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Research Update:

Aruba 'BBB+/A-2' Ratings Affirmed; Outlook Remains Stable

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Table Of Contents

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Overview

- The ratings on Aruba reflect its stable parliamentary government, its status as a member of the Kingdom of the Netherlands, and its relatively high per capita GDP.
- These rating strengths are countered by Aruba's highly concentrated economy and relatively high fiscal deficits over the past three years.
- We are affirming our 'BBB+/A-2' sovereign credit ratings on Aruba.
- The stable outlook reflects our view that Aruba will gradually reduce its fiscal deficit, which will lower its fiscal and external vulnerabilities.

Rating Action

On June 16, 2014, Standard & Poor's Ratings Services affirmed its 'BBB+/A-2' long- and short-term sovereign credit ratings on Aruba. The outlook remains stable. We also affirmed our transfer and convertibility assessment of 'BBB+'.

Rationale

Aruba's stable parliamentary system of government and the fact that the country is a member of the Kingdom of the Netherlands (along with Curacao, St. Maarten, and the Netherlands), as well as its $24,000 per capita GDP, anchor its creditworthiness. The economy grew by 3.9% in 2013, largely because of the continued strong performance of its tourism industry. We expect the economy to grow by 2.7% in 2014. However, the closure of the Valero oil refinery in 2012 left the Aruban economy even more dependent on the tourism industry, accounting for (directly and indirectly) 84% of the overall economy.

The closure of the refinery also weakened the country's external indicators. Narrow net external debt rose to 25% of current account receipts in 2013 from 8% in 2012. The ratio of gross external financing needs to current account receipts and usable reserves, an indicator of external liquidity, also deteriorated, to 118% from 100% in 2012. Despite the continued robust performance of tourism, we do not expect these ratios to improve significantly over the next three years.

The government reduced its general government fiscal deficit to 5% of GDP in 2013 from 6.8% in 2012 largely through increases in government revenues. The government has pledged to reduce expenditures in 2014 and then freeze them over the next three years. Furthermore, the government passed major pension reform for its general pension system (AOV), which increased contributions and

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raises the retirement age to 65 over the next 10 years. The government is expected to pass a similar reform for its public-sector worker program (APFA) in the coming weeks as well. These reforms will strengthen the pension funds' finances over the coming decade. As a result, we expect the general government deficit to fall to 3% of GDP in 2014, where it will remain over the next three years. As a result, the gross general government debt burden is expected to stabilize at nearly 60% of GDP.

A fixed exchange rate and a moderately sized financial system constrain the central bank's ability to conduct monetary policy. Also, the central bank's monetary policy instruments are limited mainly to reserve requirement on bank deposits.

Outlook

The stable outlook balances the recent deterioration in the government's fiscal and debt positions as well as the country's external indicators with the expectation that the government is taking adequate measures to reduce its fiscal deficits and the continued strength of the country's tourism industry.

The government has stated that its key focus for the second term is fiscal consolidation, largely by reducing expenditures in 2014 and then freezing them over the next three years. If successful, the government's fiscal deficits in terms of GDP would greatly diminish and the debt burden would begin to fall. A better fiscal position combined with improved external liquidity (through improvements in the country's balance of payments and international reserve position) could lead to an upgrade. On the other hand, a deterioration in the country's external liquidity position due to a significant increase in net external debt or a fall in international reserves could lead to a downgrade.

Key Statistics

Aruba--Selected Indicators

	2007	2008	2009	2010	2011	2012	2013	2014e	2015f	2016f	2017f
Nominal GDP (bil. US$)	2.6	2.7	2.5	2.4	2.5	2.5	2.6	2.7	2.8	3.0	3.1
GDP per capita (US$)	26,125	27,208	24,595	23,459	24,827	24,350	24,423	25,026	26,065	27,147	28,273
Real GDP growth (%)	2.0	0.2	(11.0)	(3.2)	3.7	(1.3)	3.9	2.7	3.2	3.2	3.2
Real GDP per capita growth (%)	1.3	(0.6)	(11.7)	(3.5)	2.9	(2.8)	2.2	1.5	2.0	2.0	2.0
Change in general government debt/GDP (%)	2.1	(0.4)	2.9	2.7	6.6	6.6	5.0	3.1	2.9	2.4	2.5
General government balance/GDP (%)	1.6	3.8	2.4	(0.1)	(5.8)	(6.8)	(5.0)	(3.0)	(3.1)	(3.1)	(2.9)
General government debt/GDP (%)	34.0	32.0	38.1	42.5	46.5	53.2	57.2	58.3	58.2	57.6	57.2
Net general government debt/GDP (%)	5.2	0.6	0.8	(0.4)	7.2	14.6	19.9	22.8	24.5	25.5	26.4

Aruba--Selected Indicators (cont.)											
General government interest expenditure/revenues (%)	6.1	7.1	6.0	6.6	8.0	8.2	8.5	8.9	8.9	8.9	8.9
Other dc claims on resident nongovernment sector/GDP (%)	53.0	52.5	57.1	60.4	58.2	60.4	62.5	62.5	64.4	65.9	67.7
CPI growth (%)	5.4	9.0	(2.2)	2.1	4.4	0.6	(2.8)	1.0	2.2	2.2	2.2
Gross external financing needs/CARs plus usable reserves (%)	99.7	102.9	98.6	131.1	106.5	100.9	118.4	119.4	117.4	118.8	118.6
Current account balance/GDP (%)	10.0	0.8	8.3	(17.6)	(8.6)	4.8	(7.0)	(6.9)	(6.5)	(6.1)	(5.9)
Current account balance/CARs (%)	3.8	0.3	5.8	(21.7)	(3.1)	3.7	(7.8)	(7.7)	(7.4)	(7.0)	(6.9)
Narrow net external debt/CARs (%)	5.4	1.2	0.2	6.8	1.2	8.5	25.1	29.3	31.0	32.2	33.8
Net external liabilities/CARs (%)	52.5	54.5	98.6	192.5	60.7	84.0	141.8	145.7	150.0	153.8	158.0

Other depository corporations (dc) are financial corporations (other than the central bank) whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private-sector borrowings from nonresidents minus official reserves minus public-sector liquid assets held by nonresidents minus financial sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. The data and ratios above result from Standard & Poor's own calculations, drawing on national as well as international sources, reflecting Standard & Poor's independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. CARs--Current account receipts. e--Estimate. f--Forecast.

Related Criteria And Research

Related Criteria

- Sovereign Government Rating Methodology And Assumptions, June 24, 2013
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts. The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook.

Ratings List

Ratings Affirmed

Aruba

Sovereign Credit Rating	BBB+/Stable/A-2
Transfer & Convertibility Assessment	BBB+
Senior Unsecured	BBB+

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