CENTRALE BANK VAN CURACAO EN SINT MAARTEN

Revised growth projections as a result of the global outbreak of the coronavirus (COVID-19) and domestic preventive measures

1. Introduction

The government of Sint Maarten has implemented some precautionary measures in relation to the global outbreak of the coronavirus (COVID-19). One of these measures is the closure of the borders for commercial flights and maritime traffic, with the exception of transport of oil products and freight. On March 19, 2020, the Central Bank of Curaçao and Sint Maarten (CBCS) published a first note on the macroeconomic impact of these measures.

However, on April 8, 2020, after suspending all nonessential businesses and services, the government escalated its measures to a 24-hour curfew (i.e., lockdown) through at least April 20, 2020. Only essential and emergency workers with the required documentation are allowed to go out during the curfew. Pharmacies are open on highly restricted schedules. Furthermore, grocery stores, bakeries and supermarkets are closed but the government has made arrangements with such stores for delivery services. As a result of this lockdown, the economy of Sint Maarten has basically come to a standstill.

Meanwhile, international organizations, including the International Monetary Fund (IMF), have revised their economic projections significantly downward amid the global outbreak of the coronavirus and the extensive preventive measures governments around the world have taken. According to the World Economic Outlook of the IMF of April 2020, the world economy will contract by 3.0% in 2020. Furthermore, two of the main trading partners of Sint Maarten, the United States and the Netherlands, will experience real GDP contractions of 5.9% and 7.5%, respectively.

Against this background, the CBCS has revised its economic outlook for 2020 which is presented in this note. First, the baseline scenario is discussed in section 2. The revised outlook is presented in section 3 in which the lockdown is taken into account. Finally, section 4 provides the conclusion.

2. Baseline scenario

The CBCS calculated in March 2020 the macroeconomic impact of the closure of the borders for commercial flights and maritime traffic. Specifically, scenarios were calculated based on a closure for a period of 1 month, 2 months, 3 months, and 6 months. Furthermore, a distinction was made between a fast and a gradual recovery once the borders are reopened.

Currently, the scenario of a border closure for a period of 3 months with a gradual recovery after reopening of the borders is assumed as the baseline.

The baseline scenario is based on the following assumptions:

- The borders will remain closed for a period of 3 months. In this scenario, it is assumed that in the first three months after the reopening of the borders, exports will be 50% below the pre-crisis level. In the remainder of the year, exports will be 25% below the pre-crisis level.
- The closure of the borders has a negative effect on exports, in particular the foreign exchange earnings from tourism, transportation services and other services related to the tourism sector.
- The closure of the borders has a negative effect on economic activities and employment, particularly in the sectors tourism, transport and other services related to tourism, and thereby indirectly on domestic demand.
- As a result of the negative effects on exports and domestic demand, the closure of the borders will also have a negative effect on the import of goods and services.
- Financial support from the Netherlands and/or borrowing by the government of Sint Maarten to preserve the productive capacity of the economy and avoid a drastic drop in the purchasing power of the population are not taken into account.
- Increased public spending on, among other things, health care to reduce contagion of the Covid-19 coronavirus has not been taken into account.

Against this background, real GDP is projected to contract by 14.9% in 2020. This is a downward revision of 1.2 percentage points to the projection presented in March 2020. Furthermore, inflation is projected to reach 2.3% in 2020. This is a downward revision by 0.2 percentage point compared to the March projection as a result of the projected significant decline in international oil prices, moderated by increased prices due to disruptions in global supply chains.

The projected real GDP contraction is caused primarily by a significant decline in net foreign demand as exports will drop at a faster pace than imports. Exports are projected to fall considerably as a result of lower foreign exchange earnings from the tourism and transportation sectors. Furthermore, the revenues from businesses that cater to the tourism sector will decline, particularly the renting, timeshare and wholesale & retail trade sectors. Imports will also shrink due to the drop in tourism activities and lower domestic spending. Domestic demand will also contribute negatively to real GDP due to a decline in private and public consumption. The decline in private consumption is caused by increased unemployment and reduced purchasing power due to higher inflation.[1] Meanwhile, public consumption will go down as the government will have to reduce disbursements on goods & services due to lower tax earnings reflecting lower economic activities. By contrast, private investment is projected to increase, albeit at a much slower pace than in 2019, as important reconstruction projects such as the Princess Juliana International Airport and the Sint Maarten Medical Center are projected to continue, albeit with some delays.

[1] Inflation in 2019 was according to the CBCS' estimate 1.8% and will increase to 2.3% in 2020.

3. Effect border closure including lockdown

Based on the baseline scenario of a border closure of 3 months, the macroeconomic effect of a lockdown for a period of 1 month, 2 months and 3 months was calculated.

Only the short-term effects were calculated, i.e., the effect on economic growth in 2020. Furthermore, the other assumptions in the impact scenarios are equal to the baseline scenario. The closure of the borders and the lockdown will particularly affect economic activity in the second quarter of 2020. Based on seasonal trends, it is assumed that 24.0% of Sint Maarten's annual GDP can be ascribed to the second quarter. As a result of the lockdown, economic activities will be stalled during the second quarter of 2020.

Table 1 shows the effect of a border closure for 3 months including the lockdown on the economy of Sint Maarten:

- Baseline scenario: border closure for a period of 3 months with a gradual recovery following the reopening of the borders.
- Scenario 1: border closure for a period of 3 months with a gradual recovery following the reopening of the borders and a lockdown for a period of 1 month.
- Scenario 2: border closure for a period of 3 months with a gradual recovery following the reopening of the borders and a lockdown for a period of 2 months.
- Scenario 3: border closure for a period of 3 months with a gradual recovery following the reopening of the borders and a lockdown for a period of 3 months.

As a result of the lockdown, the real GDP contraction will be deeper compared to the baseline scenario. The longer the duration of the lockdown, the greater the negative impact will be. Consequently, a real GDP contraction between 17.0% (lockdown of 1 month) and 21.1% (lockdown of 3 months) is projected. The contraction is therefore between 2.1 and 6.2 percentage points higher than in the baseline scenario.

The deeper contraction of real GDP compared to the baseline scenario is primarily caused by a decline in domestic demand. The lockdown will have a negative impact on all components of domestic demand. However, the impact on private consumption is the most pronounced as spending, with the exception of groceries and medicine, will be halted for a period of 1 month due to the lockdown. Furthermore, private and public investments will drop compared to the baseline scenario because planned investment projects will be further delayed or in some cases cancelled as economic activities come to a standstill.

Meanwhile, the decline in net foreign demand is less pronounced in the case of a lockdown than in the baseline scenario. This can be ascribed to a deeper decline in the imports due to the stronger decline in domestic spending. The decline of the exports in the case of a lockdown will be more or less similar to the baseline scenario as Sint Maarten's main export sector is the tourism industry.

Table 1. Effect closure borders including lockdown

	2019	Baseline scenario	Scenario 1	Scenario 2	Scenario 3
Domestic demand, of which	**4.2%**	**-2.0%**	**-5.1%**	**-8.3%**	**-11.5%**
Private sector	4.0%	-1.3%	-3.9%	-6.6%	-9.1%
Investment	2.1%	0.7%	0.1%	-0.6%	-1.0%
Consumption	1.9%	-2.0%	-4.0%	-6.0%	-8.1%
Public sector	0.2%	-0.6%	-1.2%	-1.7%	-2.4%
Investment	0.0%	0.0%	0.0%	0.0%	0.0%
Consumption	0.2%	-0.6%	-1.2%	-1.7%	-2.4%
Changes in inventory	-0.2%	0.0%	0.0%	0.1%	0.1%
Net foreign demand, of which	**1.0%**	**-12.9%**	**-11.9%**	**-10.8%**	**-9.7%**
Export of goods and services	8.9%	-22.8%	-22.8%	-22.8%	-22.8%
Import of goods and services	7.9%	-9.9%	-10.9%	-12.0%	-13.1%
GDP (%, real)	**5.0%**	**-14.9%**	**-17.0%**	**-19.0%**	**-21.1%**
Inflation	1.8%	2.3%	2.3%	2.3%	2.3%
GDP in mln NAf. (nominal)	**1,913.2**	**1,672.2**	**1,632.0**	**1,593.7**	**1,553.5**
GDP in mln NAf. (real, prices of 2010)	**1,568.1**	**1,334.4**	**1,301.5**	**1,270.2**	**1,237.2**

4. Conclusion and policy recommendations

Similar to other countries, Sint Maarten also had to take the necessary measures to prevent an outbreak of the coronavirus COVID-19, which is especially dangerous for elderly and people with other medical conditions. Therefore, the borders were closed for commercial flights and maritime traffic and a 24-hours curfew, i.e., lockdown, was imposed. These measures will, however, have an adverse effect on the economy. The magnitude of this adverse effect depends on the duration of these measures and how fast the economy will recover after the borders are reopened.

The CBCS would like to emphasize that the economic projections are currently surrounded by extreme uncertainties. The world is experiencing a pandemic that has resulted in a global economic crisis. Some of the downside risks to the current outlook include the development and duration of the pandemic, the pace at which the preventive measures will be lifted, and how demand will recover.

The deep economic contraction will result in a further deterioration of the public finances. Following the hurricane in 2017, Sint Maarten was already allowed to deviate from the budgetary rules as stipulated by the Kingdom Law on Financial Supervision for Curaçao and Sint Maarten. The Kingdom Council of Ministers already agreed to prolong the allowed deviation from the rules amid the adverse effects of the border closure and lockdown. Furthermore, a first tranche of liquidity support has been from the Dutch government in the form of a 2-year bullet loan. Nevertheless, Sint Maarten will need additional funds to limit the increase in unemployment, provide financial assistance to vulnerably groups in society, and promote economic recovery.

Therefore, Sint Maarten will also have to take important steps on its own. In this respect, the CBCS would like to warn for counterproductive measures that can have a procyclical effect which could aggravate the economic contraction. At the same time, efforts should be made to keep the debt position of the country sustainable.

This analysis shows that the economic sacrifices of a lockdown are substantial. However, the consequences of the lockdown need to be financed. The longer the lockdown lasts, the less the still operating economic activities are able - partly out of solidarity - to contribute to the halted economic activities and the less sustainable the government's debt becomes. For this reason, efforts should be made to reactivate the economy in a responsible yet swift manner.

Centrale Bank van Curaçao en Sint Maarten
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Appendix

Graph 1. Effect closure of borders including a lockdown