Fact sheet

Willemstad, April 2021

Import coverage of the monetary union of Curaçao and Sint Maarten

Small open economies, such as Barbados, Bahamas, Belize, Trinidad & Tobago, Sint Maarten, and Curaçao, need to manage their foreign exchange reserves in such a way to mitigate the impact of adverse economic challenges and to ensure confidence in, and stability of, their national currency. In addition, the amount of foreign exchange reserves held by the central bank of a country fulfils mercantile purposes, such as the ability to facilitate imports for the economy. However, the question arises how to maintain sufficient foreign exchange reserves to guarantee imports and economic stability, especially for such small open economies highly susceptible to external shocks.

Reserve adequacy is referred to as a country's potential foreign exchange needs in adverse circumstances against which reserves are held as a precautionary buffer. There are several reserve adequacy approaches used in the world, each with its own strengths and limitations. The most common used approaches are (*I*) import coverage in months of imports; (*II*) reserves to money supply (M2); (*III*) reserves to short-term external debt; and (*IV*) optimal and actual reserves to GDP or imports.

The monetary union of Curaçao and Sint Maarten has been using the import coverage in terms of months of imports approach. The main benefit of this approach lies with its simplicity and straightforwardness for the public to understand. However, the limitation of this approach also lies within its simplicity, as it does not take the opportunity cost of holding reserves into account or other factors that determine a country's need for reserves.

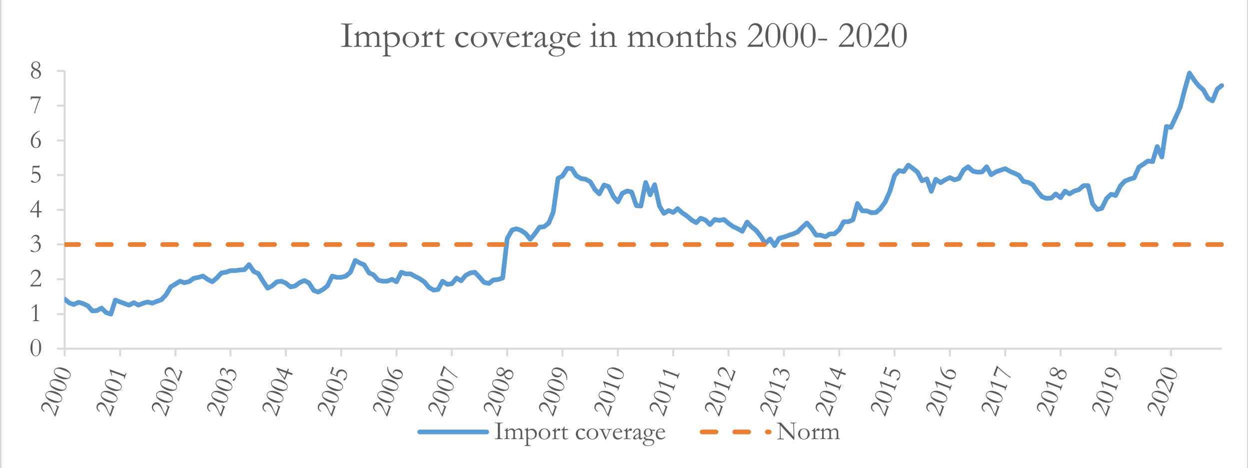
The import coverage is the number of months a country's foreign exchange reserves (excl. gold reserves) could cover the imports of goods and services from domestic demand[1]. The monetary union of Curaçao and Sint Maarten uses a forward-looking approach where estimated future imports are used to calculate the import coverage. Hence, the import coverage is calculated as the ratio between the gross official reserves in a month and the projected average monthly imports of the succeeding 12 months. To guarantee the fixed exchange rate of the guilder vis-à-vis the U.S. dollar, the Centrale Bank van Curaçao en Sint Maarten (CBCS) applies an import coverage benchmark of 3 months. This is in line with other Caribbean islands' benchmark of 3 months.

To better understand this concept, let's give an example of the import coverage as per December 31, 2020. The official foreign exchange reserves of the monetary union stood at NAf.2,908.2 million at

[1] Some countries, however, incorporate their gold reserves as part of their reserves in their import coverage estimations.

that date while the projected average monthly imports for the next twelve months were NAf.383.8 million, resulting in an import coverage of 7.6 months. The import coverage of 7.6 months considerably exceeds the benchmark of 3 months, thereby sending an assuring message that the foreign exchange reserves of the union are more than adequate. Because the projected imports are updated on a quarterly basis, the import coverage may still change. Once the actual imports of the succeeding 12 months are known, the import coverage remains fixed. The CBCS publishes the import coverage on a monthly basis in the 'Weekly International Reserve Statement' on its website.

The graph below illustrates the development of the import coverage of the monetary union during the period 2000 - 2020.[2] The dotted line marks the import coverage benchmark of 3 months. Between 2000 and 2008, the import coverage was structurally below the 3-month benchmark, increasing sharply in 2008 - 2009 reaching 5.2 months, after which it gradually dropped to 3.2 months in 2013, picking up again thereafter and peaking at 5.2 months in January 2017. After this peak, the import coverage started to gradually decline again until it recorded a turnaround in November 2018 reaching 4.3 months. The import coverage continued to increase and reached its peak in May 2020 reaching 7.9 months.



The development of the import coverage between 2008 and 2018 can be attributed mainly to the debt relief provided to the entities of the Netherlands Antilles. As part of the dismantling of the Netherlands Antilles, The Netherlands assumed the ownership of 2/3 of the outstanding debt of the former entities of the Netherlands Antilles. The outstanding debt securities were paid off according to their maturity schedule. Commercial banks, insurance companies and pension funds in Curaçao and Sint Maarten held most of these debt securities. The repayment of the debt and interest resulted in large foreign exchange inflows into the monetary union. Most of these funds remained in the

[2] The data from 2000 – 2010 refer to the Netherlands Antilles.

monetary union's economy because of international low interest rates and instability in the international financial markets.

Since the peak in January 2017, the official foreign exchange reserves of the monetary union have been following a declining trend. The main reason for this was an increase in local institutional investors' appetite to invest abroad due to rising international interest rates and securities prices, combined with a drop in exports from the union, i.e., foreign exchange income. Sint Maarten's export dropped due to the impact of Hurricane Irma, while Curaçao's export dropped particularly because of declining activities at the refinery. Moreover, in 2018, The Netherlands paid off the last maturing debt securities, resulting in a decline in foreign exchange inflows. These developments contributed to a decline of the official foreign exchange reserves of NAf.274.3 million in 2018. Because imports also dropped, the import coverage dropped only from 4.5 months at the end of 2017 to 4.4 months at the end of 2018. In 2019, the import coverage started to increase again reaching 6.4 months at the end of the year. This increasing trend was caused by the sharp decline in imports as of the second quarter of 2020, when the COVID-19 virus crisis started.

As a result of the ongoing COVID-19 pandemic, the Netherlands provided liquidity support to Curaçao and Sint Maarten in the form of 2-year interest-free bullet loans. These loans compensated the loss of government income and financed support measures for the most affected groups in society amid the corona crisis during 2020. Moreover, because of the domestic measures taken by the government to contain the spread of the virus, including the temporary closure of the borders, domestic demand and, hence, imports dropped considerably in 2020 as economic activity practically came to a temporary standstill. The transfer of these funds into the monetary union combined with significantly lower imports resulted in a spike in the import coverage in the second quarter of 2020 of 7.9 months in May. Imports are expected to gradually pick up in the next twelve months in line with a projected increase in domestic and tourism demand, resulting in a lower projected import coverage in 2021, albeit still significantly higher than the benchmark of 3-months.