Coping with Disruptive Reality

Presentation Annual Report 2020

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Thank you for joining us today. I am happy to be able to speak to you in a physical press conference even though we are still monitoring the developments on COVID-19 closely in Sint Maarten and Curaçao and are taking all precautionary measures.

Today, I would like to discuss the main economic developments in 2020 but more importantly our road to economic recovery. **Without doubt, the year 2020 was in many ways a historic and disruptive year. The pandemic affected everyone, but not least people in small and tourism-dependent island economies such as Sint Maarten and Curaçao. Since the outbreak of the pandemic, the resilience and agility of our people and businesses have been tested again and again. This reminds me of a beautiful quote of Nelson Mandela who would have turned 102 years last week:**

"Do not judge me by my success, judge me by how many times I fell down and got back up again".

Indeed today, we are going to discuss the state of our economy and the main economic prospects. In the end, however, it is the resilience and agility of the people that shape the course of the economy.

In 2020, the world economy was hit severely by the COVID-19 pandemic and measures implemented to contain the spread of the virus. As a result, an unprecedented contraction followed in which real output dropped in both the advanced and emerging & developing economies.

The monetary union of Curaçao and Sint Maarten was deeply affected by the pandemic. Both countries were relatively successful in containing the local spread of the coronavirus through stringent measures, but this success came at high economic and social costs. Particularly during the second quarter of 2020, economic activity came practically to a standstill as both countries implemented a border closure that lasted approximately three months and a total lockdown of 6 weeks. Economic activity, particularly in the tourism industry, plummeted. **Real GDP dropped by an unbelievable 19.3% in Curaçao and 22.4% in Sint Maarten.**

The significant real GDP contractions in Curaçao and Sint Maarten during 2020 were the result of sharp declines in both domestic and net foreign demand. Domestic demand still being the leading factor in Curaçao while net foreign demand dominated in Sint Maarten. An analysis by sector shows that real value added dropped in all sectors of the economy. **The decline was most pronounced in the tourism and transportation related sectors.**

One and a half year into the pandemic global prospects remain highly uncertain. Sentiment goes up and down depending on whether virus mutations or vaccination roll out has the upper hand. However, it becomes increasingly clear that the recovery will be divergent among economies. Those that are more advanced in the era of digitalization see growth quickly recovering to pre-pandemic levels. Countries that are more reliant on contact intensive industries such as tourism will need more time. **Adapting to the new reality of health protocols, vaccine roll out and responsible tourism and entertainment will be critical for tourism dependent countries. According to the latest estimates, the economies of Curaçao and Sint Maarten may only reach their pre-pandemic levels by 2024**. **We project the economic recovery to be moderate**

in 2021 with real GDP growth rates of 0.1% in Curaçao and 3.4% in Sint Maarten. The absence of growth in Curaçao is explained by another six-week lockdown during March – May showing the importance of controlling the pandemic. It is expected that the recovery will gain speed in 2022 with growth rates of 6.2% in Curaçao and 14.4% in Sint Maarten. The path of economic recovery, however, is uncertain as it depends on how the virus develops and the speed of the vaccine roll-out.

Before the pandemic, the economic performance of Curaçao and Sint Maarten was already weak. **Curaçao was in a protracted recession due mainly to the lingering spillover effects of the deep economic crisis in Venezuela. Meanwhile, Sint Maarten was starting to recover following the massive destruction caused by Hurricane Irma in 2017. In both countries, real GDP per capita was in 2019 lower than in 2010. Due to the severe shock caused by the pandemic, real GDP per capita dropped further in 2020.**

Sint Maarten has not only been hit hard by external shocks such as Irma and Covid-19. Since becoming an autonomous country, it has seen many political changes. **In its first 10 years as autonomous country, the government changed roughly every year making consistent policy hard to achieve. Building administrative capacity, implementing structural reforms and adopting measures to improve the business climate often take several years to achieve.**

In the case of Curaçao, it is important to keep in mind that over the past decade there has been a change in the economic structure largely driven by the crisis in Venezuela and the end of the Grandfather Clause in the international financial services sector. **The country's dependence on tourism has increased at the expense of other sectors such as the international financial services sector and the manufacturing sector, notably, the refinery. As a result, the economy of Curaçao became less diversified, and hence less resilient to shocks.**

Against this background, the situation in the labor market of both Curaçao and Sint Maarten has worsened. For the past couple of years, the unemployment rate in Curaçao has remained in double-digits. According to the latest Labor Force Survey of the Central Bureau of Statistics, almost 1/5 of the labor force was unemployed in 2020. **However, the rather moderate increase in the unemployment rate in 2020 compared to 2019 should be interpreted with caution. It seems that in Curaçao the so-called discouraged worker effect moderated the increase in the unemployment.** In other words, persons without a job stopped looking for a work because their perceived chances of finding work are low amid the deep economic crisis Curaçao is going through. **In Sint Maarten also the unemployment rate rose sharply into double digits in 2020 as businesses, especially in the hotels and restaurants sector, were forced to lay off employees or close their doors to minimize operational costs amid the economic crisis caused by the pandemic.**

The pandemic also left its mark on the public finances of Curaçao and Sint Maarten in 2020. In both countries, the current budget deficit widened significantly in 2020 compared to 2019 due to a decline in government revenues combined with an increase in expenditures. Tax revenues dropped sharply as one would expect, while cyclical expenditures, including unemployment benefits, increased as economic activities shrank considerably. **At the same time, both countries**

implemented very welcome and important discretionary measures including a payroll subsidy and other social transfers to vulnerable groups in society amid the coronavirus crisis. The increase in expenditures in Curaçao also reflected a transfer by the government related to the takeover of the preferential claim of the CBCS on Girobank N.V. **At the end of 2020, the current budget deficit amounted to 14.0% of GDP in Curaçao and 10.9% of GDP in Sint Maarten.**

To put the worsening of our public finances in 2020 in the context of the Caribbean, we compared the degree of fiscal activism in Curaçao and Sint Maarten with several Caribbean countries. **The degree of fiscal activism in a country can be measured by calculating the ratio between the change in the overall fiscal balance and the change in the real GDP growth. In times of an economic contraction, a ratio above 1.0 indicates that the country allowed the overall fiscal deficit to increase at a faster pace than the decline in real GDP. The degree of fiscal activism in Curaçao was exactly 1.0 in 2020. In other words, the overall fiscal balance deteriorated at the same pace as the decline in real GDP. The budget was allowed to function as a shock absorber. Meanwhile, in Sint Maarten, it was 0.3 only. However, the degree of fiscal activism in Sint Maarten should be interpreted with caution as the change in real GDP was higher than in most countries in the Caribbean. Real GDP in Sint Maarten turned around from a significant expansion of 8.5% in 2019 to a severe contraction of 22.4% in 2020. On the revenue side automatic stabilization was allowed to function fully.**

With the pandemic, public debt also increased sharply in Curaçao and Sint Maarten. At the end of 2020, total public debt stood at 86% of GDP in Curaçao. Meanwhile in Sint Maarten, the public debt to GDP ratio reached 53% in 2020. In both countries, the increase in the public debt was primarily the result of the liquidity support that the Netherlands provided amid the pandemic.

As you may know, the liquidity support from the Netherlands was extended in the form of 2-year zero interest bullet loans. Last year, the total liquidity support amounted to NAf.667 million (14.5% of GDP) for Curaçao and NAf.169 million (6.9% of GDP) for Sint Maarten. The support packages, Alivio in Curaçao and SSRP in Sint Maarten, included payroll subsidies, support for the self-employed and unemployment benefits. The Alivio and SSRP packages moderated the sharp decline in employment and private consumption, and prevented mass bankruptcies. However, it seems that the uptake turned out lower than initially expected as the economies of Curaçao and Sint Maarten were gradually recovering in the third and fourth quarter of 2020. In addition, the lengthy discussions and negotiations with the Netherlands regarding the conditions for support (i.e., Landspakketten) delayed, particularly in Sint Maarten, the provision of much needed support.

On the external front, the deficit on the current account of the balance of payments widened significantly due mainly to a sharp decline in the export of goods and services. Particularly, the foreign exchange earnings from tourism and tourism-related activities dropped dramatically in 2020 amid the strict containment measures taken by the governments, particularly the lockdown and border closure in the second quarter of 2020. **Nevertheless, gross official reserves rose as the external financing, particularly the liquidity support to the governments, and capital transfers were more than sufficient to cover the deficit on the current account of the balance**

of payments. Our peg remained strong throughout 2020. In December 2020, the import coverage stood at 7.0 months, well above the norm of 3 months.

Amid the worsened economic prospects in the monetary union caused by the COVID-19 pandemic, the Bank took some measures to enable the financial system to continue to provide financing to keep the economy running through these extremely difficult times. **Therefore, on March 20, 2020, the Bank reduced the pledging rate by 150 basis points**. As a result, the pledging rate was back at the 2008-2016 historic low level of 1.00 percent. **Furthermore, the surcharge on the pledging rate of 200 basis points on loans exceeding NAf.20.0 million was suspended. Moreover, the Bank decided to lower the interest rates it is willing to pay on certificates of deposit (CDs)** in the weekly auctions to stimulate the banks to hold more funds liquid to be able to meet the increased liquidity demand from their clients during the crisis. In addition, banks were allowed to provide a moratorium of debt and interest payments to their clients for 3-6 months, and **capital transfers abroad have been restricted until further notice** to minimize capital flight.

Against this background, deposits in the banking system remained stable while excess liquidity increased, driven mainly by the inflow of funds related to the liquidity support to the governments of Curaçao and Sint Maarten. Growth in private credit extension decelerated from 1.8% in 2019 to 0.7% in 2020. The lower pace of growth during 2020 can be fully accredited to Curaçao where growth was near absent (0.1%). By contrast, the growth in private credit extension in Sint Maarten accelerated from 1.0% in 2019 to 2.4% in 2020.

Even though we have seen some signs of recovery, the crisis is still ongoing. **Therefore, to prevent business closures, bankruptcies, and a reduction of the labor force, the governments should first of all continue to provide financial support to the most affected sectors and workers.** These measures should be complemented by programs aimed at (re)training and skills development of the unemployed to increase their prospects in the labor market as soon as the recovery takes hold.

The pandemic has more than ever exposed our economic and social vulnerabilities and has underscored the importance of measures to make our economies more resilient to shocks. To increase the pace of economic recovery it is very important that the governments of Curaçao and Sint Maarten take the necessary steps to unlock private investments by reducing the cost of doing business, the lengthy administrative procedures and red tape. In a small open economy, expansionary policy through higher government spending tends to have a rather small economic impact due to the high import content of our public consumption and investments (i.e., leakage). Therefore, the government should take a facilitating role and create the macroeconomic environment and business climate that is conducive for private investment to increase our production capacity leading to a higher pace of growth.

However, the focus should not only be on a sustainable recovery of growth but also on a more inclusive growth path that provides opportunities to all groups in society and distributes aggregate income in a fairer manner. To this end, structural reforms that accelerate productivity while improving social cohesion are crucial. In particular investing in the education system and stimulating lifelong learning, addressing rigidities in the labor market, and improving the quality of and access to digital technologies are very important.

As the economies of Curaçao and Sint Maarten are not expected to reach their pre-pandemic levels until 2024, high fiscal deficits will persist over the medium term making additional liquidity support from the Netherlands indispensable. However, this poses a risk to debt sustainability. **Fiscal consolidation is therefore crucial for both countries to achieve sound public finances but budget balance cannot be achieved overnight. A multiannual budget is needed to achieve a balanced budget in 2024. This multiannual budgets should include operational targets for the current budget balance and the primary balance and include the budgetary impact of structural reform measures from the country packages. The path towards a balanced budget should be designed carefully to prevent fiscal measures, especially when they are pro-cyclical, from hampering economic recovery. In addition, public financial management must be strengthened while tax reforms are needed to broaden and diversify the tax base to raise revenue in the least growth-distorting way.**

The Netherlands has tied additional liquidity support to Curaçao and Sint Maarten to strict implementation of structural reforms and fiscal consolidation. **The agreed upon structural adjustment program ("landspakket") should benefit both countries by improving their competitiveness, promoting sustainable and inclusive economic growth, and strengthening resilience**. The decades long experience with structural adjustment programs by the International Monetary Fund shows that there are at least three critical success factors that should be taken into account when designing and implementing a reform program. First of all, the program will only succeed if strong ownership is taken by the governments of both Curaçao and Sint Maarten. Second, overoptimistic macro-economic assumptions should be avoided when designing the budgetary framework of the program. As discussed, in the case of the "landspakket" of Curaçao and Sint Maarten, a multiannual budgetary framework is absent and should be established as soon as possible. Finally, the agenda should take into account the capacity constraints of both countries in setting the deadlines to achieve the agreed-upon actions and targets. Program objectives and conditions should be parsimonious and well targeted.

The response to COVID-19 illustrated our ability to take urgent and decisive action in close collaboration within the Kingdom. At the same time, COVID-19 has underscored our vulnerabilities. It is therefore crucial that on our path to economic recovery we focus on making our economies more resilient and agile so that we can bounce back swiftly from future shocks. **A constructive dialogue and cooperation between the Kingdom partners will prove the most effective way towards overcoming this crisis and embarking on a sustainable and inclusive growth path for Curaçao and Sint Maarten.**

With this, it is only fitting to come back to and conclude my remarks with another quote from Nelson Mandela

"It always seems impossible, until it is done".