CENTRALE BANK VAN CURACAO EN SINT MAARTEN

Analysis development in gross official reserves and the import coverage

1. Introduction

The global outbreak of the coronavirus (COVID-19) has caused an unprecedented crisis. The pandemic is primarily a health crisis that is inflicting high and rising human costs. Furthermore, the necessary measures to reduce contagion, including quarantines, social distancing, border closures, and lockdowns, have significant adverse economic and social effects. Because of these measures, economic activity has fallen drastically around the world. Curaçao and Sint Maarten implemented strict preventive measures, including a border closure for commercial flights and maritime traffic combined with a strict lockdown, to ensure the safety of their citizens. Meanwhile, after approximately six weeks of a total lockdown, the countries have started to relax the measures and are gradually restarting economic activity. Furthermore, the border closures will be relaxed by July 1, 2020, by allowing commercial flights from some destinations.

As both countries are mainly dependent on tourism, the negative economic consequences of the preventive measures, particularly the border closures, are substantial. According to the latest projection of the Centrale Bank van Curaçao en Sint Maarten (CBCS), the economies of Curaçao and Sint Maarten are expected to contract by 20.4% and 24.5% in 2020, respectively, assuming the borders remain closed for a period of 3 months, a total lockdown of 6 weeks, and both governments receive liquidity support from the Netherlands part of which is bound to strict conditions.

The preventive measures have also affected the balance of payments of the monetary union. Due to the border closure, the foreign exchange revenues from tourism activities are projected to drop considerably. Furthermore, even after the re-opening of the borders, the recovery of the tourism sector is projected to be slow as economic contractions in key source markets such as the United States and the Netherlands, and fear of travelling will undercut foreign demand for overseas travel. At the same time, imports are projected to drop on the back of lower domestic demand and tourism spending. Also, the oil import bill will drop due to a sharp decline in international oil prices. Against this background, the CBCS has projected a considerable increase in the current account deficit of the monetary union in 2020 that will result in a decline in gross official reserves. Therefore, the CBCS recommended in a letter to the ministers of Finance of Curaçao and Sint Maarten in March 2020, to request balance of payments support from the Netherlands in the amount of NAf.60 million per month for each country.

Since April 2020, there has been a surge in the gross official reserves of the monetary union caused mainly by the inflow of liquidity support from the Netherlands for Curaçao and Sint Maarten and the capital restriction that the CBCS put in place to prevent capital flight. This note covers the recent development and short-term projection of the monetary union's gross official reserves and import coverage.

The note is structured as follows. Section 2 discusses the balance of payments projection for the union for 2020. Section 3 covers the development of the official reserves of the union between January and May 2020. Section 4 addresses the projected monthly import coverage for the remainder of 2020 based on two scenarios, while section 5 discusses some alternative scenarios. Finally, the conclusion and recommendations are presented in section 6.

2. Balance of payment projection for 2020

In this section, the balance of payment projection for the monetary union is discussed. First, a projection that was made before the global pandemic will be discussed and, second, a new projection including the coronavirus outbreak, the containment measures taken by the governments of Curaçao and Sint Maarten, the capital restriction by the CBCS, and the first and second tranche of liquidity support. Both projections are presented in Table 1.

Table 1. Balance of payments projection (in mln NAf.)*

	2019	2020 pre-COVID-19 projection	2020 closed border and lockdown projection
Current account balance, of which:	-1,201.9	-1,093.3	-1,880.9
Trade balance	-2,920.2	-2,943.9	-2,968.9
Services balance	1,714.4	1,801.1	1,057.6
Income balance	1.2	20.1	-6.8
Current transfer balance	2.7	29.5	37.2
External financing, of which:	1,176.6	750.6	1,900.6
Direct investment	186.8	228.9	139.0
Portfolio investment	190.0	79.2	602.2
Loans & credits	799.8	442.5	1,219.4
Capital transfers	37.7	128.3	62.5
Change in gross reserves of the central bank	-70.6	-73.0	221.7
Statistical discrepancies	-83.0	141.4	79.4

Pre-COVID-19 outbreak projection

In January 2020, before the outbreak of the COVID-19 pandemic, the CBCS projected that the deficit on the current account balance of the monetary union would drop from NAf.1,201.9 million in 2019 to NAf.1,093.3 million in 2020. The lower projected deficit would be caused primarily by an increase in the net export of goods and services combined with an improvement of both the income and current transfers balances. The net export of goods and services was projected to increase because of a rise in exports, moderated by higher imports. The gain in exports reflected mainly the projected increase in foreign exchange earnings from tourism activities in both Curaçao and Sint Maarten over the course of 2020. For Curaçao, an increase of 5.0% in foreign exchange earnings from tourism activities was projected, while the projected increase for Sint Maarten was 8.5%. Moreover, it was estimated that more earnings from ship repair activities in Curaçao would contribute to the gain in exports. However, a decline in the revenues from refining and related transportation activities in the harbor of Curaçao would dampen the growth in exports. Furthermore, foreign exchange earnings from bunkering activities would drop on the back of a projected decline in international oil prices and lower volumes sold.

Meanwhile, the import bill was projected to rise due to, among other things, an increase in the import of construction material reflecting ongoing investments in Curaçao and reconstruction activities in Sint Maarten. Furthermore, the wholesale & retail trade sector in Sint Maarten was projected to import more merchandise supported by the expected increase in domestic spending. In Curaçao, however, merchandise imports by the wholesale & retail trade sector was expected to drop because of the introduction of the general consumption tax, ABB, that would reduce consumer spending. In addition, more construction services were projected to be acquired from abroad in Sint Maarten related to the reconstruction of key infrastructure that was damaged by the hurricanes in 2017, particularly the airport. However, a projected decline in international oil prices would moderate the rise in imports.

In January 2020, the CBCS projected an improvement of the income balance caused primarily by a decline in interest and dividend payments to foreign investors. Meanwhile, the current transfers balance was projected to improve because of a decline in current transfers paid to abroad, moderated by lower current transfers received from abroad.

Capital transfers were projected to increase compared to 2019, reflecting the transfer of funds from the Sint Maarten Reconstruction, Recovery and Resilience Trust Fund managed by the World Bank. Meanwhile, external financing into the monetary union was projected to increase, albeit at a slower pace compared to 2019, reflecting a worsening of the loans & credit, direct investment and portfolio investment balances. Gross official reserves were projected to drop by NAf.73.0 million in 2020 as the external financing and capital transfers would not have been sufficient to cover the current account deficit of the monetary union.

Projection based on 3- month border closure and 6 weeks lockdown

Following the measures taken by the governments of Curaçao and Sint Maarten and the projected global economic recession amid the COVID-19 pandemic, the CBCS has adjusted its balance of payments projection for 2020. The new projection is based on the assumption of a 3 months borders closure and a 6 weeks lockdown. Furthermore, it is assumed that exports will recover gradually once the containment measures are relaxed and, subsequently, totally removed.

In the new projection, the current account of the balance of payments will worsen considerably and reach a NAf.1,880.9 million deficit in 2020. The higher deficit is the result of a significant decline in the net export of goods and services combined with a deterioration of the income balance. By contrast, the current transfers balance is projected to improve. The projected decline in the net export of goods & services is caused by significantly lower exports, moderated by a drop in imports. Exports are projected to drop as economic activities came to a standstill for a period of 6 weeks during the total lockdown. Also, the border closure of 3 months will result in lower foreign exchange earnings from tourism, transportation, bunkering, and ship repair activities. In particular, the foreign exchange earnings from tourism activities were adjusted downward. In this new projection, the foreign exchange earnings from tourism are projected to drop by 37.0% in Curaçao as well as in Sint Maarten in 2020 compared to 2019. Furthermore, the earnings from refining activities were adjusted downward as the negotiations with the Klesch Group have been delayed amid the COVID-19 pandemic.

The import of goods and services was also revised downward due to a projected decline in domestic and tourism spending. Furthermore, the projected sharp decline in international oil prices will lower the oil import bill considerably.

Meanwhile on the income balance, the dividend and interest earnings on foreign assets are projected to drop significantly consistent with the global recession and the sharp decline in interest rates on the international financial markets. As a result, the surplus that was projected on the income balance for 2020 before the COVID-19 virus outbreak will turn around into a deficit. The current transfers balance will improve primarily because of a drop in current transfers to abroad (notably remittances) due to lower economic activity and the lockdown in the second quarter of 2020.

The capital transfers from abroad were adjusted downward based on the assumption that reconstruction projects in Sint Maarten will be delayed on the back of the global pandemic and related containment measures. Meanwhile, external financing into the monetary union was revised upward due mainly to a further worsening of the portfolio investment balance as a result of the first and second tranche of liquidity support from the Netherlands to Curaçao and Sint Maarten.[1] Furthermore, the loans & credits balance is also projected to worsen at a faster pace due to an increase in foreign

[1] In this projection, the CBCS has only included the part of the second tranche of liquidity support that was transferred by June 16, 2020 to the countries of Curaçao and Sint Maarten. Curaçao received by the end of May NAf.141.0 million and on June 16, 2020 NAf.63.0 million. Sint Maarten received NAf.24.0 million end of May 2020 but has not received the part of the second liquidity support of NAf.29.0 million yet (i.e., the part that is bound to conditions).

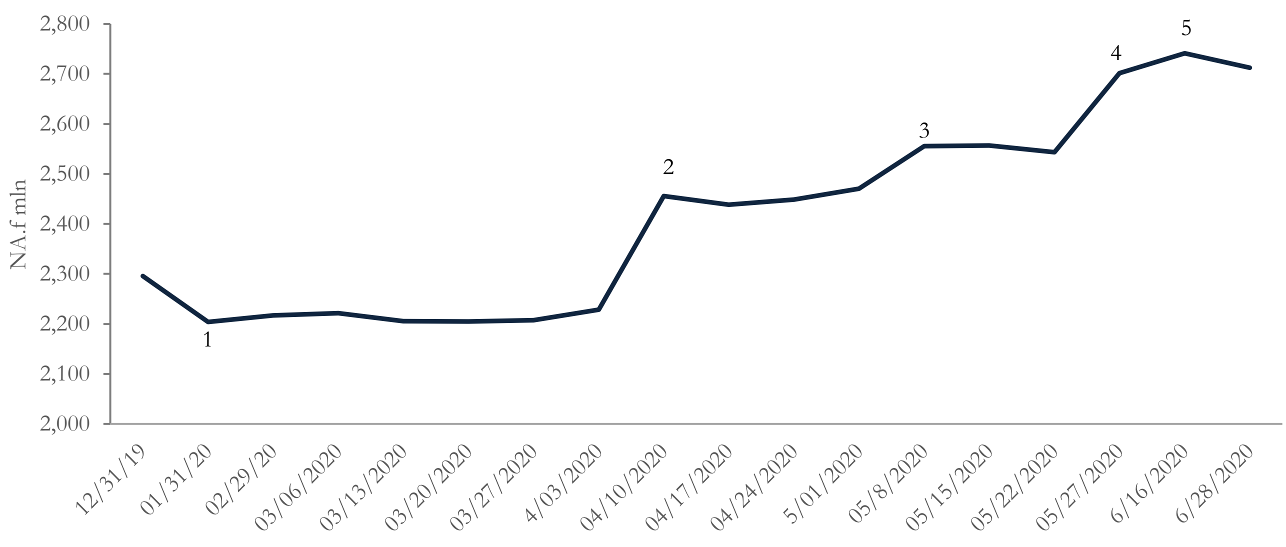
liabilities combined with a decline in foreign assets. By contrast, net direct investments into the monetary union will be lower compared to the pre-COVID-19 projection due to delays in the execution of major projects in the tourism sector and the takeover of the refinery in Curaçao. Moreover, the capital restriction imposed by the CBCS will reduce the increase in net foreign assets on the direct investment, portfolio investment, and loans & credits balances.

Despite the higher projected current account deficit, gross official reserves are projected to rise by NAf.221.7 million in the new projection as the external financing and capital transfers from abroad will be more than sufficient to cover the current account deficit.

3. Development in the gross official reserves between January and June 2020

The development in the gross official reserves of the monetary union between January and June 2020 is illustrated in Graph 1.

Graph 1 Official reserves January- June 2020



During the period January – June 2020, five noteworthy developments have taken place that are indicated by the numbers 1 through 5 in Graph 1:

1. A net decline in the official reserves mainly related to the transfer of dollar deposits abroad by commercial banks;
2. A net increase in the official reserves by NAf.227.0 million mainly due to the transfer of funds from the Netherlands related to the first tranche of liquidity support to Curaçao of NAf.177.0 million related to the COVID-19 crisis and NAf.44.0 million liquidity support to Sint Maarten related to the year 2019. Moreover, Sint Maarten received NAf.20.0 million liquidity support in the beginning of May 2020 related to the COVID-19 crisis;

3. A net increase in the official reserves due to the transfer of funds from abroad by institutional investors;
4. A net increase in the official reserves by NAf.158.0 million mainly due to the transfer of funds from the Netherlands related to the second tranche of liquidity support to Curaçao (NAf.141.0 million) and Sint Maarten (NAf.24.0 million).
5. A net increase in the official reserves by NAf.65.0 million on June 16 primarily due to the transfer of the remainder of the second tranche of liquidity support to Curaçao.

During the months February and March 2020, the level of official reserves remained stable. By the end of March, the CBCS imposed a capital restriction by suspending the extension of foreign exchange licenses for transfers abroad to mitigate a potential outflow of foreign exchange. Because of these developments, the official reserves increased from a stable level of NAf.2.2 billion in February - March to NAf.2.7 billion at the end of June 2020.

4. Projected import coverage for 2020

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.[2] To support the fixed exchange rate of the guilder vis-à-vis the U.S. dollar, the CBCS applies an import coverage benchmark of 3 months.

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 3 months. Hence, the import coverage of March 2020 is based on the official reserves in March 2020 and the projected average monthly imports for April – June 2020.

The CBCS identified two scenarios to estimate the monthly import coverage for 2020:

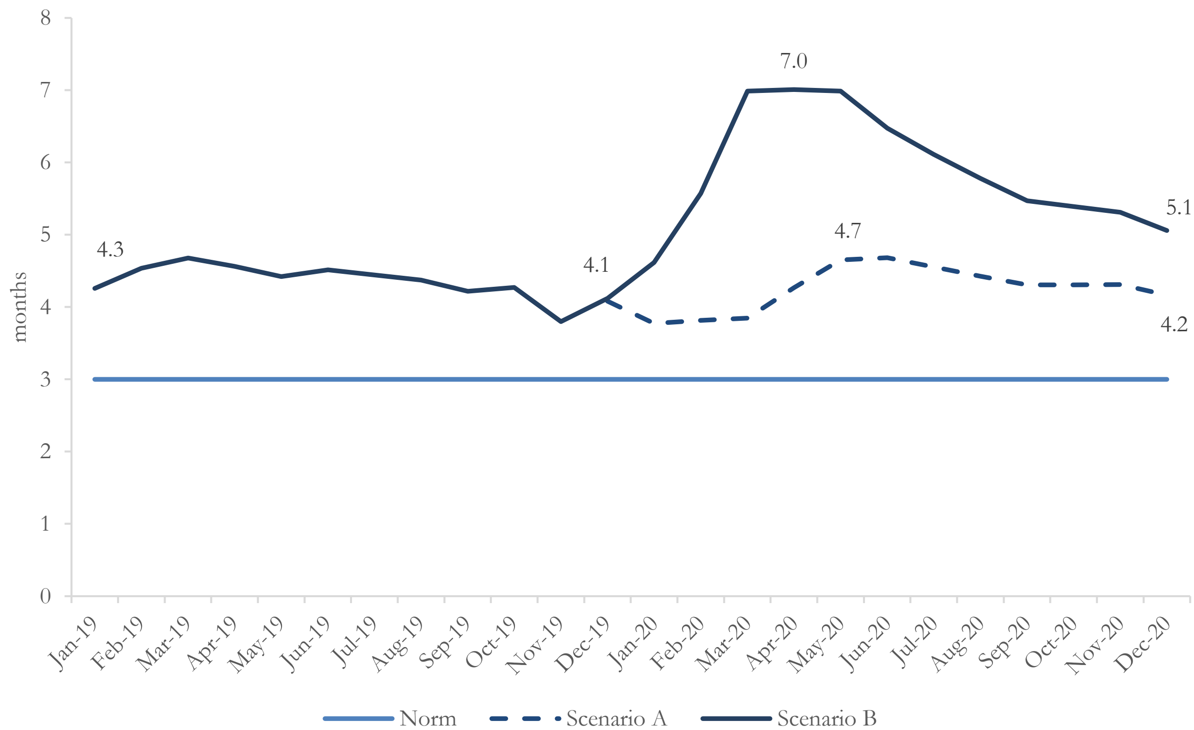
1. *Scenario A*: import coverage estimation based on the imports from the pre-COVID-19 balance of payments projection.
2. *Scenario B*: import coverage estimation based on the imports from the 3-month border closure and 6 weeks total lockdown balance of payments projection.

The imports in scenario B are significantly lower than in scenario A. In both scenarios, the development in the gross official reserves is based on the 3-month border closure and 6 weeks total lockdown balance of payments projection. In other words, the first and second tranche of liquidity support is included in the import coverage in both scenarios. The scenarios were estimated excluding any additional tranches of liquidity support from the Netherlands in 2020. Also, the part of the second tranche of liquidity support that Sint Maarten has not received yet and that is bound to conditions has not been included in this conservative projection.

[2] Some countries, however, incorporate their gold reserves in their import coverage estimations.

Graph 2 illustrates the development in the import coverage over the period 2019-2020.

Graph 2 Projected import coverage development 2020



In December 2019, the import coverage stood at 4.1 months. In scenario A, the import coverage will peak in May – June 2020 at 4.7 months driven primarily by the surge in gross official reserves due to the received tranches of liquidity support from the Netherlands. Thereafter, the import coverage will decline gradually to reach 4.2 months in December 2020. The projected average import coverage in 2020 is in scenario A 4.3 months.

In scenario B, the import coverage will peak at 7.0 months in March - May 2020 due mainly to the sharp decline in the import of goods and services amid the 3-month border closure and 6 weeks lockdown. After an increase in gross official reserves due to the liquidity support, the import coverage will drop gradually after May 2020 because of an increase in imports as economic activities gradually resume. The decline in the import coverage after the peak is steeper in scenario B than in scenario A and will reach 5.1 months in December 2020. In scenario B, the projected average import coverage in 2020 is 5.9 months.

Despite the deep economic contraction in the monetary union, the import coverage is projected to remain well above the benchmark of 3 months in 2020, thereby sending a strong signal about the stability of the fixed peg between the NAf. and the U.S. dollar.

5. Alternative scenarios for the import coverage

Under the assumptions made in section 4, the import coverage would remain well above the norm of 3 months in 2020. In this section, some alternative scenarios are calculated to assess what development in imports, gross official reserves and a combination of these two would result in an import coverage of 3 months in December 2020. In these alternative scenarios, the imports and gross official reserves follow the same development as in scenario B up until the month of May 2020.

Higher import growth as of June 2020

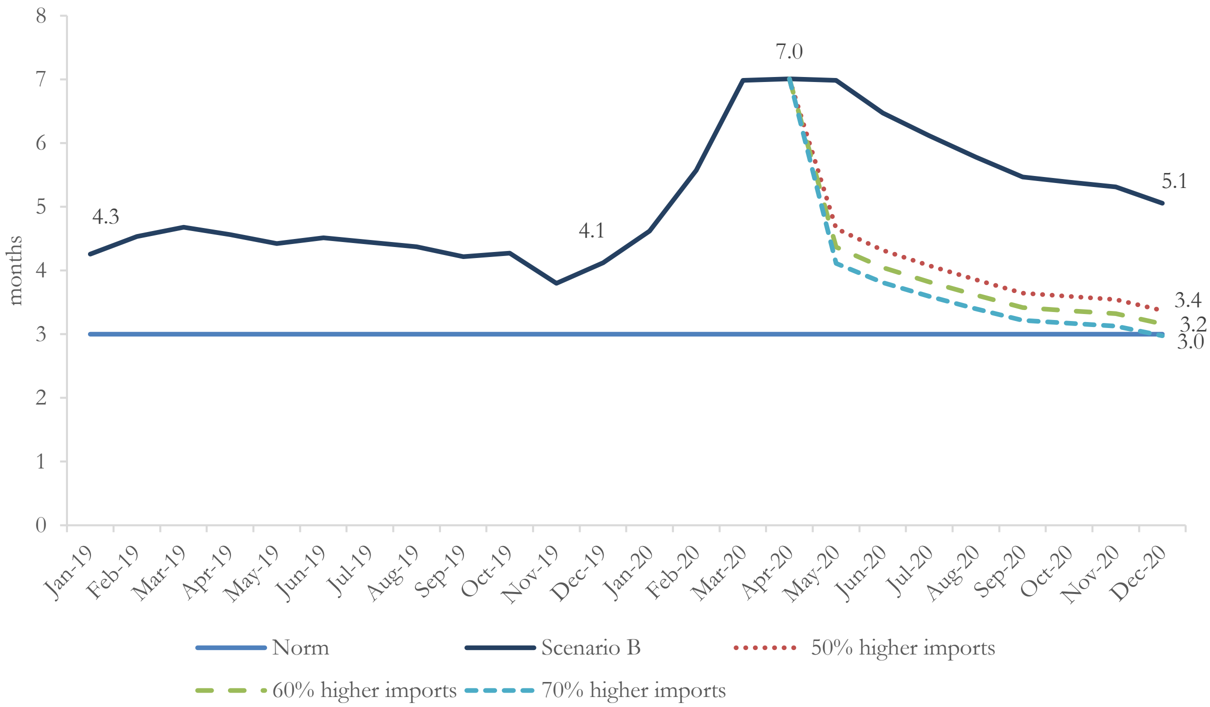
Through an iteration process, several scenarios were calculated assuming that the level of imports as of June 2020 would be higher than in Scenario B.[3] Graph 3 shows the development in the import coverage if the imports would be 50%, 60% and 70% higher than the projected import in scenario B as of June 2020. The development in gross official reserves is similar as in scenario B.

As shown in the graph, only if the imports are 70% higher than in scenario B, the import coverage will be equal to the norm of 3 months at the end of the year. In the case of 50% and 60% higher imports than in scenario B, the import coverage will be 3.4 and 3.2 months, respectively, in December 2020. Hence, it can be concluded that if, as of June 2020, the imports are more than 70% higher than the projected imports in scenario B, the import coverage will be below the norm of 3 months in December 2020.

In that case, total imports in 2020 would exceed NAf.7.3 billion. This is, however, an unrealistically high level of imports given that domestic demand and tourism spending are projected to drop significantly in both Curaçao and Sint Maarten.

[3] Through an iteration process, alternative scenarios were calculated starting at 5% higher imports than in scenario B. In the graphs, the results of the alternative scenarios that are the closest to the 3-month norm are presented.

Graph 3 Projected import coverage if imports are higher than in scenario B



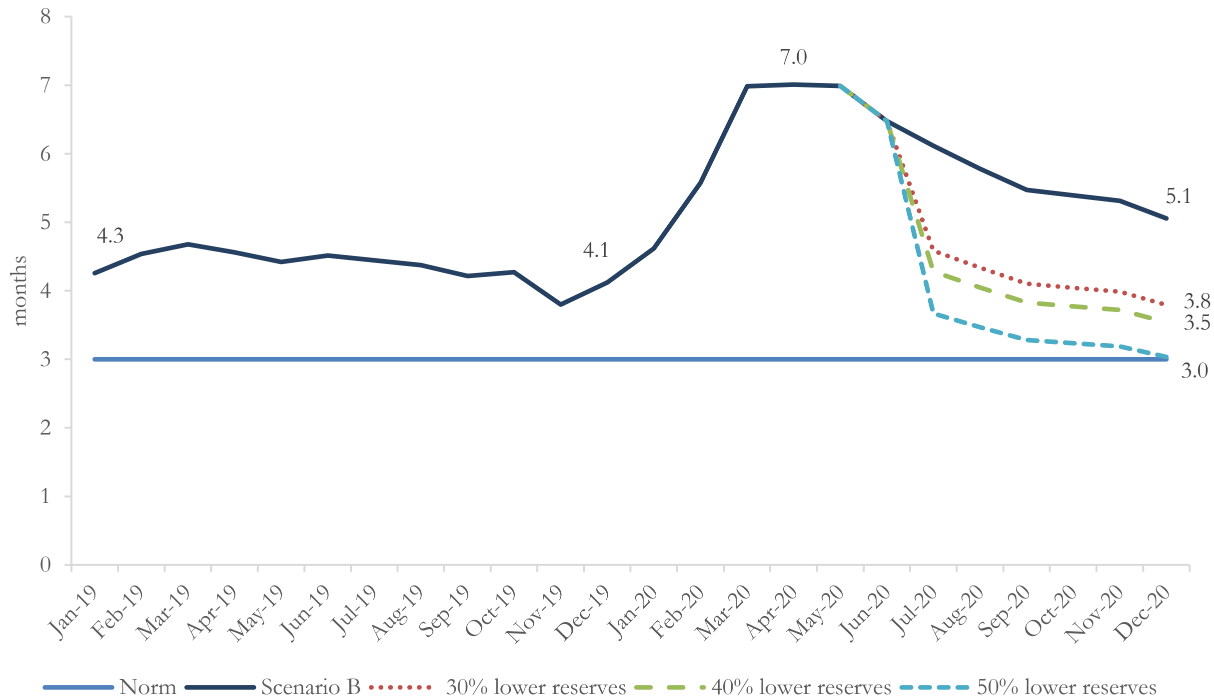
Lower gross official reserves as of June 2020

Graph 4 shows the development in the import coverage if gross official reserves would be 30%, 40% and 50% lower than the projected level in scenario B.[4] The projected imports are similar to scenario B. The graph shows that only if gross official reserves are 50% lower than projected in scenario B, the import coverage will drop to 3 months in December 2020. In the case of 30% and 40% lower gross official reserves, the import coverage will be 3.8 and 3.5 months, respectively, in December 2020.

Hence, if as of June 2020, gross official reserves are more than 50% below the projected level in scenario B, the import coverage will drop to less than 3 months in December 2020.

[4] Through an iteration process, several alternative scenarios were calculated starting at 5% lower than the projected level of gross official reserves. In the graph, the scenarios that are the closest to the 3-month norm are presented.

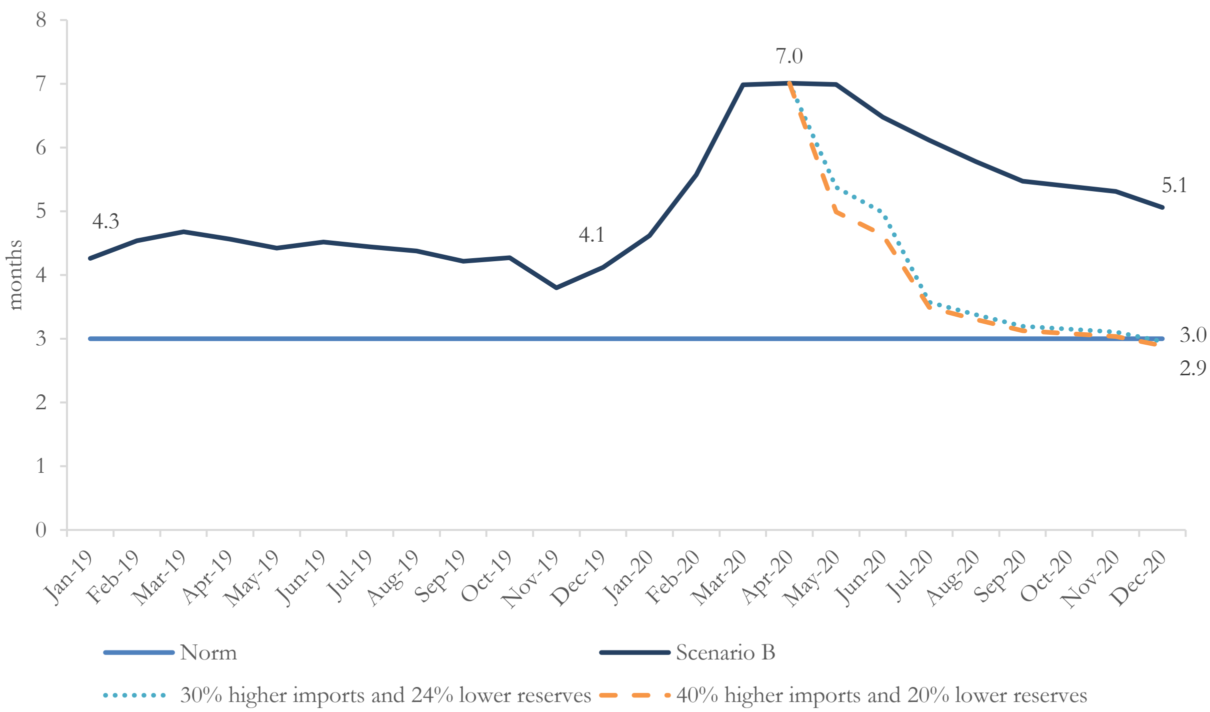
Graph 4 Projected import coverage if gross official reserves are lower than in scenario B



Higher imports and lower gross official reserves as of June 2020

Through an iteration process, several scenarios were calculated when imports are higher and gross official reserves are lower than in scenario B. The calculations show that if imports are 30% higher and gross official reserves 24% lower than in scenario B, the import coverage will drop to 3.0 months in December 2020. Meanwhile, if imports are 40% higher and gross official reserves 20% lower than in scenario B, the import coverage will drop to 2.9 months at the end of 2020 (see Graph 5).

Graph 5 Projected import coverage if projected imports are lower and gross official reserves are higher than in scenario B



6. Concluding remarks

The global outbreak of the coronavirus has caused an unprecedented crisis. The pandemic has affected the economies of Curaçao and Sint Maarten significantly. The economic contraction is expected to hit double digits in 2020 for both countries. Furthermore, the pandemic and the containment measures taken by the governments of Curaçao and Sint Maarten have had a negative effect on the current account of the balance of payments of the monetary union. The current account deficit is projected to widen considerably due mainly to a strong decline in exports, moderated by lower imports. Particularly the tourism sector has been severely affected. Even though the borders will be partially re-opened in July 2020, the tourism sector is projected to recover slowly amid the economic contractions in the main source markets and a fear for travelling. Meanwhile, the pressure on the current account balance of the monetary union will remain high due to increasing imports from domestic demand as a result of the phasing out of the domestic measures to contain the COVID-19 virus, moderated by a gradual pickup of exports.

Against this background and to support the fixed exchange rate with the US dollar, the CBCS recommended the governments of Curaçao and Sint Maarten to seek balance of payments support from the Netherlands in addition to liquidity support to finance support programs for businesses and individuals and the budget gap. The Kingdom Council of Ministers approached the Nederlandsche

Bank (DNB) to advice on the request of balance of payment support. On April 30, DNB adviced positively on providing this support.

Up to now, direct balance of payment support, however, has not been necessary. As the first and second tranche of liquidity support from the Netherlands to Curaçao and Sint Maarten have been transferred in U.S. dollar, i.e., implicit balance of payments support, the gross official reserves of the monetary union has increased significantly. This increase finances the loss of foreign income preventing pressure on the fixed exchange rate between the NAf. and the U.S. dollar. Consequently, the import coverage is projected to remain well above the 3-month norm during 2020. Some illustrative scenarios were included that show by how much higher imports and/or lower reserves from June 2020, the import coverage could drop to the 3-month norm by December 2020. The results of these scenarios, however, do not seem very plausible. First, given the impact of the coronavirus crisis on domestic demand and tourism, imports are not expected to increase at a fast pace in the second half of 2020. Furthermore, with the current capital restriction in place, a fast decline in gross official reserves also seems unlikely. If necessary, the CBCS can always take additional measures.

The current high level of import coverage is only temporary and reflects a significant drop in imports that is not related to the economic fundamentals of Curaçao and Sint Maarten but rather a total lockdown that put economic activity to a standstill. Therefore, the CBCS will keep monitoring the development in gross official reserves and imports closely and take the necessary measures, if needed. For the time being, the capital restriction will remain in place. Once economic activities are picking up, a gradual lifting of the restriction will be considered.

Recommendations:

A. The governments of Curaçao and Sint Maarten should take the necessary steps to re-activate economic activities, particularly in the tourism sector, while taking precautionary measures to contain a new outbreak of the coronavirus. The intention of Curaçao to open the borders for tourism from the Netherlands as of July 1, 2020 may support the recovery of the tourism industry.
B. The governments of Curaçao and Sint Maarten should take the necessary steps to support other foreign income generating activities, like ship repair, financial industry, call centers, transnational education.
C. Further reduce the dependency of Curaçao and Sint Maarten on fossil fuel by channeling more resources to green and blue energy sources and actively support the implementation of these renewable energy sources.
D. Even though the liquidity support resulted in a surge in gross official reserves, it also represents an increase in the indebtedness of the monetary union that will influence the balance of payments in the future. Therefore, both governments are recommended to negotiate with the Netherlands on converting (part of) the liquidity support into a grant.

Centrale Bank van Curaçao en Sint Maarten
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