**Number**	**Amount**
Participation in local company by nonresident	10	20.7	10	16.1
Transfer to own account abroad	38	69.3	47	71.6
Portfolio investment abroad	55	395.8	45	383.3
Purchase of local bonds through foreign banks	-	-	11	92.6
Participation abroad	1	0.2	5	15.8
Borrowing abroad	47	148.0	31	105.4
Lending abroad	56	58.3	48	44.7
Intercompany financing	67	268.6	28	70.1
Request for foreign bank account	82	-	97	-
Request for local nonresident account	12	-	7	-
Granting guarantee abroad	3	-	10	-
Exemption int. fin. & bus. serv. companies	689	-	580	-
Other	62	21.3	63	10.9
Total	1,122	982.2	982	810.5

7.3 License fee

Starting January 1, 1996, a fee was introduced for the license to operate as a foreign exchange bank. This license fee is assessed on the international transactions of foreign exchange banks and replaced the foreign exchange tax in force through December 1995. The license fee is calculated on the basis of the payments made by residents to nonresidents, with the exception of the re-investment of funds abroad, the re-exports of the free-zone companies, and payments by the government.[16] The Bank assesses and collects the license fee in Curaçao and Sint Maarten, the proceeds of which are remitted to the government of each country.

Table 31 License fees collected from 2010 through 2012 (in thousands NAf.)

	2010		2011		2012	
	Curacao	**St. Maarten**	**Curacao**	**St. Maarten**	**Curacao**	**St. Maarten**
January	3,667.9	2,064.6	4,408.6	2,056.2	3,787.4	2,075.5
February	3,791.1	1,851.9	3,544.3	2,013.6	3,856.1	2,486.3
March	4,206.8	2,256.5	4,987.8	2,288.6	4,526.4	2,089.2
April	3,875.1	1,849.4	3,506.9	1,873.7	3,743.8	1,890.6
May	5,025.4	1,969.1	4,802.9	1,916.5	4,461.8	1,976.4
June	4,250.8	1,775.8	4,381.5	1,958.8	4,586.8	1,720.7
July	4,044.1	1,936.1	4,258.7	1,556.4	4,474.4	1,698.9
August	5,391.3	1,608.6	4,266.7	1,741.1	4,505.1	1,687.7
September	4,507.7	1,848.7	4,392.0	1,682.7	3,895.5	1,550.5
October	4,204.8	1,654.7	4,172.9	1,641.3	4,187.0	1,660.0
November	4,093.8	1,856.5	6,434.4	1,732.3	5,395.1	2,673.9
December	4,731.3	2,380.7	4,770.8	3,081.3	5,211.2	2,345.7
Total	51,790.1	23,052.6	53,927.5	23,542.5	52,630.6	23,855.4

Table 31 provides an overview of the license fees collected by Curacao and St. Maarten from 2010 through 2012. The amount of license fees collected in Curaçao dropped by NAf.1,296.9 thousand

[16] The exemption for payments in Aruban florins was revoked as of March 1, 2012, based on an agreement between the governments of Curaçao, Sint Maarten, and Aruba.

(2.4%) to NAf.52,630.6 thousand in 2012. By contrast, the amount of license fees collected in Sint Maarten increased in 2012 by NAf.312.9 thousand (1.3%) to NAf.23,855.4 thousand.