IMF Executive Board Concludes 2015 Article IV Consultation with the Kingdom of the Netherlands—Aruba

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On April 8, 2015, the Executive Board of the International Monetary Fund (IMF) concluded the 2015 Article IV consultation[1] with the Kingdom of the Netherlands—Aruba, and considered and endorsed the staff appraisal without a meeting.[2]

Aruba is a small, open economy with one of the highest living standards in the Caribbean. Over 85 percent of the economy depends on tourism, making Aruba the third-most tourism-dependent country in the world. This marked dependence on external economic conditions is a key reason why Aruban growth volatility has been among the highest in the region. However, the long-standing fixed exchange rate regime against the US dollar, supported by prudent policies, has kept imbalances in check until recent years.

Aruba has been recovering from a severe double-dip recession. The economy faced two major shocks over the past five years: the global financial crisis and shutdown of the Valero oil refinery in 2012. After a strong recovery in 2013 with growth reaching 4.75 percent, the pace of activity moderated in 2014. Despite a rebound in tourism, the loss in momentum reflected a broad-based contraction in domestic demand due to fiscal policy uncertainty and investment delays.

Although external imbalances have improved recently, they remain elevated. The current account (CA) deficit is estimated to have narrowed to 7.5 percent of GDP in 2014, mostly reflecting strong tourism growth. External debt decreased to 105 percent of GDP and roll-over risks are mitigated as 90 percent of the debt is long term.

After worsening sharply over 2008-2012, the fiscal deficit narrowed to 5.25 percent of GDP in 2014. In particular, the overall fiscal balance deteriorated markedly by 11 percentage points of GDP over 2008-2012, reflecting the reduction in the business turnover tax (BBO), increasing wage-related expenditures, and a structural decline in output growth. To address these fiscal challenges, the authorities undertook major entitlement reforms in 2014. Specifically, the general (AOV) and public administration (APFA) pensions as well as the health care system (AZV) were all reformed. While these reforms, together with expenditure restraint, yield important savings, public debt nonetheless surpassed 80 percent of GDP in 2014.

In 2015, growth is projected to rise to 2.25 percent. The tourism sector—the mainstay of the Aruban economy—is envisaged to grow, albeit at a slower rate. Moreover, domestic demand is slated to recover notably amid subsiding policy uncertainty and as key public-private partnership projects move forward. Despite lower global oil prices, the energy tariff increase and the introduction of the health-care levy in late 2014, is expected to raise the inflation rate to .75 percent in 2015. Although the CA balance is projected to register a deficit, buoyant tourism exports would help reduce its size to –3.5 percent of GDP in 2015.

Executive Board Assessment

In concluding the 2015 Article IV consultation discussions with the Kingdom of the Netherlands—Aruba, Executive Directors endorsed the staff's appraisal as follows:

Aruba's gradual recovery from the double-dip recession is underway. After a strong initial tourism-led rebound, the economy lost momentum in part due to heightened fiscal policy uncertainty. Looking ahead, a broad-based recovery underpinned by robust tourism activity, the mainstay of the Aruban economy, and robust domestic demand is envisioned. However, real GDP is projected to reach its pre-crisis peak only by the end of the decade.

The main near-term risks to the outlook are external in nature. Given its high dependence on tourism, the Aruban economy is vulnerable to spillovers associated with global slowdowns. As they are the most important sources of tourists, Aruba is particularly susceptible to downturns in the U.S. and Venezuela. Over the medium term, timely implementation of renewable energy investments could boost growth prospects.

Putting debt on a downward trajectory is an immediate policy priority. Although major structural reforms have been initiated, public debt surpassed 80 percent of GDP in 2014. Attributes such as Aruba's vulnerability to external shocks, the predominance of the tourism sector, and the exchange rate peg call for the urgent rebuilding of fiscal policy space. While the authorities' ambitious medium-term adjustment plan is welcome, sustained fiscal effort at least until 2020 is warranted to durably set debt on a downward path. There is a need to establish a formal medium-term fiscal framework to enhance the credibility of these plans.

Additional revenue and expenditure measures are needed to achieve the desired fiscal consolidation. Without additional measures, fiscal deficits would remain elevated, and debt would continue to rise over the medium term. Therefore, given the size of the fiscal adjustment, additional revenue effort in the form of greater indirect tax collection appears warranted. With regards to expenditure, a priority is to reduce wage-related expenses given the large size of the wage bill. Further measures to ensure that the health care system becomes self-financing should also be considered. PPP-related expenditure commitments should be fully accounted for.

The accommodative monetary policy stance is appropriate. Given projected low inflation and moderating growth rates, as well as evidence of slack in the economy, staff currently sees no need for monetary tightening. If, however, signs of overheating appear, the authorities should stand ready to tighten the monetary policy stance appropriately.

Competitiveness needs to be safeguarded to ensure a stable recovery. Initiatives to diversify markets and efforts to promote Aruba's reputation as an upscale destination have continued to reap dividends as evidenced by the uptrend in visitor nights and Aruba's growing share in the Caribbean tourism market. Given that the U.S. accounts for 55 percent of tourists, however, staff sees further scope for market diversification. To further improve competitiveness and preserve external stability, Aruba would need greater flexibility in the labor market and more enabling business conditions. It will be important to finance prospective growth initiatives, including those associated with renewable energy, through FDI.

Aruba: Selected Economic Indicators, 2012–16

	2012	2013	2014	2015	2016
			Prel.	Projections	
			(Percent change)		
Real economy					
Real GDP	-1.4	4.7	1.2	2.2	1.8
Real domestic demand	-1.0	0.9	-3.0	1.2	1.7
Consumption	2.0	4.1	-1.9	1.1	1.6
Private	0.4	4.0	-0.5	1.1	1.6
Public	6.1	4.3	-5.2	1.2	1.5
Gross investment	-8.4	-7.9	-6.4	1.7	2.0
Exports of goods and services	-5.8	6.4	3.0	2.6	1.9
Imports of goods and services	-4.3	1.0	-2.9	1.3	1.7
			(Percent change)		
Consumer prices					
Period average	0.6	-2.4	0.4	0.7	1.2
End-period	-3.7	0.1	2.2	0.3	1.2
			(Percent of GDP)		
Central government operations					
Revenues	22.5	24.7	23.5	23.7	23.8
Expenditures [1/]	31.8	31.1	28.6	28.1	27.9
Of which: capital	2.3	2.0	1.1	0.8	0.8
Overall balance	-9.2	-6.4	-5.2	-4.4	-4.1
Gross central government debt	67.8	73.9	81.6	83.4	84.5
Savings and investment			(Percent of GDP)		
Gross investment	26.7	24.0	22.2	21.6	21.6
Foreign saving	-3.8	13.0	7.5	3.5	4.0
Domestic saving	30.4	11.0	14.7	18.1	17.6
Balance of payments			(Percent of GDP)		

Current account balance	3.8	-13.0	-7.5	-3.5	-4.0
Oil	5.1	-8.0	-7.8	-4.1	-4.6
Non-oil	-1.3	-5.0	0.3	0.5	0.6
FDI	-12.7	8.5	4.5	2.0	1.9
Gross foreign assets of central bank (millions of U.S. dollars)	787	666	693	703	684
Gross foreign assets of central bank (months of imports)	3.3	3.5	3.7	4.0	3.8
External debt	108.3	112.4	105.1	101.2	99.6
	(Millions of local currency, unless otherwise indicated)				
Monetary					
NFA	1,288	1,131	1,174	…	…
NDA	2,123	2,161	2,302	…	…
Credit to private sector (year-on-year percent change)	2.6	5.3	4.2	…	…
Broad money	3,410	3,292	3,476	…	…
Deposits (year-on-year percent change)	7.8	-4.2	5.6	…	…
Memorandum items:					
Nominal GDP (millions of Aruban florins)	4,534	4,629	4,745	5,005	5,194
Nominal GDP (millions of U.S. dollars)	2,533	2,586	2,651	2,796	2,902

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

[1/] Includes net acquisition of non-financial assets.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board

[2] The Executive Board takes decisions under its lapse-of-time procedure when the Board agrees that a proposal can be considered without convening formal discussions.