IMF Executive Board Concludes 2021 Article IV Consultation Discussions with the Kingdom of the Netherlands—Aruba

April 21, 2021

Washington, DC: On April 16, 2021, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation discussions [1] with the Kingdom of the Netherlands—Aruba.

COVID-19 has caused unprecedented disruption to economic activity, triggering Aruba's deepest recession in history, but the policy response was swift. Tourism came to a complete halt during the 2020Q2 causing ripple effects across the economy. Real GDP is estimated to have shrunk by 25.5 percent in 2020, with considerable strain to the labor market and business sector. The Central Bank of Aruba (CBA) eased monetary and macroprudential policies, supporting private credit despite the deep output contraction. The multi-pronged fiscal package has provided essential income and liquidity support to the affected businesses and households and has helped contain bankruptcies and unemployment. However, supportive expenditure policies and large revenue losses turned the fiscal balance from a small surplus in 2019 to a deficit of 17 percent of GDP in 2020. As a result of the large deficit and deep GDP contraction, public debt increased from 72 to 117 percent of GDP.

A moderate recovery is projected for 2021 amid exceptionally high risks. Real GDP growth in 2021 is expected at about 5 percent, supported by Aruba's favorable testing capacity and vaccination prospects compared to other Caribbean countries. The pandemic is likely to have lasting effects on the economy, which is only expected to reach the pre-COVID level of real GDP in 2025. The fiscal deficit is expected to remain elevated in 2021, reflecting continued expenditure support and persisting weakness in tax revenues. Public debt will peak at about 130 percent of GDP in 2021 and gradually decline thereafter. The fiscal adjustment needed over the medium term to restore debt sustainability is sizable both by historical and international standards. Like other countries, downside risks are predominant and primarily stem from the uncertain evolution of the pandemic. Implementation risks to the needed fiscal adjustment and risks to debt sustainability are also high, but are partly mitigated by the sizable share of obligations to the Dutch government.

Executive Board Assessment [2]

The authorities' swift policy response to the COVID-19 pandemic helped contain the human and economic damage. The multi-pronged fiscal package provided temporary income support, wage subsidies, liquidity assistance, and tax deferral measures. In addition, the Central Bank (CBA) eased monetary and macroprudential policies to support private credit and injected liquidity in the banking sector. These measures were instrumental in saving lives and preventing an even sharper downturn.

Policy support remains critical to contain the effect of the pandemic, given the tepid recovery projected in 2021. The decision to extend fiscal support in 2021 is appropriate, in view of continuing economic weakness and elevated risks. Premature retrenchment could hurt the recovery and pose even larger costs on the economy. The authorities are encouraged to prepare a contingency plan if current conditions persist, including the extension of some fiscal support into 2022 if additional financing sources can be identified.

Strict prioritization of spending and revenue mobilization is necessary as the recovery takes hold, in order to contain debt sustainability risks. Expenditure measures should be targeted to households and businesses in immediate need within a generalized effort to improve the efficiency of total spending. Measures to improve tax compliance would broaden the tax base while more fairly distributing the tax burden across the economy. The introduction of a value-added tax (VAT) should be accelerated to offset the revenue shortfall from the recent reduction in direct taxes while protecting the vulnerable, as well as on efficiency grounds.

Over the medium-term, Aruba will need a substantial and sustained fiscal consolidation to restore sustainability and rebuild fiscal buffers. A credible, growth-friendly and inclusive medium-term consolidation plan will be essential to set public debt on a firm downward trajectory. Key elements would include: (i) enhancing the tax system to raise revenues while minimizing distortions and protecting vulnerable groups; (ii) containing the public wage bill; and (iii) reforming the social safety net.

Strengthening the fiscal policy framework will help guide fiscal policy. Adopting a well-designed medium-term budget framework would strengthen fiscal planning and help achieve multi-year fiscal discipline. Enhancing the debt management strategy would guide financing decisions and mitigate refinancing risks arising from the bunching of maturity in 2022/23 when the loans received from the Netherlands come due under current terms.

Monetary and macroprudential policies should remain accommodative to support the recovery. The current level of foreign reserves is adequate, but should be increased over the medium term in view of the high uncertainty regarding the resumption of tourism receipts. The CBA is encouraged to remove the recently imposed capital flow management measure once economic conditions normalize. Premature tightening of macroprudential policies should be avoided to prevent adverse macro-financial feedback effects that might weaken the financial system and reduce welfare. As conditions for approval of the new exchange restrictions are not met, staff does not recommend their approval.

Banks are liquid and well-capitalized, though continued CBA vigilance for emerging financial vulnerabilities would be appropriate. Non-performing loans (NPLs) were contained at 5 percent at end-2020. However, provisions for deteriorating asset quality are affecting profits and NPLs could rise significantly once the fiscal support to households and businesses is lifted. Close monitoring is essential to ensure early intervention and maintain financial stability. Adoption of Basel II would further improve the financial sector's resilience.

Comprehensive structural reforms are key to diversifying the economy and boosting potential growth. COVID-19 brought to the fore the urgency of advancing diversification efforts to help contain tourism-related output volatility and catalyze growth. In the short-term, shifting to lower density tourism models would help reduce permanent scarring while decreasing negative environment externalities. Labor market reforms that foster flexibility would boost potential growth and improve external competitiveness. Strengthening the link between education, training, and skill demand and broadening access to digital infrastructure will reduce the long-term impact of COVID-19, particularly for unskilled, more vulnerable workers, helping alleviate inequalities and spur equitable growth. Policies that tackle inequality and strengthen resilience to climate risks should be continued, along with structural reforms that improve the business environment, including anti-corruption and AML/CFT measures.

Table 1. Aruba: Selected Economic Indicators

Basic Data, Social and Demographic Indicators

Area (sq. km)	180		
Population (thousands, 2020q3)	111.9	Literacy rate (percent, 2018)	97.8
Population growth rate (percent, 2016-20 average)	0.5	Percent of population below age 15 (2019)	17.2
Nominal GDP (millions of U.S. dollars, 2019)	3,342	Percent of population age 65+ (2019)	15.2
GDP per capita (thousands of U.S. dollars, 2019)	29.9	Life expectancy at birth (years, 2018)	76.2
Unemployment rate (percent, 2019)	5.2		

Economic Indicators

	2019	**Est. 2020**	**Projections 2021**	**2022**
	(Percent change)			
Real economy				
Real GDP	0.4	-25.5	5.0	12.0
GDP deflator	3.9	-1.3	0.1	2.0
Consumer prices				
Period average	3.9	-1.3	0.1	2.0
End-period	3.6	-3.1	1.3	2.5
	(Percent of GDP)			
Central government operations				
Revenues	23.7	24.4	21.6	21.7

Expenditures	22.9	40.6	39.7	28.1
Of which: capital	0.5	0.8	0.5	0.5
Overall balance	0.3	-17.0	-18.6	-6.9
Primary Balance	4.2	-11.7	-13.0	-0.6
Cyclically adjusted primary balance (percent of potential GDP)	4.1	-4.8	-7.7	0.8
Gross central government debt	72.2	117.0	130.3	121.4
Savings and investment				
Gross investment	21.1	11.3	11.9	17.3
Of which: public	0.5	0.8	0.5	0.5
External saving	-2.5	16.3	13.7	3.8
Domestic saving	23.7	-5.0	-1.7	13.5
Balance of payments				
Current account balance	2.5	-16.3	-13.7	-3.8
Oil	-4.5	-3.8	-4.6	-4.6
Non-oil	7.0	-12.5	-9.1	0.8
FDI	-4.0	4.4	3.3	2.0
Gross official reserves (millions of U.S. dollars)	999	1,151	1,189	1,239
Gross official reserves (months of next year's imports)	7.5	8.6	7.3	6.7
External debt	89.0	131.2	132.3	128.6
	(Millions of Aruban florins, unless otherwise indicated)			
Monetary				
NFA of Banking System	1,713	2,056	2,160	2,466
NDA of Banking System	2,857	2,736	2,875	3,282
Credit to private sector (percent change)	6.6	0.5	5.2	14.2
Broad money	4,569	4,792	5,034	5,748
Deposits (percent change)	8.0	4.3	5.1	14.2
Memorandum items				
Nominal GDP (millions of Aruban florins)	5,982	4,399	4,621	5,277
Nominal GDP (millions of U.S. dollars)	3,342	2,458	2,582	2,948
Unemployment rate (percent)	5.2	14.0	…	…

Sources: Aruban authorities and IMF staff estimates and projections.

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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] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.IMF.org/external/np/sec/misc/qualifiers.htm .

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