ANNUAL REPORT 1998

Bank van de Nederlandse Antillen

1. REPORT OF THE PRESIDENT

1.1 General review

Economic activities in the Netherlands Antilles declined in 1998 for the third consecutive year, reflected by a contraction in real Gross Domestic Product of 0.3%. The downturn was attributable to the decline in domestic demand. The decline in domestic demand resulted from persistent low consumers' and producers' confidence related to the uncertainties surrounding the government's policy towards the financial-economic crisis. Government consumptive spending increased, while government investment declined. The economic recession contributed to a further increase in the unemployment rate. As a result of mainly the decline in domestic spending and, hence, merchandise imports, combined with the improvement of our export performance, our international reserves position recorded a marked increase.

The decline in economic activities was accompanied by a substantial deceleration of the inflation rate, reaching the lowest level since 1992. The deceleration was caused by both domestic and foreign factors. The main domestic factor was, among other things, the fading effect on prices of the sales tax and turnover tax. Foreign factors contributing to the decline in inflation were the low inflation rates in our main trading partners and the tumbling world oil prices. However, the recent agreement between the oil producing countries to reduce their production is pushing oil prices up again, which is expected to contribute to an increase of the inflation rate in 1999.

The overall performance of the tourist sector, our main export industry, was positive in 1998. Both the number of stay-over and cruise visitors increased and foreign exchange income earned recorded a growth. However, developments by island varied. In St. Maarten, the growth in stay-over tourism decelerated and cruise tourism recorded a marginal decline, which was caused by the passing of hurricane Georges in September 1998. In Curacao, the number of stay-over visitors continued to decline, but cruise tourism recorded a satisfactory growth. Only in Bonaire all tourism indicators deteriorated. Developments in Bonaire and partly in Curacao can be explained, among other things, by the lack of airlift and increased competition from other destinations. The outlook for 1999 is positive, given various developments contributing to an increase in the number of visitors. The number of charter flights is expanding rapidly, well-known hotel chains are attracted to improve product quality, existing hotels are expanded and new hotels are under construction, and a golf course and a mega-pier for large cruise ships in Curacao are almost finalized. Since tourism is our main source of foreign exchange revenues, the Bank wishes to underscore the importance of full support by the authorities to facilitate viable initiatives is this sector. A structural improvement of our tourist sector will namely expedite the adjustment process in our economy.

The free zone in Curacao recorded a further expansion in activities in 1998. This was reflected by marked increases in re-exports and the number of visits. The expansion in activities can be attributed partly to the establishment of a free zone area at the airport. Given the growing interest in setting up a business in this area, the floor space for business units will be expanded in 1999, which is expected to boost activities further.

Another sector that performed well in 1998 was the oil industry, reflected by a further increase in the amount of oil refined. The higher production was realized at lower operational costs, reflecting the success of the efforts to improve cost efficiency and competitiveness. However, to secure the refinery's long-term viability, large investments are imperative. The implementation of an upgrading program has already started and the preparations for the construction of a power plant, according to the "build, own and operate" principle, are in a final stage. The Bank wants to underscore the importance of a full and timely implementation of these projects for a revival of our economy.

In contrast, activities in the international financial and business services sector continued to decline. The deterioration was reflected in a drop both in income received for services rendered and in profit tax transferred to the government. This development can be attributed partly to the erosion of our competitive position vis-à-vis other jurisdictions as a result of the changes in the tax arrangements with the Netherlands. However, the prospects for the sector look promising. This optimism is based on new initiatives, such as the introduction of the private foundation and the establishment of a securities exchange, the latter expected to become operational during 1999.

In addition, the transportation sector recorded an overall decline in activities in 1998, which was primarily oil related. Bunker sales decreased substantially, while oil transshipment and storage activities recorded an overall deterioration. The latter was attributable entirely to the development in Bonaire, as this sector performed well in Curacao and St. Eustatius. The decline in oil transshipment in Bonaire contributed to a decline in harbor activities, as a result of the drop in the number of tankers piloted. Furthermore, the ship repair sector registered a decline in activities measured by the number of man-hours sold, despite an increase in the number of ships repaired.

In contrast to the above, the national carrier Air ALM recorded a marked growth in the number of passengers transported, but cargo shipments continued to decline. However, to ensure the company's long-term viability, a comprehensive restructuring plan is urgently called for. Only a credible business plan with prospects for a profitable operation can gain investors' confidence and raise the necessary funds on the capital market. In this respect, the Bank welcomes the recently formed strategic alliance with Air Aruba and the Venezuelan airline Aserca, which will strengthen Air ALM's regional position. Airport activities in Curacao increased, owing mainly to the strong growth in the number of transit passengers. The latter reflects the airport's function as a regional hub. The harbor of Curacao performed well also, as both the number of ships piloted and the amount of cargo handled increased. Cargo transshipment in particular recorded a substantial growth, which can be related to an increase in exports to the European Community.

Turning attention to the external sector, the deficit on the current account of the balance of payments improved in 1998, owing to the overall growth in exports, the decline in merchandise imports, and the improvement of the income balance. However, further analysis of the underlying factors of these developments reveals several weaknesses. Of our main economic pillars, only the tourist sector recorded an increase in foreign exchange revenues. The decline in merchandise imports was related to the muted domestic spending and the fall in world oil prices. Furthermore, the improvement of the income balance was attributable to relatively large interest and dividend receipts of a transitory nature. The improvement of the current account was supplemented by an increase in the surplus on the capital account, attributable to both the private and official capital balances. The improvement of the private capital balance resulted mainly from the volatile short-term capital component, while the higher surplus on the official capital balance can be explained by an increase in development aid received from the Dutch government. The improvements in both the current and the capital balance of the balance of payments resulted in an increase in our foreign exchange reserves. It should be noted, however, that the balance of payments surplus in 1998 is not firmly established. For a lasting improvement of our balance of payments and, hence, foreign exchange reserves position, efforts should be made to strengthen our export sector. The success of these efforts depends, however, on regaining investors' confidence with the implementation of a viable and comprehensive structural adjustment program.

On the fiscal front, the cash deficit of the General Government increased significantly in 1998. The higher deficit was due mainly to an increase in expenditures, resulting from the reduction of arrears to the civil servants pension fund APNA by the Central Government and higher interest payments. Government revenues decreased slightly, due to less tax revenues related to the economic recession. Despite its increase, the cash deficit was substantially lower than the deficit on a commitment basis, as a result of the persistent financing constraints on the domestic capital market. As a consequence, payments continued to be deferred and arrears increased further, which had repercussions for the quality of government services and public investments. In addition, these actions erode the financial position of private suppliers, which will aggravate the recession. To prevent a liquidity crisis, corrective measures must be taken without further delay. These measures should focus on a structural reduction in expenditures resulting in a balanced budget in the near term. Only a credible fiscal consolidation policy can restore investors' confidence and increase the availability of funds at competitive rates to facilitate the restructuring of the public finances and the recovery of our economy.

The increase in net international reserves resulted in an expansion of the money supply in 1998. The domestic sector, however, recorded a moderate contractionary impact due to the government sector and miscellaneous factors. The demand for liquid assets by the government sector contracted owing to the nonmonetary financing of the deficits of the island governments. The private sector recorded a moderate expansionary impact, due entirely to the increase in loans extended by the commercial banks. However, the growth in credit extension remained well within the limit set in the monetary cash reserve arrangement, reflecting the reticent spending behavior in light of the persistent uncertainties in the economy.

During 1998, the Bank took several steps aimed at a more market-oriented monetary policy. The cash reserve percentage of the monetary cash reserve arrangement has been reduced, relieving the penalty on excess credit, and from January 1, 1999, direct restrictions on credit to the private sector were abolished. However, the ceiling on net credit to the government remained in place to minimize monetary financing of the deficits. In addition, the limit on net foreign investments for commercial banks (i.e., the B-9) was abolished as of September 1998. In the new monetary policy the reserve requirement has become the Bank's main instrument. This instrument aims to reduce over-liquidity in the banking system and, hence, limit the possibility of excess credit extension. As a result, the reserve requirement percentage has been increased several times based on the developments in the free reserves of the commercial banks and the official foreign exchange reserves vis-à-vis benchmarks determined by the Bank. Any changes in the reserve requirement will depend mainly on the impact of the government's efforts to address the financial-economic crisis.

1.2 Policy considerations

The economic recession in the Netherlands Antilles continued in 1998 against the background of a weakening world economy. The crisis in Asia spilled over to the emerging markets of Russia and Latin America and is expected to slowdown the buoyant growth of the US and European economies.

The persistent downturn in economic activities in the Netherlands Antilles is related strongly to the crisis in the public finances and the lack of corrective measures in 1998 as a result of the long formation period of the new government and uncertainties surrounding its policy to address the financial-economic situation. It is evident that strong actions are urgently needed to prevent a deepening of the recession.

The recovery plan presented by the government on November 30, 1998, was a welcome first step in addressing the financial-economic crisis, but needs further elaboration. The General Government's cash deficit for 1999 is estimated at NAf 275 million (6% of GDP), substantially higher than the NAf 85 million (2% of GDP) deficit in 1998. The deterioration of the deficit is a result of a decline in revenues and an increase in expenditures. The main factors contributing to the decline in revenues are the replacement of the 6% sales tax (ABB) on the Leeward Islands by a 2% turnover tax, the reduction of the turnover tax on the Windward Islands from 3% to 2%, and the reduction of income and profit taxes, which are part of the government's recovery plan. The increase in expenditures is attributable primarily to the carry-over of expenditures from 1998, investments related toY2K issues, and the settlement of a guarantee. It is clear that a deficit of this magnitude cannot be financed in the domestic nonbanking sector. The government was not able to raise more than NAf 45 million in net borrowing in 1998. To avoid a financial crisis and move to a more sustainable fiscal situation in the next few years, strong adjustment measures have to be adopted without further delay.

The fiscal adjustment measures should focus on a structural reduction in expenditures, primarily through a reduction of the wage bill. This could be attained by streamlining the government bureaucracy through the further privatization of government agencies, a tight wage policy to minimize wage drift, and the further restructuring of the pension scheme. The measures on the wage front should be complemented with a reform of the health care system. On the revenue side, efforts should be made to enhance further tax administration and tax enforcement. In addition, the intended reduction in income and profit taxes should be accompanied by a strengthening of indirect taxes, i.e., the turnover tax, to prevent erosion of the tax base.

Concomitant with the fiscal consolidation measures, actions directed at an improvement of our investment climate are urgently called for. These actions should be included in a policy set up along the lines of the Interamerican Development Bank report. The Bank's recommendations include the reduction of red tape, labor market rigidities and market protection, complemented with a strengthening of the telecommunication infrastructure and education. Furthermore, wage increases should be limited to improvements in productivity. This aim should be supported by a shift in focus in labor negotiations from higher wages to the implementation of training programs, which increase productivity and, eventually, wages. The Bank wants to stress that the prospects for economic recovery will be enhanced only if the authorities adopt market-oriented reform and resist the temptation of direct intervention.

To underpin the authorities' commitment to correct the financial-economic situation, the fiscal policy package as well as the economic reforms should be accompanied by a detailed time schedule for its implementation with quantitative and policy benchmarks to monitor its progress. Only this two-tier approach of the structural adjustment of our economy supported by a specific plan of action will create a climate for regaining investors' confidence and a resumption of investments. The Bank wants to re-iterate that visible progress in fiscal consolidation supported by trade and investment policies is a necessary condition for the economic reforms to be effective in stimulating economic activity. Through reduction of the fiscal deficits, the government will free-up scarce financial resources to finance the much-needed investments of the private sector. This policy approach will lay a foundation for a sustainable recovery of our economy and, hence, the creation of jobs to reduce the unacceptably high unemployment rate.

The necessary fiscal and economic reforms in our economy will be complemented by an appropriate monetary policy. The elimination of direct credit controls, as part of the Bank's new more market-oriented monetary stance, offers the commercial banks more flexibility to finance projects for productive purposes. For 1999, the Bank will pursue an active reserve requirement policy to sterilize excess liquidity in the banking sector and, hence, the risks of excessive credit extension vis-à-vis our balance of payments objectives. Any changes in the reserve requirement are related to progress in the government's consolidation efforts.

The aggravation of the financial-economic crisis pose enormous challenges for the authorities. The only way to counter the crisis is through the implementation of a credible and comprehensive structural adjustment program. This program must achieve a structural reduction of the government deficits and a revitalization of the economy. The National Plan Commission, which is entrusted with the task to transform the current recovery program into a comprehensive national restructuring program, is an important step towards this objective. However, it should be clear that the current economic situation calls for bold actions by the authorities. If we are to achieve a sustainable improvement of our economy, it is therefore essential that the Commission's recommendations be fully implemented without delay.

E.D. Tromp
President

2 DEVELOPMENTS IN THE REAL SECTOR

2.1 General economic developments

Real gross domestic product, the broadest gauge of national economic activity, decreased by 0.3%[1] in 1998, following a contraction of 1.8% in 1997. For three consecutive years, the economy of the Netherlands Antilles has remained gloomy. More even, the weak economy was coupled with higher unemployment and modest inflation. So far, however, the sluggish global economy has not had a major impact on our export sector, including the free zone, tourism, transportation, and financial sectors, but the shrinking domestic spending outweighed the growth of exports. Annual inflation slowed to 1.2%, down from 3.1% of 1997. The lower inflation of our principal trading partners, the depressed global oil prices, and the bottoming-out effects of the indirect taxes imposed by the government approximately two years ago were the main causes for the decelerating trend in price inflation.

[1] Estimate of the BNA

2.1.1 National production and spending

The decline in real GDP of the Netherlands Antilles was a result of fewer production activities led by a decline in domestic demand. In spite of the good performance of the free zone and tourism, these sectors were unable to offset the eroded domestic demand. Consumer and producer confidence was low because of the growing unemployment and uncertainty concerning the government's policies for tackling the mounting budget deficit. As a result, consumers did not want to spend money on consumption, and producers have been putting off their investments, waiting for the economy to improve. Government investment tumbled by 21.6%, but government consumption surged by 3.4%. Higher government consumption was related to back payments to the pension fund (APNA) for civil servants.

2.1.2 Inflation

In the Netherlands Antilles, the consumer price index eased from 3.1% in 1997 to 1.2% in 1998, the lowest annual inflation rate since 1992. Inflation remained in check for the following reasons: the tapering effects of the sales tax and turnover tax, the lower inflation rates of our main trading partners (the Netherlands and the USA), and the tumbling world oil prices. Consumer prices in both the Netherlands and the USA slowed to 2.0% and 1.6%, respectively, in 1998.

An analysis of inflation by island shows that St. Maarten's inflation rate was the highest at 1.9%, followed by Bonaire and Curaçao at 1.3% and 1.1%, respectively (table 2.1). The largest price rise in St. Maarten (5.6%), Bonaire (4.9%), and Curaçao (1.9%) occurred in the category "transport and communication." The major force behind this increase was the higher telephone rates for local calls. "Beverages & tobacco" also recorded large increases in St. Maarten (4.3%) and Bonaire (5.5%). The price gain in the item "beverages & tobacco" was led by a rise in the costs of beverages. Furthermore, in Curaçao, the surge of 2.3% in the sector "health" was associated with higher-priced medical care costs. Lower clothing costs, meanwhile, were responsible for the smallest price hike in "clothing & footwear" in St. Maarten (0.5%), Bonaire (0.0%), and Curaçao (0.0%).

Table 2.1
Inflation rates for Curaçao, Bonaire, and St. Maarten in 1997 and 1998 (% changes)

	Curaçao		Bonaire		St. Maarten	
	1997	1998	1997	1998	1997	1998
Food	2.3	1.2	1.7	0.2	3.0	1.5
Beverages & tobacco	3.7	1.1	2.8	5.5	1.3	4.3
Clothing & footwear	0.7	0.0	0.0	0.0	0.4	0.5
Housing	3.9	0.9	2.4	0.5	3.6	0.9
Housekeeping & furnishings	2.1	0.8	1.5	0.8	1.7	0.9
Health	3.3	2.3	3.8	0.4	0.1	1.4
Transport & communication	4.1	1.9	4.2	4.9	5.4	5.6
Recreation & education	2.5	0.8	1.9	2.2	2.5	1.1
Other	4.6	1.2	3.3	0.9	2.9	1.1
General inflation rate	3.1	1.1	2.3	1.3	3.1	1.9

2.1.3 Labor market

With ever more people jobless, unemployment remained one of the major problems facing the Antillean government. For years the labor market has been suffering from structural unemployment, and in recent years, demand deficient unemployment also has become apparent. However, according to the Vacancy Survey[1], job-openings are available for people with various levels of education (table 2.4). For 1998, the Antillean unemployment rate worsened to 15.8%, measured against 14.9% in 1997. Due to the growing jobless rate and falling employment opportunities, many people have migrated and continue to leave the islands looking for better prospects overseas.

In Curaçao, the unemployment rate swelled from 15.3% in 1997 to 16.7% in 1998[2] (table 2.2). Additionally, youth unemployment did not show any improvement, jumping to 35.5%. According to the Department of Labor and Social Affairs, the number of personnel laid off was down by 22.8% to 564 for the year 1998, compared to 731 in 1997. The dismissals were apparent in all sectors, but confined mostly to the trade, hotel & restaurant, and social services sectors.

[1] Vacancy Survey 1998, Central Bureau of Statistics
[2] Arbeidskrachtenonderzoeken 1998, CBS

Table 2.2 *Labor market developments in Curaçao*			
	1996	**1997**	**1998**
Total population	151,611	152,035	150,663
Total labor force	66,216	66,380	65,009
Number of unemployed	9,252	10,134	10,828
Unemployment rate	14.0%	15.3%	16.7%
Number of employed	56,964	56,246	54,181

Source:
Arbeidskrachtenonderzoeken, Central Bureau of Statistics

Both Bonaire's and St. Maarten's unemployment were estimated to have risen by 0.1 percentage point to, respectively, 7.5% and 17.2%[1] in 1998. This rise was attributable to Bonaire's weak tourism sector and above all to St. Maarten's tourism industry, which was slower than in 1997, owing primarily to hurricane Georges that hit the island in September 1998.

[1] Estimate of the BNA

2.1.3.1 Vacancy survey

The Central Bureau of Statistics conducted a Vacancy Survey on all the islands of the Netherlands Antilles in 1998. This survey formed part of the Business Census, and, therefore, government services were not included. Although the statistics differed by island, some general remarks can be made from the survey.

Table 2.3 *Vacancies by sector*		
Sectors	**Employed**	**Vacancies**
Agriculture/Mining	470	27
Industry	5,044	125
Utilities	1,253	25
Construction	3,962	43
Trade	15,022	258
Hotel & restaurant	8,432	181
Transport	4,671	57
Financial services	4,930	108
Business services	6,959	180
Education	555	22
Health care	4,286	91
Other services	5,158	186
Total	60,742	1,303

Source: Vacancy Survey 1998, Central Bureau of Statistics

The number of vacancies were 1,303 (table 2.3), of which 19.8% were in the trade sector, followed by "other services" (14.3%), and "hotel & restaurant" and "business services" both with 13.9%. More than 40% of the vacancies were newly created jobs.

Employment that required a primary level of education had a relatively high percentage of vacancies (9.5%). Meanwhile, jobs that required mid and higher levels of education (MBO/HBO/University) accounted for 35.5% of the vacancies (table 2.4).

Table 2.4
Vacancies by level of education

Level of Education	**Vacancies**	**Level of Education**	**Vacancies**
Primary level	124	MBO	255
MAVO	153	-Technical	86
LBO	240	-Administrative	67
-Technical	148	-Social care	48
-Administrative	17	-Other	54
-Social care	61		
-Other	14	HBO/University	207
		-Technical	33
HAVO	117	-Administrative	117
Not relevant	196	-Social care	23
Not known	11	-Other	34

Source: Vacancy Survey 1998, Central Bureau of Statistics

2.2 Developments by sector

2.2.1 Mining

Bonaire's salt industry experienced a mixed performance in 1998. Salt production tightened by 37.5% in 1998, contrasting with the increase of 14.4% in 1997. Conversely, salt exports in 1998 were up by 23.4%, as opposed to a decline of 9.3% a year earlier.

2.2.2 Industry

The oil industry recorded some favorable results in 1998. Oil production expanded, as the amount of oil refined drifted up by 2.4%, after the 15.6% increase in 1997. On the other hand, total operational costs dropped by 13.1%, linked to a reduction in the refinery's own use of fuel and material costs.

Activities in Curaçao's ship repair sector registered a mixed picture in 1998. The number of man-hours sold dipped by 2.5%, compared to a drop of 19.0% in 1997. The number of ships repaired, however, increased by 18.9% in 1998, up from the 5.0% rise of the year before. The amount of foreign exchange income generated, however, declined by 7.1%.

2.2.3 Utilities

Water production in the Netherlands Antilles expanded by 6.8% in 1998, following a gain of 1.5% in 1997. An analysis by island showed that the largest growth in water production occurred in Curaçao (8.3%). Bonaire's and St. Maarten's water production also picked up, by 1.2% and 0.9%, respectively, in 1998.

The Antillean electricity production was up by 6.2% for the whole year of 1998, higher than the 2.4% increase of 1997. This expansion was related to a rise of 5.7%, 7.8%, and 7.6% for Curaçao, Bonaire, and the Windward Islands, respectively.

2.2.4 Construction

For 1998, the construction sector in Curaçao offered mixed developments. The number of total finished projects edged up by 17.3%, helped by the rise of nonresidential projects. Conversely, the value of construction permits dropped by 12.7%, indicating a possible slowdown in construction activities on the island. In Bonaire, the value of completed construction projects dropped by 17.4% in 1998, compared to a decline of 10.7% in 1997.

2.2.5 Trade

In 1998, free zone re-export activities increased, by 19.5%, compared to a 33.8 % growth a year ago. In addition to the positive re-export performance, the number of free zone visits grew by 27.6%, higher than the 8.4% growth in 1997. The number of free zone visits were up in all the main markets, except for Brazil.

2.2.6 Tourism

Tourism activities in the Netherlands Antilles posted gains in 1998, as both stay-over and cruise tourism grew by 1.7% and 0.3%, respectively. An analysis by island showed that only St. Maarten had a positive stay-over arrival turnout. Moreover, all islands except Curaçao reported a sluggish cruise industry. Alongside the surge in stay-over tourism, the number of visitor nights picked up by 0.9%. Foreign exchange earnings from tourism improved by 15.1% in 1998, in comparison to an expansion of 13.4% in 1997.

The tourist sector in St. Maarten reflected mixed performance for the year 1998. The number of stay-over visitors grew by 4.4%, lower than the rise of 20.4% in 1997. The higher 1998's stay-over arrivals came from all markets, including South America (4.7%) and the Caribbean (6.1%), but primarily from North America (6.9%) and Europe (1.5%) (table 2.5). In contrast, the number of cruise passengers declined by 0.5% in 1998, following a jump of 34.8% in 1997. Compared to last year, both the increases in stay-over and cruise passenger numbers were much lower in 1998. This slowing has been caused mainly by hurricane Georges, which swept through the island in the third quarter of 1998. In addition, the growth rates in 1997 were relatively high due to the progress in the recovery of the tourist sector after the damage caused by hurricanes Luis and Marilyn in September 1995.

Table 2.5
Growth in stay-over tourism by island (% change)

	Curaçao		**Bonaire**		**St. Maarten**	
	1997	**1998**	**1997**	**1998**	**1997**	**1998**
North America, of which:	-5.6	9.0	0.4	-1.7	32.6	6.9
-U.S.A.	-3.0	8.5	3.3	-1.6	29.6	6.6
-Canada	-35.2	18.1	-50.2	-5.6	61.2	9.0
Europe, of which:	-6.1	-8.5	-4.7	-2.2	9.7	1.5
-The Netherlands	-7.3	-7.8	-7.1	-4.0	24.6	3.8
-France	n.a	n.a.	2.3	-20.4	7.1	-3.9
-Germany	-7.5	-17.7	10.6	-11.6	n.a.	n.a.
-Other Europe	7.3	-7.1	-3.7	18.8	13.2	25.1
South & Central America, of which:	0.5	1.8	-7.2	10.4	32.3	4.7
-Venezuela	6.4	16.5	-8.9	23.7	67.4	4.9
-Brazil	-23.7	-32.8	-8.9	-16.8	89.1	-31.9
-Other S&C America	3.8	-19.1	-0.1	-9.1	15.4	15.4
Caribbean, of which:	-2.8	-7.3	-14.5	-15.2	3.2	6.1
-Aruba	5.0	-12.4	-14.5	-15.5	n.a.	n.a
-Santo Domingo	-2.5	-7.9	-14.5	-14.4	-0.2	7.4
-Other Caribbean	-8.2	-3.1	n.a.	n.a.	3.8	5.9
Rest of World	-9.2	-7.0	-27.7	-18.3	4.7	-1.2
Total	-4.3	-3.2	-3.6	-1.7	20.4	4.4

Curaçao's tourism industry also recorded mixed results in 1998, as the number of stay-over tourists slipped by 3.2%, while the number of cruise tourists edged up by 7.7%. Stay-over tourism from Curaçao's largest market dropped, reflected by the decline of 7.8% in the number of Dutch visitors. For the last several years, the lack of flight capacity and the competition with other destinations has deterred many Dutch tourists from visiting Curaçao. Moreover, the Caribbean market did not fare any better, as its visiting numbers fell by 7.3%. Canadian and Venezuelan arrivals, however, expanded by, respectively, 18.1% and 16.5%, but were outweighed by the contraction in the European and Caribbean markets. Coupled with the weak stay-over tourism were the drops in both the number of visitor nights (5.2%), and the hotel occupancy rate (10.2%).

Contrary to the developments in both St. Maarten and Curaçao, Bonaire registered decreases of 1.7% and 42.4% in stay-over and cruise tourism, respectively. The deterioration in stay-over tourism was apparent in most markets: North America (1.7%), Europe (2.2%), and the Caribbean (15.2%). Only the South American market showed a growth, as the number of travelers from Venezuela swelled by 23.7% in 1998.

2.2.7 Transportation

In 1998, the national airline "Air ALM" revealed a growth of 10.0% in the number of passengers transported, an improvement over the 3.3% gain of a year ago. On the other hand, cargo shipments declined by 7.7% in 1998, compared to a 23.6% fall in 1997.

Curaçao's airport activities, as measured by total passenger movements, were up by 4.7% in 1998, following the rise of 1.1% in 1997. The 1998 expansion was the result of advances of 17.8% and 1.0% in the flow of transit passengers and total passenger departures, respectively. Moreover, the number of commercial landings ticked up marginally from 5.7% in 1997 to 5.8% in 1998, attributable to the charter flights of Sobelair and Canada 3000 in the last few months of 1998.

For the year 1998, both Curaçao's and Statia's oil transshipment and storage activities performed well. However, oil transshipment and storage movements in Bonaire shrank by 39.6% and 37.0%, respectively. Oil transshipment in the Netherlands Antilles plunged by 13.9% in 1998, a result of the sharp reduction in Bonaire's oil transshipment.

The harbor sector in Curaçao performed well in the year 1998, as the number of ships piloted into the harbor increased by 11.0%. The positive harbor developments were ascribable to a rise in the number of freight vessels that visited the harbor. This rise can be explained by the increases of 40.4% and 4.7%, respectively, in transshipment and local cargo shipments. Besides the improved cargo movements, bunker sales of water in Curaçao expanded by 15.3% in 1998, after dropping 25.6% in 1997.

3 PUBLIC SECTOR AND DEVELOPMENT AID

3.1 Cash overview and financing

3.1.1 Introduction

Even though there was no Structural Adjustment Program (SAP) for 1998, the deficit of the General Government was lower than the deficit in 1996 when the SAP was introduced. Several measures were in place during 1998, including a new wage structure, a freeze on wages until the end of 1998, reduction in vacation allowance, and measures in the pension scheme. In addition, several departments were transformed into independent organizations within the framework of the core-task analysis.

Compared to 1997, however, the deficit of the General Government, i.e., the Central Government and the Island Government of Curaçao combined, deteriorated by NAf.29.7 million in 1998 (table 3.1). This development can be ascribed to a NAf.27.0 million increase in expenditures and a NAf.2.7 million drop in revenues compared to 1997.

Table 3.1 Overview of cash operations of the General Government, 1996 - 1998 (in millions NAf.)			
	1996	**1997**	**1998**
Revenues	1,283.6	1,269.6	1,266.9
Tax revenues	1,084.8	1,119.5	1,114.4
Nontax revenues	191.2	142.0	143.4
Capital revenues	0.9	0.4	0.1
Grants	6.7	7.6	9.0
Expenditures	1,439.0	1,324.7	1,351.7
Current	1,365.2	1,269.3	1,341.1
Capital	73.8	55.4	10.6
Balance	-155.4	-55.1	-84.8

As can be seen from table 3.2, the deficit as a percentage of GDP increased from 1% in 1997 to 2% in 1998. Revenues as a percentage of GDP remained at 29% in 1998, while expenditures increased from 30% of GDP in 1997 to 31% in 1998. Remarkable is the increase in the interest payments as a percentage of GDP -- from 3% in 1997 to 4% in 1998 -- and the low level of investments as a percentage of GDP, which remained at 1%.

The impact of interest payments on the deficit of the governments also is shown in this table. The primary balance, i.e., excluding interest payments, showed a surplus of 2% of GDP in 1998, compared to an overall cash deficit of 2% of GDP.

The tax burden in 1998 remained at the same level as in 1997. The increase in 1997 was the result of the introduction of new taxes (the sales tax on Curaçao and Bonaire, and the turnover tax on the Windward Islands), the increase in some of the tariffs, and the improved collection of taxes. The collective burden in 1998 also remained the same compared to 1997. In 1997 the collective burden increased due to the introduction of general insurance for chronic illness 'AVBZ'.

Table 3.2 Selected key variables of the General Government, 1996 - 1998 (cash basis, % of GDP)			
	1996	**1997**	**1998**
Revenues	29%	29%	29%
Tax revenues	25%	26%	25%
Expenditures	33%	30%	31%
Wages and salaries	16%	14%	14%
Interest payments	3%	3%	4%
Investments	1%	1%	1%
Balance	-4%	-1%	-2%
Primary balance	-1%	2%	2%
Tax burden [1)]	22%	23%	23%

Collective burden [2)]	26%	28%	28%

[1)] Excluding taxes from the international financial and business services sector.
[2)] Tax burden plus burden of social premiums (AOV/AWW/AVBZ) collected by SVB and BZV.

As can be seen from table 3.3, a declining trend in funds raised on the domestic capital market is noticeable for the Central Government and the Island Government of Curaçao. Therefore, the lower cash deficits in 1997 and 1998 compared to 1996 also are the result of financing constraints on the domestic capital market. Investors are less willing to lend to the government, even at higher interest rates.[1] As a result, the government was forced to postpone or reduce certain expenditures. The projected expenditures for 1998[2] amounted to NAf.1551.8 million compared to a realization of NAf.1351.7 million.

[1] The yields on government bonds increased from 8.25% in 1995 to 9.25% in August 1998
[2] According to 'Nota Herstelprogramma 1998, Koerscorrectie noodzaak!'

Table 3.3
Government lending on the domestic capital market (in millions NAf.)

	1995	1996	1997	1998
Gross lending	274.5	175.2	145.2	184.2
Central Government	105.5	123.7	70.8	83.2
Island Government of Curaçao	141.9	51.5	74.4	101.0
Net lending	146.5	80.3	42.2	44.5
Central Government	47.1	50.8	33.6	29.9
Island Government of Curaçao	99.4	29.5	8.6	14.6

3.1.2 Central Government

The deficit of the Central Government increased by NAf.26.3 million in 1998 compared to 1997 (table 3.4). This increase is the result of a NAf.39.5 million increase in expenditures and a NAf.13.2 million increase in revenues.

The increase in revenues can be ascribed mainly to the NAf.17.5 million rise in tax revenues, which resulted mainly from a NAf.14.1 million increase in sales tax and a NAf.13.3 million increase in import duties. The increase in sales tax can be ascribed to improved control and collection, the increase in import duties to the OCT-transshipment.[1]

[1] Certain goods that are taxed in the Netherlands Antilles, which belongs to the Overseas Countries and Territories (OCT) of the European Community, can enter freely into the European Community.

The higher expenditures can be attributed entirely to current expenditures, which increased by NAf.85.6 million in 1998 compared to 1997. The capital expenditures dropped by

NAf.46.1 million, the result of NAf.12.3 million lower investments and NAf.27.5 million lower net lending.

The higher current expenditures can be ascribed primarily to a NAf.32.1 million increase in wages and salaries and a NAf.62.3 million increase in transfers. The increase in wages and salaries can be ascribed to the NAf.36.6 million increase in pension premiums, attributable to the settlement of arrears of 1997 and the final settlement for 1996. The increase in transfers is attributable primarily to a NAf.55.9 million increase in transfers to other government levels. In contrast, interest payments dropped by NAf.17.5 million. This drop is related to the 1998 payment of NAf.10.4 million in interest to the Netherlands by the Island Government of Curaçao, included in the debt settlement for 1997 with mentioned Island Government.

The higher transfer to other government levels resulted because part of the debt settlement for 1997 (NAf.20.0 million) with the Island Government of Curaçao was paid in 1998. Also the revenue-sharing with the Island Government of St. Maarten was settled. The amount due was netted with the early redemption of the loan received from the Central Government to regularize outstanding arrears with 'APNA' and 'SVB' (NAf.27.5 million) by the Island Government of St. Maarten. The latter explains the sharp drop in net lending.

Table 3.4
Overview of cash operations of the Central Government, 1996-1998 (in millions NAf.)

	1996	**1997**	**1998**
Revenues	498.2	542.5	555.7
Tax revenues	372.7	441.3	458.8
Taxes on property	15.0	23.9	21.0
Taxes on goods and services	186.9	287.2	296.8
Excises	138.3	148.6	142.6
Sales tax	41.8	127.7	141.8
Taxes on international trade and transactions	162.2	121.8	132.5
Import duties	150.5	118.4	131.7
Other taxes	8.6	8.4	8.5
-Nontax revenues	118.6	93.5	87.8
Entrepreneurial & property income	57.7	42.1	40.8
Fees, charges, and sales	39.9	38.3	43.5
-Capital revenues	0.2	0.0	0.1
-Grants	6.7	7.7	9.0
Expenditures	579.6	575.8	615.3

-Current	530.0	535.9	621.5
Wages and salaries	301.8	290.6	322.7
Goods and services	89.9	92.6	101.8
Interest payments	54.4	74.9	57.4
Subsidies to public companies	8.3	5.5	5.0
Transfers	75.6	72.3	134.6
-Capital, of which:	49.6	39.9	-6.2
Investments	26.1	34.7	22.4
Net lending	11.0	-4.2	-31.7
Balance	-81.4	-33.3	-59.6

As can be seen from table 3.5, the Central Government deficit in 1998 was financed primarily nonmonetarily by the issuance of securities with the public. A relatively small amount was financed monetarily.

Table 3.5
Financing of the cash deficit of the Central Government (in millions NAf.)

	1996	1997	1998
Cash deficit	-81.4	-33.3	-59.6
Monetary financing	-12.8	3.6	5.2
Central Bank	3.7	6.0	1.1
Coins & notes	0.8	0.9	3.8
Commercial banks	-17.3	-3.3	0.3
Nonmonetary financing	94.2	29.7	54.4
Government securities with the public	79.7	27.7	65.7
Other	14.5	2.0	-11.3

3.1.3 Island Government of Curaçao

The deficit of the Island Government of Curaçao increased slightly by NAf.3.4 million in 1998 compared to 1997 (table 3.6). This increase resulted from a NAf.15.9 million increase in revenues and a NAf.19.3 million increase in expenditures.

The increase in revenues can be attributed to NAf.26.7 million higher grants, and to NAf.12.2 million higher nontax revenues. The increase in grants resulted because part of the 1997 debt settlement with the Central Government was received in 1998. The increase in nontax revenues can be attributed to a NAf.11.4 million increase in entrepreneurial and property income due to higher dividend payments by public companies.

In contrast, tax revenues dropped by NAf.22.6 million. This drop can be ascribed mainly to the NAf.16.4 million decrease in profit taxes. Taxes on property dropped by NAf.4.4 million, while taxes on goods and services dropped by NAf.8.8 million. Fewer taxes were collected because of the economic recession.

The higher expenditures can be explained by NAf.18.0 million higher current expenditures and NAf.1.3 million higher capital expenditures. The rise in current expenditures can be ascribed mainly to a NAf.34.6 million increase in interest payments. This increase must be seen against the background of the increasing indebtedness of the Island Government of Curaçao and the financing against higher interest rates. Also the interest payments of 1997 to the Netherlands (NAf.10.4 million) was settled in 1998 through the debt settlement with the Central Government. In contrast, subsidies dropped by NAf.11.1 million, the result of the government's policy of reducing subsidies.

Table 3.6
Overview of cash operations of the Island Government of Curaçao, 1996 - 1998 (in millions NAf.)

	1996	1997	1998
Revenues	808.9	748.6	764.5
-Tax revenues	712.1	678.2	655.6
Taxes on income and profits	659.7	617.2	607.9
Profit tax	277.3	271.9	255.5
Wage tax	339.0	316.2	329.5
Taxes on property	19.4	17.1	12.7
Taxes on goods and services	33.0	43.9	35.1
-Nontax revenues	72.6	51.3	63.5
Entrepreneurial & property income	24.0	18.3	29.7
Fees, charges, and sales	28.9	20.2	24.5
-Capital revenues	0.7	0.4	0.0
-Grants	23.5	18.7	45.4
Expenditures	882.9	770.4	789.7
-Current	858.7	754.9	772.9
Wages and salaries	400.4	307.4	303.4
Goods and services	207.1	208.3	207.1
Interest payments	72.7	73.2	107.8
Subsidies	89.5	83.9	72.8
Transfers	89.0	82.1	81.8
-Capital, of which:	24.2	15.5	16.8
Investments	15.8	14.0	15.8
Balance	-74.0	-21.8	-25.2

As can be seen from table 3.7, the 1998 deficit of the Island Government of Curaçao was financed entirely nonmonetarily, the result of the issuance of securities with the public and through other sources of nonmonetary financing. The monetary financing dropped by NAf.25.6 million, due to the drop in government securities held by the commercial banks.

Table 3.7
Financing of the cash deficit of the Island Government of Curaçao (in millions NAf.)

	1996	1997	1998
Cash deficit	-74.0	-22.0	-25.2
Monetary financing	-11.0	-9.8	-25.6
Central Bank	11.2	-3.5	1.7
Commercial banks	-22.2	-6.3	-27.3
Nonmonetary financing	85.0	31.8	50.8
Government securities with the public	88.4	24.3	20.8
Other	-3.4	7.5	30.0

3.2 Public sector debt and guarantees

3.2.1 Introduction

The public sector debt of the Netherlands Antilles increased by NAf.215.6 million (7.4%) in 1998 compared to 1997 (table 3.8). As a percentage of GDP, the debt increased from 66.8% in 1997 to 71.1% in 1998.

The increase in the public sector debt can be ascribed to both the domestic and foreign component. The domestic debt increased by NAf.178.9 million, while the foreign debt increased by NAf.36.7 million. In addition, the outstanding amount of guarantees increased by NAf.10.7 million.

Table 3.8
Public sector debt and guarantees (in millions NAf; end of year)

	1996	1997	1998
Domestic debt [1)]	2,171.2	2,353.4	2,532.3
Foreign debt	662.5	571.0	607.7
Total debt	2,833.7	2,924.4	3,140.0
% of GDP	65.1	66.8	71.1
Guarantees	385.6	352.3	363.0
Total debt and guarantees	3,219.3	3,276.7	3,503.0
% of GDP	74.0	74.8	79.3

[1)] Consolidated

3.2.2 Public sector domestic debt

The increase of NAf.178.9 million in the consolidated domestic public debt can be explained mainly by the NAf.106.2 million increase in the debt of the Island Government of Curaçao (table 3.9).

The increase in the debt of the Island Government of Curaçao resulted mainly from the build up of arrears at the 'APNA' and the 'SVB' by NAf.58.2 million and NAf.18.3 million, respectively, and from the increase in government securities by NAf.14.5 million. The latter increase resulted from the increase in government securities held by the public (NAf.26.5 million) and by the Central Bank (NAf.15.0 million), while government securities held by the commercial banks dropped by NAf.21.3 million.

The debt of the Central Government increased by NAf.39.3 million, mainly because of the increase in outstanding securities with the public by NAf.66.4 million. In contrast, the debt at the 'APNA' dropped by NAf.22.9 million, the result of the settlement of arrears of previous years. The debt of the other island governments increased by NAf.39.3 million, as a result of increased arrears at 'APNA' and 'SVB.'

Table 3.9
Composition of public sector domestic debt (in millions NAf; end of year)

	1996	1997	1998[1]
Central Government	910.0	972.9	1012.2
Central Bank	52.5	65.0	64.6
Commercial banks	163.4	88.9	89.7
Securities with the public	530.8	639.0	704.7
Social Security Bank (SVB)	78.1	74.9	75.9
Civil servants pension fund (APNA)	49.0	63.9	37.2
Other	36.2	41.2	40.1
Island Government of Curaçao	1220.1	1323.1	1429.3
Central Bank	0.0	0.0	15.0
Commercial banks	103.4	142.8	121.5
Securities with the public	401.0	370.2	391.0
Social Security Bank (SVB)	9.2	24.8	43.1
Civil servants pension fund (APNA)	527.3	630.6	712.3
Other	179.2	154.7	146.4
Other Island Governments	66.1	83.1	98.7
Social Security Bank (SVB)	24.1	31.5	39.8
Civil servants pension fund (APNA)	42.0	51.6	58.9
Total consolidated debt	2,171.2	2,353.4	2,532.3

1) Preliminary

3.2.3 Public sector foreign debt

The foreign debt increased by NAf.36.7 million in 1998 over the 1997 figure. This increase resulted mainly from the depreciation of the Netherlands Antilles guilder (pegged to the US dollar) compared to the Dutch guilder. The debt to the Netherlands, denominated in Dutch guilders, was only NAf.0.2 million lower in 1998 than in 1997, because the government of the Netherlands Antilles postponed almost all principal payments on loans due since 1996. This action is related to their persistent liquidity problems.

3.3 Development aid

3.3.1 Introduction

According to the 1998 budget of the 'Kabinet voor Nederlands-Antilliaanse en Arubaanse Zaken,' the funds made available for development assistance amounted to Hfl.258.4 million for the Netherlands Antilles and Aruba. This figure includes government projects as well as technical assistance. Compared to 1997, the development assistance dropped by Hfl.22.1 million, mainly the result of fewer funds available for housing and education.

3.3.2 Government projects

The funds spent on government projects dropped by NAf.19.3 million in 1998 compared to 1997. This drop was the result mainly of a NAf.19.4 million drop in funds spent on housing and a NAf.9.2 million drop in funds spent on roads and bridges. In contrast, NAf.7.1 million more was spent on health.

3.3.3 Social and cultural projects

Expenditures on social and cultural projects in 1998 dropped by NAf.1.4 million, the result of a NAf.2.6 million drop in expenditures by 'OKSNA'[1] and a NAf.1.2 million increase in expenditures by 'Sede Antia.'[2]

3.3.4 Aid from the European Community

The National Indicative Program (NIP) for the eighth development fund was signed recently. The amount of funds available will be Euro 37 million for the Netherlands Antilles and Aruba together. Of this amount, Euro 26.6 million will be available for the Netherlands Antilles in the form of grants. The funds will be made available in two tranches. In the first tranche, 70% of the funds, i.e., Euro18.6 million, will be made available immediately. The second tranche is made available under the condition that 80% of the funds of the first tranche are committed before November 30, 2000. The program will focus on the social sector and on the infrastructure.

[1] Overlegorgaan Kulturele Samenwerking van de Nederlandse Antillen. This institution promotes cultural development.
[2] A non-governmental organization that intermediates in the cofinancing of private initiatives.

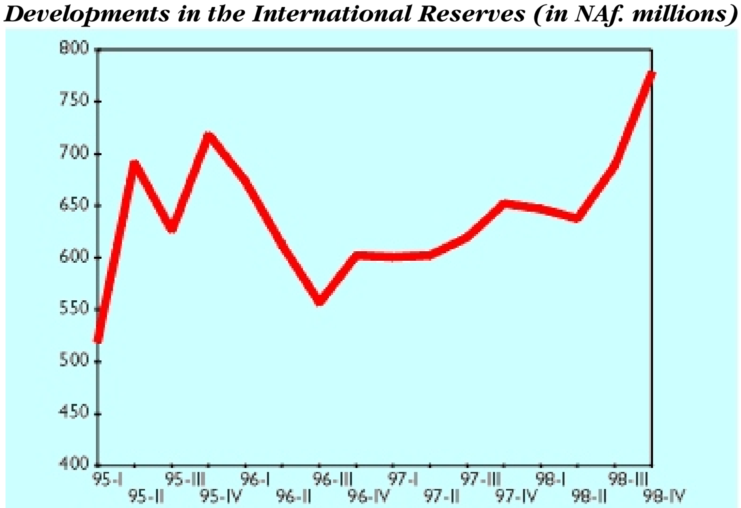
4 THE EXTERNAL SECTOR

4.1 Introduction

The primary objectives for 1998 were to restore confidence in the government by reducing the government deficits and to improve the external reserves position. With regard to the external sector, the current account deficit was expected to stay flat, approximately NAf.136 million, while the international reserves would increase by NAf.22.4 million, given the debt relief by the Netherlands.

As it turned out, the economy deteriorated further showing a contraction in real GDP of 0.3%, while aggregate demand fell. The sluggish domestic demand had a positive impact on the external balance in our open economy, but a lasting improvement of our external reserves requires growth in the foreign exchange-generating sectors. Unfortunately, our tourist sector was the only foreign exchange-generating sector that improved in 1998 compared to 1997. Overall, the balance of payments recorded a surplus of NAf.135.3 million in 1998, which resulted in an international reserves position of NAf.777.7 million, including gold (graph 4.1).

Graph 4.1
Developments in the International Reserves (in NAf. millions)



Movements in the current account contain valuable information about the actions and expectations of all market participants in an open economy. For this reason, policymakers tend to focus on the current account as an important macroeconomic variable. The current account improved in 1998 compared to 1997. However, this improvement should be interpreted with caution. The main factors that contributed to the improvement of the current account were the decline in the trade deficit, due mainly to a combination of higher exports and lower imports, and a transitory high surplus on the income balance. In contrast, net earnings from the foreign exchange-generating sectors dropped following an increase in 1997. The capital account recorded a higher surplus in 1998 than in 1997.

Table 4.1
Balance of payments summary [1] (in millions NAf.)

	1997	**1998**	**diff.**
Current account	-174.7	-140.4	34.4
Capital account	232.8	269.7	36.9
Statistical discrepancies	-8.4	6.0	14.4
Balance of Payments	49.7	135.3	85.6
Change in reserves [2]	-49.7	-135.3	-85.6
-with commercial banks	-1.1	-78.6	-77.5
-with Central Bank	-48.6	-56.7	-8.1
Memorandum items			
Official reserves (excluding gold)			
-in millions NAf.	386.9	443.6	56.7
-in months of merchandise imports	1.9	2.2	0.3
Total reserves (excluding gold)			
-in millions NAf.	462.6	597.9	135.3
-in months of merchandise imports	2.3	3.0	0.7

[1] Cash basis
[2] -Sign denotes an increase in reserves (excluding gold)

4.2 The current account

The deficit on the current account of the balance of payments improved by NAf.34.4 million to NAf.140.4 million in 1998. As illustrated in table 4.2, the improvement of the current account was the result of:

- a marked rise in the level of exported goods, almost entirely related to the re-exporting activities by the free zone companies;
- a drop in imports, due mainly to lower payments for oil imports as a result of depressed oil prices; and
- a significant improvement in the income balance.

These developments mitigated the NAf.134.6 million loss in earnings by two of our main foreign exchange-generating sectors, namely, the international financial and business services sector and the transportation sector. In addition, tourist expenses by residents abroad increased considerably in 1998, after a drop in 1997.

Table 4.2
A breakdown of the current account [1]) (in millions NAf.)

	1997	1998	diff.
Trade balance	-1.997.3	-1.860.5	136.7
-Exports	478.4	542.3	63.9
-Imports	2.475.6	2.402.8	-72.8
Services balance	1.837.5	1.721.8	-115.7
-Receipts, of which:	2.874.0	2.884.5	10.5
-Transportation	606.2	568.0	-38.2
-Travel	1.115.6	1.284.1	168.5
-Int. fin. & bus. services sector	669.8	573.4	-96.4
Taxes	146.8	114.7	-32.1
Operational income	523.0	458.7	-64.3
-Expenditures, of which:	1.036.4	1.162.7	126.3
-Travel	455.3	542.6	87.3
-Int. fin. & bus. services sector	208.8	180.7	-28.1
Income balance [2])	83.5	121.2	37.7
Unrequited transfers [3])	-98.5	-122.9	-24.4
Current account balance	-174.7	-140.4	34.4

[1]) Cash basis
[2]) Income: investment and labor income.
[3]) Unrequited transfers: private remittances (excl. labor income).

4.2.1 The trade balance

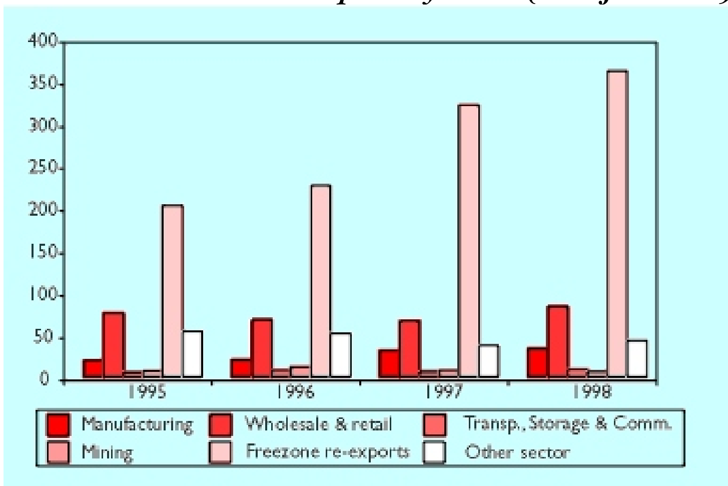
The trade balance improved by NAf.136.7 million in 1998, compared to 1997. This improvement was attributable to a combination of higher exports and lower imports.

Merchandise exports increased by NAf.63.9 million. A breakdown by island reveals that this increase in exports was related almost entirely to the re-exporting activities of some of the main free zone companies on Curaçao (see graph 4.2). The rice- and sugar-exporting industries have been practically shut down on Curaçao and Bonaire, since the changes in the agreement for Overseas Countries and Territories (OCT) giving preferential access to the European Community.

The NAf.72.8 million drop in imports contributed to a further improvement in the trade deficit. This drop was primarily the result of NAf.103.1 million lower payments for oil imports due to the drop in world oil prices. On the other hand, non-oil related imports increased by NAf.30.4 million. This growth was induced primarily by higher imports related to the free zone activities on Curaçao. Adjusted for free zone imports, non-oil related imports actually dropped by NAf.18.3 million during 1998, particularly in the utilities sector.

A breakdown by island reveals that the merchandise balance on Curaçao improved by NAf.79.4 million as a result of higher re-exports by the free-zone companies and lower imports, induced particularly by the drop in payments made for oil imports.

Graph 4.2
Breakdown merchandise exports by sector (in NAf. millions)



The merchandise balance on Bonaire improved by NAf.3.6 million in 1998 compared to 1997, due primarily to a NAf.3.1 million decline in imports related to sluggish domestic demand. Salt exports were doing well until an accident forced the company to shut down temporarily. On the other hand, the rice industry practically ceased its operations due to the changes in the OCT agreement with the European Community.

The merchandise balance on the Windward Islands also improved in 1998 compared to 1997, particularly as a result of lower oil imports. Non-oil-related imports decreased slightly by NAf.2.6 million.

Table 4.3 gives a breakdown of the merchandise imports by main sectors for 1997 and 1998. Corrected for free zone-related imports, non-oil-related imports dropped by NAf.18.3 million. If, in addition, investment- related imports of approximately NAf.15 million are deducted, non-oil- related imports actually decreased by approximately NAf.33 million in 1998.

Table 4.3
Merchandise imports by main sectors [1] (in millions NAf.)

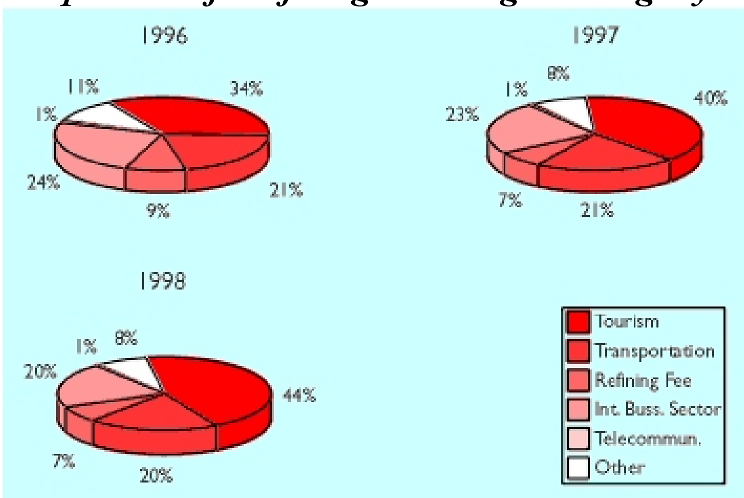
	1997	1998	Diff.
Manufacturing	118.3	132.2	13.9
Utilities	59.6	46.8	-12.8
Wholesale & retail (excl. free zone)	989.7	988.6	-1.1
Transport & telecommunication	87.4	92.1	4.7
Hotels & restaurants	18.2	17.8	-0.4
Construction	33.4	30.9	-2.5
Free zone	365.2	413.9	48.7
Other	419.5	399.4	-20.1
Total nonoil-merchandise imports	2.091.3	2.121.7	30.4
Total nonoil-merchandise imports, excl. free zone	1.726.1	1.707.8	-18.3

[1] Cash basis

4.2.2 The services balance

Developments in the services balance in 1998 were determined primarily by the increase in foreign exchange expenses, rather than an increase in foreign exchange receipts. This situation contrasted with 1997, when the opposite development occurred. The only sector that improved its performance in 1998 was the tourist sector. Net earnings from the tourist sector increased by NAf.81.2 million compared to 1997, despite a considerable increase in tourist expenses by residents abroad. Contrary to this development, the net foreign exchange earnings from the international financial and business services sector and the transportation sector dropped by NAf.68.3 million and NAf.48.6 million, respectively, compared to 1997. Despite this development, these two sectors maintained a combined share of 40% of total foreign exchange generated by the services sector, after the 45% share held by the tourist sector (graph 4.3).

Graph 4.3
Composition of the foreign exchange earnings by the services sector (in %)



4.2.2.1 Tourism

The tourist sector continued to perform well in 1998, as measured by the amount of foreign exchange revenues generated. As can be seen in table 4.4, total foreign exchange receipts from the tourist sector increased by 15.1 %, particularly on Curaçao and the Windward Islands. However, these considerable increases in foreign exchange receipts should be viewed with caution. Particularly on the Leeward Islands, stay-over tourism has been declining and its economic impact is considered greater than that of cruise tourism. In 1998, stay-over tourism recorded an increase of 1.7%. However, an analysis by island reveals that only the Windward Islands contributed to this increase. In addition, except in Curaçao, cruise tourism was not as buoyant in 1998 as in 1997.

Table 4.4
Foreign exchange revenues from tourism per island [1] (in millions NAf.)

	1994	1995	1996	1997	1998
Bonaire	58.0	66.1	75.8	79.0	77.7
Curaçao	333.9	314.0	332.0	358.9	467.3
Windward Islands	751.5	624.4	576.2	677.7	739.1
Netherlands Antilles	1.143.4	1.004.5	984.0	1.115.6	1.284.1
Percentage growth [2]	4.9%	-12.1%	-2.0%	13.4%	15.1%

1) Cash basis
2) Compared to the previous year

The tourist sector on the Windward Islands performed well in 1998, despite a slowdown in the fourth quarter due to hurricane Georges. The foreign exchange receipts from the tourism sector increased by 9.1 %, reflecting the 4.4% growth in stay-over tourism. However, compared to 1997, the growth in stay-over tourism slowed, and the number of cruise tourists declined, the result of the aftermath of the hurricane.

The tourist sector on the Leeward Islands showed mixed developments in 1998. Foreign exchange receipts from tourism on Curaçao increased by 23.2 %, almost entirely related to the 7.7% growth in cruise tourism. However, the number of stay-over tourists, dropped for the fourth year in succession. Foreign exchange receipts from the tourist sector on Bonaire decreased by 1.7 %, concomitant with the drop in both stay-over and cruise tourism.

Tourist expenses by residents abroad also increased considerably in 1998, by NAf.87.3 million (19.2%) compared to 1997, despite the depressed economy.

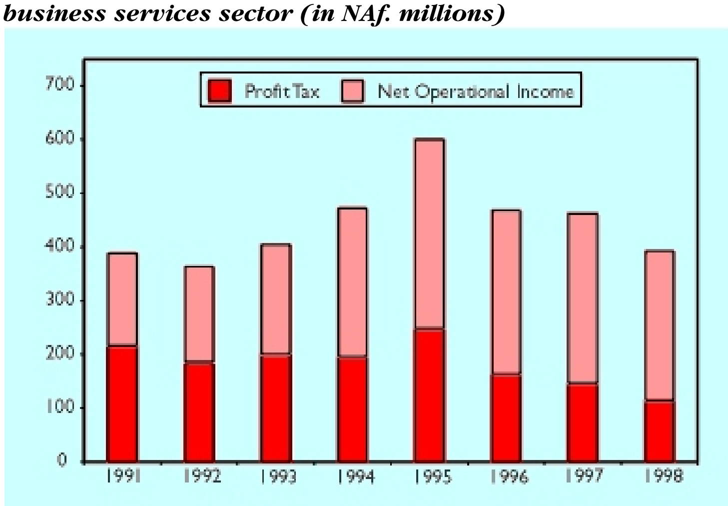
4.2.2.2 The transportation sector

Foreign exchange earnings from transportation declined by NAf.38.2 million in 1998 compared to 1997. This decline, the first since 1993, was primarily the result of a NAf.42.7 million (19.6%) drop in receipts from bunker activities. This can be ascribed to depressed oil prices, which resulted in lower bunker fuel prices. The drop in revenues from bunker activities offset a combined NAf.25 million rise in revenues from passenger fares and shiphandling activities.

4.2.2.3 The international financial and business services sector

Foreign exchange earnings from the international financial and business services sector declined further in 1998 by NAf.96.4 million, compared to 1997. This deterioration can be ascribed primarily to the drop of NAf.64.3 million in operational services receipts, particularly by the trust companies. Profit tax receipts dropped also, by NAf.32.1 million. The foreign exchange outflow in the international financial and business services sector recorded a drop of NAf.28.1 million, due primarily to a decline in fees paid for services rendered.

Graph 4.4
Breakdown of foreign exchange income generated by the international financial and business services sector (in NAf. millions)



4.2.2.4 The refining industry

The B.O.O. (Build, Own, & Operate) project and the IRUP upgrading program at the oil refinery were expected to generate an increase in economic activity in 1998. However, the start of the B.O.O. project was postponed to 1999, pending certain negotiations. The IRUP program has started; however, its first phase consists mainly of technical engineering done in Venezuela. Consequently, the expected increase in foreign exchange inflow from the refining industry did not materialize, resulting in an unchanged amount of foreign exchange income generated of NAf.206.6 million, the same as in 1997.

4.2.2.5 Other services

Other services consist primarily of telecommunication services, which experienced a drop of approximately NAf.7 million in foreign exchange earnings for the fourth consecutive year in 1998. The competition from primarily 'call-back'services abroad is still a major factor influencing the performance of our telecommunication sector.

4.2.3 The income balance

The income account of the balance of payments recorded a surplus of NAf.121.2 million in 1998, an increase of NAf.37.7 million compared to 1997. This improvement can be ascribed entirely in the investment income balance. As table 4.5 reveals, the improvement in the investment income balance was the result of a substantial rise in receipts of profit and interest income by NAf.25.1 million and NAf.57.3 million, respectively. The rise in profit transfers was due to commercial bank activities, while the rise in interest receipts was recorded particularly by local commercial banks and pension funds of approximately NAf.72 million.

Table 4.5
Breakdown of the income account [1] (in millions NAf.)

	1997	1998	Diff.
Investment income	85.6	134.4	48.8
-Direct investment income	-32.9	-5.4	27.5
Received	10.2	35.3	25.1
Paid	43.1	40.7	-2.4
-Other investment income	118.5	139.8	21.3
Received	159.6	216.9	57.3
Paid	41.1	77.1	36.0
-Labor income	-2.1	-13.2	-11.1
Received	10.4	11.2	0.8
Paid	12.5	24.4	11.9
Total income balance	83.5	121.2	37.7

[1] Cash basis

4.3 The capital account

The surplus on the capital account of the balance of payments rose by NAf.36.9 million to NAf.269.7 million in 1998, compared to 1997. This development can be attributed to both the private and official capital balance.

4.3.1 The private capital balance

Table 4.6 shows that the improvement in the private capital balance of NAf.11.6 million was primarily the result of a substantial increase in net other capital flows by NAf.102.0 million. These funds are particularly related to interbank flows of business enterprises. In contrast, the net portfolio balance deteriorated by NAf.52.8 million as a result of more re-investments by the insurance companies. Net borrowing activities from abroad declined also. This drop in borrowing was recorded mainly in the utilities sector, the result of large investments made in 1997, which were financed by foreign funds. Overall, the net loan balance fell by NAf.27.4 million.

4.3.2 The official capital balance

The official capital balance improved by NAf.25.3 million, mainly as the result of more Dutch aid receipts. Most of the foreign amortization payments due for 1998 to the Dutch Government were deferred, although no agreement has been reached concerning this issue. The increasing arrears in principal payments since 1996 are related to the persistent liquidity problems of the government.

Table 4.6
A breakdown of the capital account [1] (Net flows, in millions NAf.)

	1997	**1998**	**Diff.**
Private capital,	111.5	123.1	11.6
of which:			
-direct investm. (real estate)	25.2	15.1	-10.1
-portfolio investm. (securities)	16.4	-36.4	-52.8
-loans (net)	43.3	5.8	-37.5
-comm. banks borrowings	-10.2	-0.1	10.1
-other private cap.	36.8	138.8	102.0
Official capital,	121.3	146.6	25.3
of which:			
-loans & grants	128.6	148.5	19.9
-other gov. capital	-7.3	-1.9	5.4
Capital balance	232.8	269.7	36.9

[1] Cash basis

5 MONETARY DEVELOPMENTS

5.1 Introduction

Monetary developments during 1998 must be seen against the background of a lack of confidence in our still sagging economy by economic agents, in particular entrepreneurs. This development is reflected in the marked increase in investments in time deposits by companies and financial institutions at the expense of investments in productive assets. Further, domestic credit to the private sector grew less than permitted, while net domestic credit to both the Central Government and the island governments dropped.

The new monetary policy, which became effective on September 15, 1998, implies a shift from direct to indirect, more market-oriented instruments. Beginning in October 1998, the cash reserve percentage of the monetary cash reserve arrangement was gradually reduced, thereby reducing the penalty on excess credit. Effective January 1, 1999, the Bank lifted the direct limit on credit extension to the private sector through a reduction of the cash reserve percentage for private sector credit to 0%. From this date, excessive domestic spending through credit extension will be controlled by an active reserve requirement policy. However, the current ceiling on government net domestic credit will be maintained at the level of October 31, 1996, to minimize monetary financing of the budget deficits.

The reserve requirement has become the Bank's main monetary policy instrument since the introduction of the new monetary policy in September 1998. The reserve requirement is a policy instrument aimed at reducing over-liquidity in the banking system and, hence, limiting the possibility of excess credit extension by commercial banks. The measure requires banks to place a deposit (reserve requirement) on a blocked account with the Bank. The size of the reserve requirement of a particular bank is determined as a percentage of its domestic debt. The current reserve requirement policy determines the reserve requirement percentage monthly, based on the developments in the free reserves of the commercial banks and the official foreign exchange reserves vis-à-vis benchmarks determined by the Bank. This policy resulted in an increase from 4% to 6% in September 1998, to 6-½% in October 1998, and a further increase to 8% in November 1998. A maximum of 25% of the reserve requirement may be held in interest-bearing certificates of deposit. The remainder is non-interest-bearing.

Another element of the Bank's new monetary policy is the elimination of the limit on net foreign assets of commercial banks (i.e., the B-9 limit). Net investments abroad still can be controlled indirectly through an increase of the reserve requirement, if the funding of these investments results in an unacceptable decline in the official reserves. However, commercial banks are not allowed to have a negative net foreign assets position. Any negative position is subject to a penalty.

5.2 Developments in the money supply and in the money-creating process

5.2.1 Money supply

During 1998, the money supply increased by 3.7% (NAf.96.6 million), compared to an increase of 2.6% (NAf.65.3 million) in 1997. This development was primarily the result of the acceleration in the growth rate of the near-money component of the money supply.

As shown in table 5.1, the near-money component of the money supply recorded a 4.8% (NAf.74.1 million) increase during 1998 compared to a 2.7% (NAf.41.0 million) increase in 1997. This acceleration in the growth of the near-money component can be explained by the development in savings deposits, which expanded by 3.5% (NAf.38.2 million) in 1998, a marked turnaround compared to the 1.1% (NAf.12.0 million) contraction during 1997. Time deposits, which are all held by non-individuals, increased by 7.8% (NAf.35.9 million) during 1998 compared to a 12.9% (NAf.53.0 million) expansion during 1997. The increase in 1998 was attributable primarily to non-bank financial institutions (NAf.30.6 million) and business enterprises (NAf.20.8 million). This development can be attributed to the rise in interest rates on time deposits, as a consequence of the rise in the interest rates on government bonds, and to the reticent attitude of many entrepreneurs towards risky investments because of the sagging economy.

Table 5.1
Developments in the money supply and its components (in millions NAf. and percentage changes)

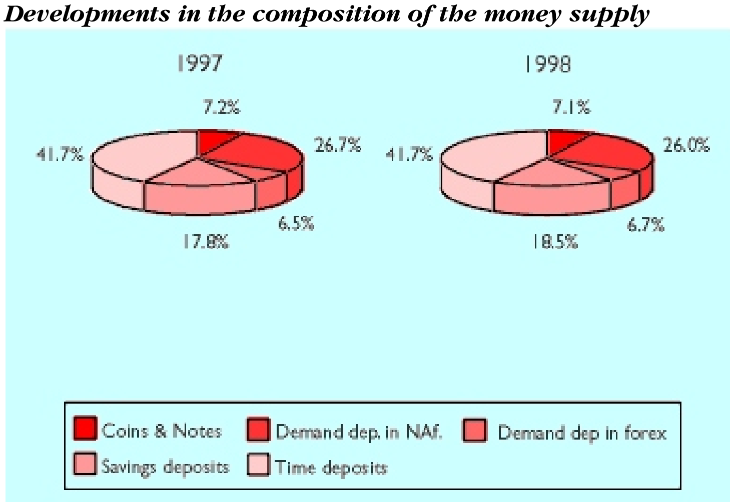
	1997		1998	
Coins & notes with the public	188.0	(-3.9%)	192.9	(2.6%)
Total demand deposits in:	864.7	(3.8%)	882.3	(2.0%)
-Neth. Ant. guilders	694.8	(3.1%)	701.3	(0.9%)
-Foreign currency	169.9	(7.1%)	181.0	(6.5%)

MONEY (M1)	1,052.7	(2.4%)	1,075.2	(2.1%)
Time deposits	463.0	(12.9%)	498.9	(7.8%)
Savings	1,086.3	(-1.1%)	1,124.5	(3.5%)
NEAR MONEY	1.549.3	(2.7%)	1,623.4	(4.8%)
MONEY SUPPLY (M2)	2,602.0	(2.6%)	2,698.6	(3.7%)

The money component of the money supply increased by 2.1% (NAf.22.5 million) in 1998 compared to a 2.4% (NAf.24.3 million) increase in 1997. The increase in the money component during 1998 can be explained primarily by the rise in total demand deposits held by the public, which grew by 2.0% (NAf.17.6 million). Coins and notes with the public expanded by 2.6% (NAf.4.9 million) during 1998, compared to a 3.9% (NAf.7.6 million) in 1997.

Graph 5.1 reveals an increase by 0.7 percentage points to 18.5% in the share of time deposits in the composition of the money supply. This increase was at the expense of the share of demand deposits in local currency, which dropped by 0.7 percentage points in 1998 to 26.0%.

Graph 5.1
Developments in the composition of the money supply



5.2.2 Factors affecting the demand for liquid assets

During 1998, the total demand for liquid assets grew by 3.7% (NAf.96.6 million), compared to a 2.6% (NAf.65.3 million) expansion during 1997 (table 5.2). This development was induced entirely by the marked acceleration in the growth rate of net foreign assets. The 22.2% (NAf.129.5 million) increase in net foreign assets during 1998 was the net result of a NAf.269.7 million surplus on the capital account of the balance of payments, on the one hand, and a NAf.140.4 million deficit on the current account, on the other.

The impact of domestic factors on the demand for liquid assets turned around from a 0.3% (NAf.5.3 million) expansion in 1997 to a 1.6% (NAf.32.9 million) contraction in 1998. This contraction was induced by the continued decrease in the demand for liquid assets by the general government and the contractionary impact caused by an administrative reclassification of banking license fee earnings by the Bank. The reclassification was reflected in the marked increase in absolute terms of the miscellaneous item.

The demand for liquid assets by the general government contracted by 17.0% (NAf.28.2 million) during 1998, compared to 1.2% (NAf.2.0 million) during 1997. The drop in 1998 was the result of contractions by NAf.21.5 million and by NAf.6.7 million in the demand for liquid assets by the island governments and the Central Government, respectively. The decrease in the demand for liquid assets by the Central Government during 1998 was primarily the result of a drop in the Central Government's net liabilities at the Central Bank by NAf.10.8 million. The amount of Central Government paper held in portfolio by commercial banks increased from NAf.83.9 million at the end of 1997 to NAf.89.7 million at the end of 1998. The contraction in the demand for liquid assets by the island governments was primarily induced by the NAf.21.3 million drop in the amount of treasury paper issued by the Island Government of Curaçao, held by commercial banks.

Credit extension to the private sector turned around from a 0.6% (NAf.12.8 million) contraction during 1997 to a 1.4% (NAf.32.4 million) expansion during 1998. The growth during 1998 can be explained almost entirely as the net result of an increase by NAf. 36.0 million in loans to the private sector, on the one hand, and decreases by NAf.0.4 million and NAf.0.7 million in amounts receivables and securities and participations, respectively, on the other. These developments, especially if seen against the background of a permissible growth rate for credit extension to the private sector of 2.25% for 1998, reflect the reticent attitude of banks not only towards lending, but also towards investments during 1998.

Table 5.2
Developments in the demand for liquid assets by sector (in millions NAf. and percentage changes)

	1997		1998	
General Government, of which:	166.0	(-1.2%)	137.8	(-17.0%)
-Central Government	80.1	(4.8%)	73.4	(-8.4%)
-Island Governments	85.9	(-6.2%)	64.4	(-25.0%)
Private sector	2,263.0	(-0.6%)	2,295.4	(1.4%)
Miscellaneous	-411.6	(-4.7%)	-448.7	(9.0%)
Domestic sector	2,017.4	(0.3%)	1,984.5	(-1.6%)
Net Foreign Assets	584.6	(11.4%)	714.1	(22.2%)
Total Liquid Assets	2,602.0	(2.6%)	2,698.6	(3.7%)

5.3 Domestic credit extension by commercial banks

The growth in domestic lending to the private sector by the commercial banks during 1998 accelerated by 1.4 percentage points to 1.5%, compared to the 0.1% (NAf.2.4 million) expansion in 1997 (see table 5.3). This development can be explained primarily by the turnaround in consumer loans from a 5.8% (NAf.29.7 million) contraction during 1997 to an 8.0% (NAf.38.1 million) expansion in 1998. Business loans expanded by 3.9% during 1998, while mortgages contracted by 3.8%. For both categories, this meant a turnaround compared to 1997.

Government paper held in portfolio by the commercial banks amounted to NAf.211.2 million at the end of 1998. This figure is NAf.36.6 million below the amount held at the end of October 1996, which served as the base to determine the current ceiling for net domestic credit to the general government. This decrease is a reflection of the reluctance of commercial banks to even refinance the government debt in light of the uncertainties regarding the government's finances.

Table 5.3
Domestic loans and government paper at commercial banks (per end of period in millions NAf.)

	1997		1998	
Private sector loans, of which:	2,198.6	(0.1%)	2,232.3	(1.5%)
-Mortgages	925.7	(4.0%)	890.3	(-3.8%)
-Consumer loans	478.1	(-5.8%)	516.2	(8.0%)
-Business loans	794.8	(-0.4%)	825.9	(3.9%)
Government paper	231.7	(-2.0%)	211.2	(-8.8%)

A breakdown of commercial banks' private sector lending by island group reveals that the 1.4 percentage points rise in the growth rate of total lending to the private sector during 1998 resulted entirely from an increase in lending on the Leeward Islands. Table 5.4 reveals a 2.5% increase in private sector lending on the Leeward Islands during 1998 compared to a 0.5% increase during 1997. This acceleration can be attributed primarily to the marked turnaround in consumer loans from a 5.3% contraction in 1997 to a 10.9% expansion in 1998. The growth rate of business loans accelerated by 2.7 percentage points to 3.9% during 1998. Mortgages, however, contracted by 3.8%, compared to the 3.5% expansion during 1997. The decline in the outstanding amount of mortgages during 1998 reflects the marked contraction (12.7%) in the value of construction licenses granted on Curaçao during 1998.

Table 5.4
Domestic loans at commercial banks on the Leeward Islands (per end of period in millions NAf.)

	1997		1998	
Private sector loans, of which:	1,670.9	(0.5%)	1,711.9	(2.5%)
-Mortgages	644.2	(3.5%)	619.7	(-3.8%)
-Consumer loans	366.1	(-5.3%)	406.1	(10.9%)
-Business loans	660.6	(1.2%)	686.1	(3.9%)

On the Windward Islands, outstanding loans to the private sector contracted further by 1.4% in 1998 (tabel 5.5). This development can be ascribed primarily to the turnaround from a 5.1% expansion to a 3.9% contraction in mortgages. Consumer loans contracted by 1.7%, while business loans expanded by 4.2% during 1998, a substantial turnaround compared to the 7.5% contraction during 1997. The expansion in business loans may be the first sign of rebirth of confidence by the business community on the Windward Islands.

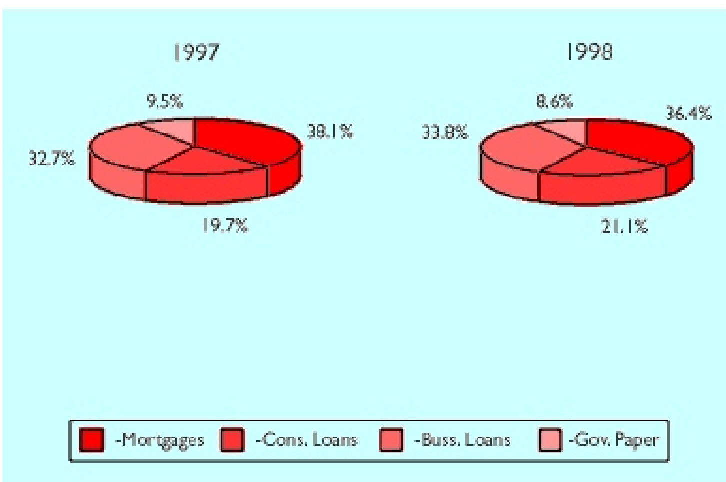
Table 5.5
Domestic loans at commercial banks on the Windward Islands
(per end of period in millions NAf.)

	1997		1998	
Private sector loans	527.7	(-1.2%)	520.4	(-1.4%)
of which:				
-Mortgages	281.6	(5.1%)	270.6	(-3.9%)
-Consumer loans	112.0	(-7.6%)	110.1	(-1.7%)
-Business loans	134.1	(-7.5%)	139.7	(4.2%)

5.3.1 Developments in the lending portfolio of commercial banks

Graph 5.2 reveals rises by 1.4 percentage points to 21.1% and by 1.1 percentage points to 33.8% in the shares of consumer loans and business loans, respectively, in the total lending portfolio of commercial banks during 1998. These rises were at the expense of the shares of mortgages and government paper, which dropped by 1.7 percentage points to 36.4% and by 0.9 percentage points to 8.6%, respectively.

Graph 5.2
Developments in the lending portfolio of commercial banks



6 DOMESTIC FINANCIAL MARKET DEVELOPMENT

6.1 Introduction

As in 1997, the general government continued to experience difficulties with the financing of its deficits in 1998. Despite an increase in its funding requirements, the general government was not able to raise more than NAf. 44.5 million in new borrowing from the domestic money and capital market during 1998. The net borrowing during 1998 represented a NAf.2.4 million increase compared to 1997.

Antillecom N.V. opened the year 1998 with a five-year 9.25% coupon bond issue of NAf.23.7 million in the domestic capital market. The amount raised was increased by NAf.3.7 million above the original issue amount. The strong demand from local investors for this corporate bond indicated that local companies can find competitive funding in the local capital market, a positive sign for its further development.

During the third quarter of 1998, the Bank changed its monetary policy by allowing commercial banks to hold certificates of deposit (CDs) issued by the Bank to comply with part of their reserve requirement. Because they are negotiable among domestic commercial banks, these CDs will give the banks more flexibility in the management of their liquidity.

6.2 Financial instruments and the money market

Effective September 16, 1998, the Bank allowed commercial banks to hold interest-bearing certificates of deposit (CDs) issued by the Bank to comply with a maximum of 25% of their non-interest-bearing reserve requirement. In addition, the number of CDs issued per month was reduced to create larger issues, which promotes the secondary market for these securities. Concomitantly, the Bank increased the reserve requirement from 3% to 8% during 1998.

During 1998, the average monthly amount of CDs outstanding was NAf.16.5 million, a 179.7% increase over the average NAf.5.9 million during 1997. The strong increase can be attributed to the change in the Bank's monetary policy.

The interest rates on the CDs offered by the Bank continued to be linked to the US dollar target fed fund rate. The interest rate on the three-months CD was set at a slightly improved margin of the target fed funds rate minus 137.5 basis points.

Table 6.1 indicates that commercial banks held, on average, NAf.16.5 million in CDs, NAf.92.2 million in required reserves, and NAf.50.4 million in demand deposits at the Central Bank during 1998. When compared to the average holdings in 1997, this represented a 179.7% increase in CDs, a 83.7% increase in required reserves and a 15.9% decrease in demand deposits.

Table 6.1
Outstanding balances of certificates of deposit, required reserves, and demand deposits of commercial banks at the Central Bank in 1998 (in millions NAf.)

	Certificates of deposit	Reserve requirement of banks at the BNA	Demand deposits at the BNA
January	0	64.2	74.9
February	4.5	64.3	83.4
March	2.5	64.0	45.6
April	2.5	87.4	77.7
May	2.5	87.3	92.4
June	26.0	88.6	46.0
July	19.0	89.3	32.9
August	14.0	90.0	58.1
September	32.5	99.1	24.5

October	34.6	106.9	18.6
November	43.6	132.3	20.1
December	44.2	132.9	30.9
Monthly average	16.5	92.2	50.4

6.3 The market for government bonds

In the primary market, both the Central Government and the Island Government of Curaçao began issuing semi-annual coupon bonds to make government bonds more attractive for investors and to facilitate the future reopening of these issues, because investors have less accrued interest[1] to pay after the coupon date. The reopening of bond issues has other advantages also. By increasing the total amount of a bond issue outstanding, the governments stimulate secondary market trade of the bond, as sellers are better able to offer the quantity buyers require. Furthermore, the reopening of existing bonds improves the efficiency of the governments' debt maturity structure because it limits the need to issue frequently small and less liquid private placements across the maturity spectrum.

The general government issued bonds for a total amount of NAf.194.7 million during 1998, NAf.150.2 million of which was to refinance maturing issues. Consequently, net borrowing amounted to NAf.44.5 million,[2] only NAf.2.4 million higher than in 1997. The Central Government received NAf.29.9 million (67.2%) of total net borrowing, while the Island Government of Curaçao received the remaining NAf.14.6 million (32.8%).

During 1998, the Central Government's net borrowing[3] amounted to NAf.29.9 million, 11.0% less than the net borrowing of NAf. 33.6 million during 1997 (table 6.2). This borrowing was primarily met through the issuance of public loans, which increased by NAf.46.8 million over 1997. In addition to the public bond issues, the Central Government borrowed NAf.36.5 million from the civil servants pension fund APNA to convert NAf.16.5 million of premium arrears and to settle arrears totaling NAf.20.0 million with the Island Government of Curaçao. The remaining liquidity deficit was financed by the accumulation of arrears with other creditors and by deferment of expenditures.

1 Interest that has accumulated between the most recent payment and the sale of a bond, calculated by multiplying the coupon rate by the number of days that have elapsed since the last payment.
2 Excluding new debt conversions
3 Excluding debt conversions.

Table 6.2
Domestic capital market borrowing by the Central Government (outstanding amounts, in millions NAf. per year end)

	1996	**1997**	**1998**
Private placement	115.3	143.8	145.3
Public issues	380.3	401.0	447.8
Wage bonds	22.1	17.6	13.2
Treasury bills	72.9	61.8	47.8
Subtotal	590.6	624.2	654.1
Debt conversions	138.9	138.9	175.4
Total	729.5	763.1	829.5
Net borrowing [1)]	50.7	33.6	29.9

[1)] Excluding debt conversions

Table 6.2 shows that total negotiable loans outstanding for the Central Government increased by 8.7% or NAf.66.4 million[1] to NAf.829.5 million in 1998. Of this amount, NAf.447.8 million (54.0%) were public loans, NAf.145.3 million (17.5%) private placements, NAf.47.8 million (5.8%) treasury bills, NAf.13.2 million (1.6%) wage bonds,[2] and NAf.175.4 million (21.1%) debt conversions.

The liquidity position of the Island Government of Curaçao aggravated in 1998, as it had to deal with negative net borrowing for most of the year. In the end, net borrowing[3] totaled NAf.14.6 million in 1998. As a result, arrears with APNA accumulated, and arrangements were made with its publicly owned enterprises to finance part of the liquidity shortfall through the purchase of securities issued in the domestic money and capital market.

[1] Including APNA and SVB debt conversions.
[2] Bonds issued to civil servants to settle pay equalization and indexation.
[3] Excluding debt conversions.

Table 6.3
Domestic capital market borrowing by the Island Government of Curaçao (outstanding amounts, in millions NAf. per year end)

	1996	1997	1998
Private placement	178.1	189.2	181.4
Public issues	221.0	219.1	243.6
Wage bonds	28.2	22.5	16.9
Treasury bills	17.1	22.1	25.6
Subtotal	444.4	452.9	467.5
Debt conversions	60.0	60.0	60.0
Zero Coupon/Annuity	381.3	413.7	437.0
Total	885.7	926.6	964.5
Net borrowing 1)	29.3	8.5	14.6

1) Excluding debt conversions.

The outstanding debt of the Island Government of Curaçao on the capital market increased by NAf.37.9 million or 4.1% to NAf.964.5 million in 1998 (table 6.3). This increase in debt concealed the fact that approximately NAf.60 million[1] in arrears have been accumulated with APNA. Table 6.3 further shows that NAf.243.6 million (25.3%) of the total outstanding debt was public loans, NAf.181.4 million (18.8%) private placements, NAf.25.6 million (2.7%) treasury bills, NAf.16.9 million (1.7%) wage bonds,[2] and NAf.497.0 million (51.5%) arrears converted into debt securities. Thus, arrears conversions are the largest debt component of the Island Government of Curaçao.

Table 6.4 shows the debt maturity schedule for the general government in the domestic money and capital market at the end of 1998. The schedule reveals that 22.8% of outstanding securities had a short maturity of two years or less. Securities ranging from two to five years comprised 30.6% of total outstanding issues, while 46.6% had maturities of five years or more. Compared to 1997, the share of longer-term securities increased from 36.7% to 46.6% in 1998.

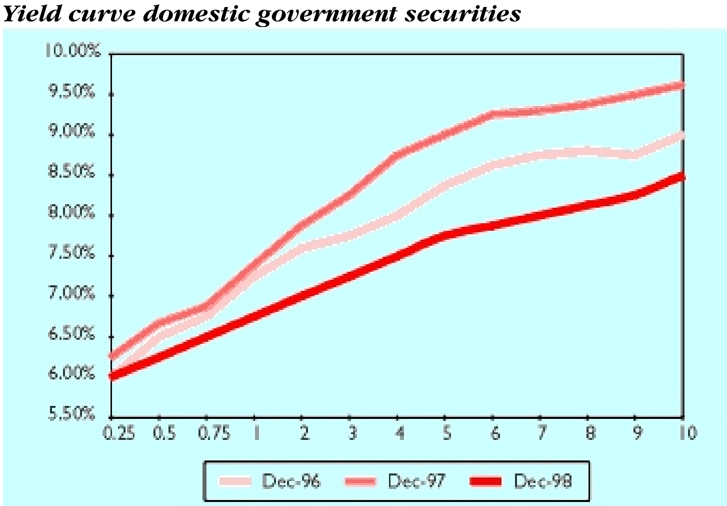
[1] Preliminary
[2] Bonds issued to civil servants to settle pay equalization and indexation

Table 6.4
Maturity structure of total outstanding government securities in 1998

	0-2 years	2-5 years	Over 5 years	Total
Central Government	21.6%	33.5%	44.9%	100%
Island Government of Curaçao	23.8%	28.1%	48.1%	100%
Total	22.8%	30.6%	46.6%	100%

The maturity structure of the Island Government of Curaçao improved significantly with the refinancing of the maturing zero-coupon bond with a value of NAf.436.2 million into a thirty-year annuity loan with monthly installments. Noteworthy is that 97.7% of the bond issues during 1998, totaling NAf.194.6 million, had a maturity of 5 years and longer. However, the general government must take credible measures to bolster investors' confidence and, hence, induce them to invest in (longer-dated) government securities.

Graph 6.1
Yield curve domestic government securities



Domestic investors drove down the yield on domestic government debt between 25 and 130 basis points in the latter half of 1998, as the yield on U.S. Treasury securities declined during the same period. U.S. Treasury yields declined between 90 and 128 basis points, subsequent to the flight to quality prompted by the Russian debt default. Domestic money market yields[1] decreased by 25 to 64 basis points, as the U.S. Federal Reserve reduced its Fed funds target rate by 75 basis points to 4.75% during three consecutive months commencing September 29, 1998.

The domestic yield curve remained steep during 1998, but shifted downwards in line with the downward shift in US Treasury securities. The spread between the 10-year domestic bond and a comparable 10-year US Treasury bond increased from 370 basis points at the end of 1997 to 385 basis points at the end of 1998. Irrespective of the movement in US

Treasury yields, the general government has to take credible actions to reinforce investors' confidence to counteract the trend towards increasing yield spread between US Treasury securities and domestic bond yields.

[1] Yield on short-term securities typically shorter than 1 year.

7 INTERNATIONAL AND REGIONAL DEVELOPMENTS

7.1 Introduction

The year 1998 was characterized mostly by a deteriorating world economy, caused largely by the Asian, Russian, and Latin American crises, which worsened in the last few months of the year. For the last months of 1998, the trade sector of the industrialized countries was slowly feeling the effects of the world financial turmoil, as their growth slowed because of the decline in international trade. The weak growth in Asia and Latin America depressed demand and prices for key industrial goods and commodities. The beleaguered global demand caused a marked contraction in the demand for US exports. For 1998, the US trade deficit with Japan rose 14.3% to $64.1 billion, the highest in four years. The record trade deficit reflects basically the strength of the American economy and the weakness of Japan's. Contrary to the crises in Asia, Russia, and Latin America, the US economy remained strong, with buoyant domestic demand more than offsetting a weak export sector. On the other hand, developments in Asia remained sluggish, although South Korea and Thailand recorded some improvements. Japan's recession exacerbated and is unlikely to recover unless the country restructures its banking system so that Japanese firms and consumers can attain easier credit access to trigger an economic growth.

In 1998, the major European economies, like Germany and France, improved compared to 1997. Alongside the economic expansion in these nations, the Dutch economy, driven by consumer spending, posted an expansion in 1998. Economic growth, however, declined in the main European countries in the last quarter of 1998. The German economy contracted, and French industrial production fell more than expected, raising concerns that Europe's largest economies may slip into recession.

Despite the IMF's rescue package in July, Russia was unable to create and sustain the financial market confidence in the country's fiscal and international payments position. In August 1998, Russia's long-suffering financial sector collapsed, resulting in the ruble's depreciation and a 90-day debt moratorium. The troubles in Russia affected the stock markets in the developed countries, which reduced investors' confidence, causing a flight to quality. The fall-out from the turmoil in Russia triggered a widespread emerging-market crisis, which had adverse effects on Latin America, including Venezuela, Mexico, Chile, and Brazil. The financial pressures intensified in most of the region, raising fear of devaluation and public debt default. As a consequence, interest rates soared to discourage major capital outflow. The growth in Venezuela was worst hit by these developments, owing partially to its reliance on oil, the prices of which dropped sharply.

7.2 Economic development in Venezuela

Venezuela's Gross Domestic Product shrank by 0.7% in 1998, compared to a growth of 5.9% in 1997. Economic activities in Venezuela declined, because of depressed oil prices and high interest rates. Subsequent to the decline in oil prices was a further widening in the government budget deficit. To counteract the fiscal imbalance, the budget outlays were reduced by 5.9%. Gross investment decreased by 4.9%, caused by a reduction of 9.1% in public investment. The slight increase of 0.4% in consumption could not offset the drop in investment, as total domestic demand fell by 0.7%.

Further analysis of the aggregate demand components showed a slight increase of 0.6% in private investment, measured against the growth of 22.8% in 1997. Growth in investment was small, owing to high interest rates and the uncertainties surrounding the elections. Private consumption also was influenced by the high interest rates, which was reflected by the drop of 0.3% in consumption. The export sector weakened from 8.7% in 1997 to 2.2% in 1998, a result of lower external demand and a deterioration in terms of trade on primary goods. The decline in production was noticeable in both the oil (1.0%) and in the non-oil sectors (0.8%). Production in the oil sector dwindled after several years of sustained growth. The production in the non-oil sector decreased in 1998, in contrast to the growth of 3.9% in 1997. The fall in the non-oil sector was led by a reduction in aggregate demand, caused mainly by a contraction in public investments. The decline was noticeable in the manufacturing (4.7%), trade (5.0%), and mining (2.4%) sectors.

Venezuela's inflation decelerated from 37.6% in 1997 to 27.7% in 1998, led by the decline in aggregate demand.

Table 7.1
Economic indicators for Venezuela [1)]

	1996	1997	1998
Total GDP in prices of 1984	-0.2	5.9	-0.7
-GDP oil sector	7.7	9.5	-1.0
-GDP non-oil sector	-2.5	3.9	-0.8
Average exchange rate (Bs/US$)	419.5	488.8	548.2[2)]
CPI (%)	103.2	37.6	27.7[3)]

Source: Banco Central de Venezuela, 1998
1)Preliminary
2)Till 16-12-98
3) Till November 1998

The main objectives of Venezuela's monetary policy were to lower inflation and to preserve a sufficient level of foreign exchange. The tight monetary policy was prolonged to alleviate the disequilibrium in the money market.

7.3 Economic performance in the Netherlands

Provisional figures by the Central Planning Bureau showed that the Dutch economy grew by 3.75% in 1998, following a rise of 3.6% in 1997. This growth was fuelled by a sharp increase in consumer spending and continued strong export growth. Consumers spent 4.25% more in 1998 than in 1997, an acceleration compared to 3.0% growth in 1997. Consumer spending reached 60% of GDP, the result of increased employment (180,000 persons), higher consumer borrowing, and higher real disposable income (table 7.2). The good economic performance also was reflected by the decline in the unemployment rate from 6.6% in 1997 to 5.25% in 1998. Lower energy prices were the reason inflation remained low at 2.0% in 1998.

Table 7.2
Economic indicators for the Netherlands (annual percentage changes)

	1997	1998		1997	1998
International			**Wages and prices**		
-Guilder/dollar (level)	1.95	1.98	-Contractual wages market sector	2.2	3
Demand and output (volume)			Compens. per empl. market sector	2.3	3
-Private consumption	3.0	4.25	Household disposable income (real)	2.7	3
-Private residential investment	7.0	1.25	Consumer price index	2.2	2.0
-Private nonresidential investment	8.0	5.5	Price competitiveness	3.8	-0.5
-Exports of goods, excluding energy	7.2	7.5	**Public sector**		
-Imports of goods	7.6	7.25	General govern. fin. balance (% GDP)	-0.9	-1.25
-GDP	3.6	3.75	Gross debt general governm. (% GDP)	71.4	68.75
-GDP (billion guilders)	709	749	Taxes & social security contr. (% GDP)	43.7	43.5
Labor market			**Miscellaneous**		
-Employment (x 1000 persons)	6,206	6,386	Current balance (% GDP)	6.7	6
-Unemployment rate (%)	6.6	5.25	Labor share in enterpr. income (%)	81.2	80.75
			Long-term int. rate (%)	5.6	4.75

Source: CPB report 1998/3 and 1998/4

Although the position of price competitiveness in the Netherlands deteriorated, the export sector continued to expand in 1998, leading the current account surplus to reach 6% of GDP.

In 1998, the Dutch economy was confronted with an increasing fiscal deficit to 1.25% of GDP, compared to 0.9% in 1997. The government debt reduced from 71.4% of GDP in 1997 to 68.75% in 1998, a result of the strong growth of the economy.

Compared to the last 10 years, the credit growth in the Euro zone, which was on average 8.1% in 1998, was quite high. The Dutch economy showed a credit extension exceeding the other Euro zone countries.

7.4 Economic performance in the United States

Despite a global slowdown, the US economy has flourished for eight consecutive years. The 1998 fourth quarter GDP rose at a 5.6% growth rate, emphasizing a year that produced the strongest consumer spending in 14 years and the tamest inflation in a half-century. Real GDP in the US was 3.9%, following the 3.8% increase in 1997 (table 7.3). The economic pace moved faster in the second half of 1998 than in the first half. 1998's remarkable growth was powered by mild inflation, low interest rates, stock market wealth, and a strong job market.

Table 7.3
Economic indicators for the United States (percentage)

	1996	1997	1998
GDP growth	3.4	3.8	3.9
Inflation rate	2.9	2.3	1.6
Unemployment rate	5.4	4.9	4.3
Consumer spending	3.2	3.4	4.8
Interest rate	5.4	5.5	4.8

Source: World Economic Outlook, October 1998, IMF

These favorable factors boosted consumer purchasing power and domestic demand. American consumer spending grew 4.8%, the largest annual growth since 1984. Spending on durable goods and housing shot up last year, leading households to deplete their incomes, causing a negative saving rate.

The Federal Reserve cut overnight bank interest rates three times down to 4.75% between October and mid-November 1998 to shield the US from the financial crisis affecting world markets. Even with the strong growth and low interest rates, inflationary pressures continued dormant, as the inflation rate slowed to 1.6% in 1998, down from 2.3% in 1997.

Weak global demand, falling energy prices, a flood of inexpensive imports from Asia and elsewhere, and slack factory capacity were the key factors that allayed US inflation in 1998, amid strong growth in domestic demand. The high US currency rate and the financial crises in Asia, Russia, and Brazil have slowly stifled the demand for US exports, thus lowering the prices for a variety of industrial goods and commodities.

The US trade deficit jumped 53.0% to $168.6 billion in 1998. As a result, the US manufacturing sector laid-off more than a quarter million jobs since March.

This lay-off was driven not only by the weak export sector, but also by increased productivity in factories. Contrary to the employment cutback in the manufacturing sector, employment gains were widespread in all sectors in the month of December. The construction sector showed the largest job surge in 14 years, attributable mainly to the unusually warm weather in December. Consequently, the unemployment rate fell to a 28-year low, from 4.9% in 1997 to 4.3% in 1998.

Given the uncertainty of global conditions and after eight years of domestic expansion, the Federal Reserve's latest economic forecast suggests that the most likely outlook for the US economy in 1999 is a 2.5% to 3.0% growth accompanied by 2.5% inflation, and a 4.25% to 4.5% unemployment rate.

7.5 Economic performance in Asia

In 1998, among the countries at the center of the Asian crisis, Thailand and South Korea showed some progress towards improving confidence and devising a recovery. Japan, on the other hand, plunged deeper into recession, as real GDP contracted by 2.2%, after a 0.8% increase in 1997. Corporate profits, investments, personal income and job conditions continued to deteriorate. Japanese unemployment swelled from 3.5% in 1997 to 4.1% in 1998, the highest in five decades. Growing unemployment and decreasing incomes meant fewer people were willing to spend to buy goods, which led to higher consumer savings. The paucity of Japanese consumer spending, which accounts for 60% of the economy, pushed the country into its worst recession in more than 50 years. In 1998, consumer spending contracted by 2.2%, forcing many companies to cut production. Besides lower industrial production (6.4%), demand for American and European goods plunged, as Japan's trade surplus rose to a record $122.8 billion.

Consumer prices in Japan slowed in 1998, pushed down by weak domestic demand and tumbling world oil prices. Inflation for 1998 ended at 0.6%, compared with 1.8% in 1997.

Japan must revive its economy to help the rest of Asia recover from the economic malaise. Financial stabilization is not sufficient to ensure robust recovery; a deep restructuring of the economy also is necessary. Hence, under the pressure from the US, in November 1998, the Japanese government proposed an economic stimulus plan to improve its economy.

It has been estimated that this mega stimulus plan should create a slight economic growth of 0.5% by April 1999. This plan involved more government spending and tax cuts, while the 5% goods and services tax stayed unaltered.

8 THE FINANCIAL SECTOR

8.1 Introduction

In 1998, the Bank continued to supervise the credit institutions operating in the Netherlands Antillean financial sector to protect the interests of their creditors and to maintain the stability and integrity of the sector. Supplementary to the ordinary desk supervision, the Bank conducted regular on-site examinations at 13 credit institutions.

The number of banks operating in the domestic financial sector decreased to 14 because one international bank discontinued the operations of its onshore unit.

The number of banks operating in the international financial sector remained unchanged at 39. Banque Paribas Curacao N.V. changed its name to Banque Artesia Curacao N.V. as a consequence of a name change at corporate level.

One credit union formerly operating with a temporary license received a final license, and one new credit union was admitted.

The Bank issued a "*policy memorandum on the implementation of the fit and proper test,*" which applies to all financial institutions supervised by the Bank. The purpose of the memorandum is to outline the Bank's assessment framework with respect to fitness and probity of natural and legal persons managing, supervising, or controlling a supervised financial institution as a principal or influential shareholder.

Furthermore, the Bank continued its efforts to prevent the use of the Netherlands Antillean financial sector for illicit purposes. In the last quarter of 1998, the Bank conducted quick scans at 24 international credit institutions to ensure that the institutions are undertaking sufficient efforts to deter and detect the use of their facilities for money-laundering purposes. In the fight against money laundering, the Bank has been following directives issued by the Financial Action Task Force (FATF) and the Caribbean Financial Action Task Force (CFATF).

As a consequence of the challenges posed by the Year 2000 and the potential consequences for the financial markets associated with insufficient "Year 2000" preparedness, the Bank has assigned this issue high priority since 1997. The primary aim of the Bank's activities is to ensure that the supervised financial institutions are undertaking the necessary action to achieve "Year 2000" readiness. However, the Bank emphasizes that each institution bears its own responsibility for its systems. Following the first questionnaire in 1997, the Bank issued a second "Year 2000" questionnaire and a "Year 2000 Memorandum" for supervised credit institutions and institutional investors. Furthermore, the Bank visited the institutions that did not respond to the first questionnaire or did not meet the Bank's expectations with respect to this issue.

In the past year, the Bank further developed its policy with respect to entities providing mortgage intermediary services. The Bank expects that this policy will be conducive to a more efficient and competitive domestic mortgage market.

In the area of legislation, the Netherlands Antillean Parliament enacted the National Ordinance on the Supervision of Security Exchanges in November 1998. The purpose of the ordinance is twofold: namely, to promote the proper functioning of stock exchange markets, and to safeguard the interests of investors on the exchanges. Applicants wishing to operate a stock exchange in the Netherlands Antilles require a license from the Minister of Finance of the Netherlands Antilles. The Bank advises the Minister in the licensing process. At the end of 1998, the first request to evaluate the probity of a prospective stock exchange for the Netherlands Antilles was in process.

8.2 Domestic banking

8.2.1 General activities of commercial banks operating in the domestic banking sector

In 1998, total assets of the banks operating in the domestic banking sector of the Netherlands Antilles grew for the third consecutive year, increasing by NAf.197.6 million (4.5%) to NAf.4,559.5 million (table 8.1). The growth resulted mainly from increases in interest-bearing cash and the loan portfolio of NAf.147.4 million and NAf.71.5 million, respectively.

The increase in interest-bearing cash was accounted for largely by the increase in the reserve requirement from 3% in 1997 to 8% in 1998. The reserve requirement is an instrument of monetary policy, which is used primarily by the Bank to reduce the free reserves (overliquidity) for a certain period of time in the domestic banking system.The credit extension business, the main activity of the local banks, expanded further. The growth in the loan portfolio can be attributed mainly to time loans extended to business enterprises and individuals (growth of NAf.89.6 million). Mortgages extended to individuals increased by NAf.7.8 million, partially offsetting the decreases in mortgages extended to business enterprises and mortgages for real estate under construction of, respectively, NAf.14.0 million and NAf 7.0 million. As the average rates for mortgages in 1998 (approximately 11%) hardly changed compared to 1997, other factors like more stringent loan conditions or alternative financing sources may have induced the contraction

in mortgages extended by the local banks.

TABLE 8.1
Balance sheet of commercial banks operating in the domestic banking sector at year-end (in millions NAf.)

	1996		1997		1998	
	NAf.	**%**	**NAf.**	**%**	**NAf.**	**%**
ASSETS						
Non-int.-bearing cash	301.6	7.2	385.2	8.8	372.7	8.2
Interest-bearing cash	583.8	13.9	557.3	12.8	704.7	15.5
Investments	313.3	7.5	314.4	7.2	304.1	6.7
Loans	2,738.1	65.4	2,840.4	65.1	2,911.9	63.9
Inv. unconsol. subs.	27.0	0.6	13.4	0.3	12.4	0.3
Fixed assets	145.7	3.5	162.7	3.8	170.3	3.7
Other assets	78.0	1.9	88.5	2.0	83.3	1.8
Total Assets	4,187.5	100.0	4,361.9	100.0	4,559.5	100.0
LIABILITIES						
Demand deposits	1,159.0	27.7	1,207.4	27.7	1,262.7	27.7
Savings deposits	1,606.7	8.3	1,615.7	37.0	1,675.5	36.7
Time deposits	748.2	17.9	824.7	18.9	856.1	18.8
Total deposits	3,513.9	83.9	3,647.8	83.6	3.794.3	83.2
Borrowings	131.4	3.1	150.1	3.4	169.8	3.7
Other liabilities	181.8	4.3	194.7	4.5	206.8	4.5
Total Liabilities	3,827.1	91.3	3,992.6	91.5	4,170.9	91.5
Minority interest	4.8	0.1	5.3	0.1	5.2	0.1
Subordinated debent.	11.1	0.3	9.1	0.2	7.5	0.2
General provisions	85.9	2.1	113.2	2.6	96.1	2.1
Capital & reserves	258.6	6.2	241.7	5.6	279.7	6.1

Total Capital	360.4	8.7	369.3	8.5	388.5	8.5
Total Liabilities and Capital	4,187.5	100.0	4,361.9	100.0	4,559.5	100.0

A new development is the extension of mortgage financing by foreign lenders to residents of the Netherlands Antilles through mortgage intermediates. In 1998, mortgage financing through intermediates amounted to NAf.23.4 million.

On the liability side, the growth of the deposit base by 4.0% in 1998 was fueled mainly by an increase in savings deposits of individuals of approximately NAf.58 million. Also demand deposits contributed largely to the increase of the deposit base. Business enterprises increased their deposits withdrawable on demand by NAf.41.8 million. Demand deposits by individuals increased by NAf.15.6 million. Furthermore, time deposits also increased (NAf.31.4 million). The differences in the increase in the outstanding amounts occurred, even though the average interest rates on savings and demand deposits did not change significantly compared to the rates for time deposits.

The capitalization of the domestic banking sector increased by NAf.19.2 million (5.1%).

8.2.1.1 Solvency

Similar to 1997, the local banking sector as a whole reflected a sound capitalization underscored by the solvency surplus in this sector. The solvency surplus of the banking sector decreased somewhat due to an increase in the required capital as a consequence of an increased level of risk associated activities of the banks.

8.2.1.2 Net income

After the decrease in net income in 1997, the local banks earned a net income of NAf.45.6 million during 1998. Compared to 1997, this is an increase of approximately 86%. The increase in income was evenly distributed between interest income and other fees and commissions. Interest income as well as other fees and commissions increased by 4% during 1998. Operating expenses increased by NAf.6.8 million while extraordinary expenses decreased by NAf.4.8 million during 1998.

8.2.1.3 Liquidity

The sector reflected a further improvement in liquidity (see table 8.2). Interest-bearing cash increased because of the increase in the reserve requirement percentage. While actual liquidity increased, the required liquidity remained almost at the same level (see table 8.2).

TABLE 8.2
Liquidity at year-end (in millions NAf.)

	1996	1997	1998
Total actual liquidity	891.5	1,019.5	1,106.7
Total required liquidity	861.0	844.3	846.1
Liquidity surplus/(deficit)	30.5	175.2	260.6

8.2.2 Domestic activities of commercial banks operating in the domestic banking sector

Following an increase of 2.6% in 1997, total domestic assets of the domestic banking sector increased slightly by 1.0% in 1998 (see table 8.3). A comparison of tables 8.1 and 8.3 reveals that the increase in total assets reflected in table 8.1 was accounted for mainly by the increase in the foreign business of local banks. The increase in total loans extended by local banks (see table 8.1) was attributed mainly to nonresidents. The marginal increase in loans to residents is in line with the tight monetary policy of the Bank in 1998.

A further comparison of table 8.1 and 8.3 reveals that domestic assets comprised 67% of total assets.

TABLE 8.3
Domestic activities of commercial banks operating in the domestic banking sector at year-end (in millions NAf.)

	1996		1997		1998	
	NAf.	%	NAf.	%	NAf.	%
ASSETS						
Non-int.-bearing cash	150.7	5.1	193.1	6.4	111.2	3.7
Interest-bearing cash	121.9	4.3	144.3	4.8	240.5	7.9
Investments	274.5	9.3	260.9	8.7	238.4	7.8
Loans	2,180.1	74.2	2,199.8	73.0	2,233.6	73.4
Investm. unconsol. sub	22.0	0.8	9.8	0.3	9.5	0.3
Fixed assets	132.8	4.5	140.9	4.7	147.2	4.8
Other assets	54.3	1.8	62.6	2.1	61.6	2.0
Total Assets	2,936.3	100.0	3,011.4	100.0	3,042.0	100.0
LIABILITIES						
Demand deposits	905.3	44.8	1,193.0	43.2	1,170.5	41.5
Time deposits	444.9	16.5	483.7	17.5	532.4	18.9
Total deposits	2,559.9	94.9	2,612.6	94.6	2,659.4	94.3
Borrowings	2.8	0.1	1.6	0.1	3.7	0.1
Other liabilities	134.8	5.0	146.3	5.3	155.8	5.5

Total Liabilities	2,697.5	100.0	2,760.5	100.0	2,818.9	100.0

Table 8.4 indicates that lending to the government in 1998 remained almost unchanged from 1997. Lending to the private sector grew by 0.2% in 1997; in 1998, by 1.5%. The domestic extension of mortgages of NAf.890.3 million represents approximately 80% of the total mortgages extended by local banks.

TABLE 8.4
Domestic lending to the public and private sector at year-end (in millions NAf.)

	1996	1997	1998
Government	4.0	1.3	1.2
Private sector	2,195.1	2,198.6	2,232.3
-Consumer loans	507.7	478.1	516.2
-Business loans	797.2	794.8	825.9
-Mortgages	890.2	925.7	890.3
Total	2,199.1	2,199.9	2,233.5

Table 8.5 illustrates the distribution of the domestic deposit base between the public and private sectors. In 1998, funding of total assets through deposits by the private sector decreased slightly from 58% to 56%.

TABLE 8.5
Holders of deposits at year-end (in millions and %)

	1996		1997		1998	
	NAf.	**%**	**NAf.**	**%**	**NAf.**	**%**
Deposit holders						
- Government	130.5	5.1	95.7	3.7	96.3	3.6
-Private sector	2,429.5	94.9	2,516.9	96.3	2,563.1	96.4
Total deposits	2,560.0	100.0	2,612.6	100.0	2,659.4	100.0

Table 8.6 illustrates a further growth in the domestic deposits of the private sector in 1998. The further increase in deposits denominated in the local currency may be attributed to higher interest rates on time deposits denominated in local currencies as a consequence of increased rates on government bonds.

TABLE 8.6
Growth of domestic private sector deposits by currency (in millions NAf.)

	1996		1997		1998	
	NAf.	**%**	**NAf.**	**%**	**NAf.**	**%**
N.A. guilders	96.2	144.4	118.2	135.2	105.4	228.1
Foreign currencies	-29.6	-44.4	-30.8	-35.2	-59.2	-128.1
Total growth	6.6	100.0	87.4	100.0	46.2	100.0

Table 8.7 illustrates that local banks have increased slightly their foreign business activities. This growth is reflected in an increased share of their main foreign assets component (loans) and main foreign funding (deposits) as a percentage of their total business.

TABLE 8.7
Foreign activities of commercial banks operating in the domestic banking sector at year-end (in millions NAf.)

	1996		1997		1998	
	NAf.	**%**	**NAf.**	**%**	**NAf.**	**%**
ASSETS						
Non int.-bearing cash	151.0	12.1	192.1	14.2	261.5	17.2
Interest-bearing cash	461.9	36.9	413.0	30.6	464.2	30.6
Investments	38.8	3.1	53.5	4.0	65.7	4.3
Loans	558.0	44.6	640.6	47.4	678.3	44.7
Investm. unconsol. sub.	5.0	0.4	3.6	0.3	2.8	0.2
Fixed assets	12.9	1.0	21.8	1.6	23.1	1.5
Other assets	23.7	1.9	25.9	1.9	21.7	1.4
Total Assets	1,251.3	100.0	1,350.5	100.0	1,517.3	100.0
LIABILITIES						
Demand deposits	253.7	22.5	271.5	22.0	306.2	22.6
Savings deposits	397.0	35.1	422.7	34.3	505.1	37.4
Time deposits	303.3	26.9	341.0	27.7	323.7	23.9
Total deposits	954.0	84.5	1,035.2	84.0	1,334.9	83.9
Borrowings	128.5	11.4	148.5	12.1	166.0	12.3
Other liabilities	47.0	4.1	48.4	3.9	51.0	3.8
Total Liabilities	1,129.5	100.0	1,232.1	100.0	1,351.9	100.0

8.3 Secondary financial institutions

In 1998, the number of secondary institutions operating in the Netherlands Antillean financial sector increased by one to 37. Those institutions included credit unions, specialized institutions, savings banks, and thrift foundations. The individuals holding a dispensation to extend credit coupons ('bon') for short-term consumer credit to households numbered 18 at the end of 1998.

8.4 International banking

Total assets of the international banking sector of the Netherlands Antilles increased by NAf.9.2 billion (16.3%) to NAf.65.5 billion in 1998. Other assets increased by NAf.8.3 billion, representing the largest item in the increase in total assets. Interest receivables and other assets accounted for the majority of that increase.

The increase in total assets of the international banking sector was financed primarily through demand deposits and borrowings. The net income of the international banking sector decreased by NAf.24.9 million (6.4%) to NAf.360.5 million in 1998. The decrease in net income was mainly the result of an increase in extraordinary expenses.

TABLE 8.8
Balance sheet of commercial banks operating in the international banking sector at year-end (in billions NAf.)[1)]

	1996		1997		1998	
	NAf.	%	NAf.	%	NAf.	%
ASSETS						
Non-int.-bearing cash	1.5	3.0	1.1	2.0	2.2	3.4
Interest-bearing cash	7.8	15.4	10.5	18.6	9.7	14.8
Investments	7.2	14.2	5.9	10.5	4.7	7.2
Loans	31.7	62.5	35.8	63.5	37.6	57.4
Inv. unconsol. subs.	0.3	0.7	0.3	0.6	0.3	0.5
Fixed assets	0.1	0.2	0.1	0.1	0.1	0.1
Other assets	2.1	4.0	2.6	4.7	10.9	16.6
Total Assets	50.7	100.0	56.3	100.0	65.5	100.0
LIABILITIES						
Demand deposits	4.0	7.9	3.1	5.6	6.3	9.6
Savings deposits	0.1	0.2	0.1	0.2	0.1	0.1
Time deposits	14.7	28.9	18.3	32.4	17.2	26.4
Total deposits	18.8	37.0	21.5	38.2	23.6	36.1
Borrowings	25.5	50.2	28.6	50.8	34.7	53.0
Other liabilities	2.6	5.3	2.5	4.5	2.1	3.2
Total Liabilities	46.9	92.5	52.6	93.5	60.4	92.3
Minority interest	0.1	0.2	0.1	0.2	0.1	0.1
Subordinated debentures	0.2	0.4	0.1	0.1	0.1	0.1
General provisions	0.2	0.3	0.3	0.4	0.3	0.4
Capital & reserves	3.0	5.9	3.3	5.9	4.6	7.0
Total Capital	3.8	7.5	3.7	6.5	5.1	7.7

Total Liabilities and Capital	50.7	100.0	56.3	100.0	65.5	100.0

[1)] Figures for 1996 have been adjusted.

9 INSTITUTIONAL INVESTORS

9.1 Introduction

Changes in the institutional investors market are leading to a much more dynamic structure, which will have consequences for the way in which the insurance and superannuation industry is regulated and supervised. Legislative changes are on the way, while at the same time, our monitoring systems are being revisited. The expansion of pure financial examinations with operational and organizational aspects are evidence of these changes. They coincide with the underlying proactive philosophy of avoiding misfortunes rather than solving them.

The draft legislation regulating insurance brokers was finalized and forwarded to the government for parliamentary enactment. Some by-laws are being drafted now to conclude the legal structure. The law will offer protection to potential policyholders in the precontractual stage.

Furthermore, the government charged the Social Security Bank with the revision of the existing draft legislation on compulsory health care insurance. The draft is being discussed now.

The Inter-island Working Group for the Introduction of the Motor Insurance Guarantee Fund is working on changes concerning motor liability insurance legislation and the infrastructure needed to make the fund operational. A centralized registration system will be introduced to facilitate law enforcement.

At the request of the government, the Pension Committee organized hearings to discuss its proposals with the social partners and the providers of pension services, and reported its findings. The government is expected to take a final position based on the proposals and the results of the hearings in the first half of 1999. The proposals aim to alleviate the existing situation where two-thirds of the work force does not have a pension arrangement.

The demand for pension products is increasing in the Netherlands Antilles. Pension funds are developing a more flexible approach towards the pension plans they administer and, as such, will enter more into competition with the life insurance companies, traditionally also active in this market. However, the superannuation and the insurance industry are subject to different supervisory and tax laws.

The development of the automated reporting system is reaching its conclusion. Preparations are being made to start developing a new data retention system to process the information provided by the new reporting system.

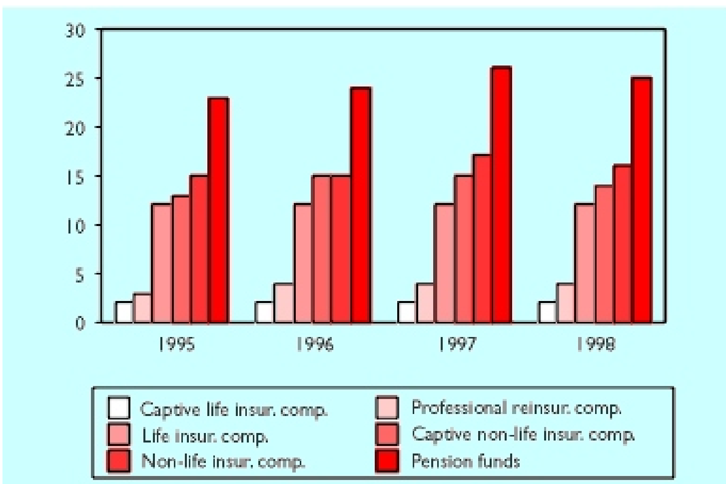
9.2 The institutional investors' sector

The number of institutional investors operating in the Netherlands Antilles decreased by three during 1998. The number of life companies remained stable at 12, three of which are locally incorporated. A smaller non-life company, involved mainly in insurance pools, stopped doing business in the Netherlands Antilles. This decreased the number of non-life insurance companies to 16, 9 of which are locally incorporated.

The number of insurance companies servicing the international markets declined by one, totaling 20 by the end of 1998. Of these companies, 2 are involved in the life insurance business, 14 in non-life insurance, and 4 in reinsurance. Most of the internationally operating insurance companies have European parents. More than fifty percent of the companies originate in the Netherlands.

The number of pension funds declined by one, totaling 25 at the end of 1998.

Graph 9.1
Composition of the institutional investors' sector (number of companies)



9.3 Overview of developments in the insurance industry

9.3.1 General

Despite the economic setback in the Netherlands Antilles, the insurance industry remained profitable. The premium volume increased in 1997, though at a slower rate. One should bear in mind, however, that adverse economic developments are not felt immediately in the insurance industry.

The "flight to quality" during the last few years resulted in a shift from small reinsurance entities towards the large reinsurance companies. This also generated an increasing number of mergers and acquisitions in the reinsurance market. This consolidation process is likely to continue. In addition, new players like ACE and AXEL in Bermuda, entered the market. As a result, this jurisdiction is developing from a niche player into a reinsurance center.

The performance of the reinsurance industry has been remarkably good despite falling reinsurance prices. The low number of natural disasters in the last four years contributed to that result. The reorganization of the London market and its return to profitability also attracted new capital to the reinsurance market.

Some major natural disasters occurred in the world during 1998. In the Caribbean, hurricanes "Mitch" and "Georges" caused considerable damage. The Windward Islands (St. Maarten, Saba, and St. Eustatius) were affected by hurricane "Georges." Considering the ample availability of capital in the reinsurance markets, reinsurance premiums are expected to remain soft in 1999.

In general, insurance rates are expected to follow the trend in the reinsurance market and will remain soft in 1999. The Windward Islands experienced stronger pressure to lower property and casualty rates, since the environment is more competitive due to the proximity of other Caribbean islands.

Discussions with the island authorities concerning an increase in the insurance premium for compulsory motor insurance must still be concluded. The present discussion addresses the magnitude of the increase and how it should be accomplished.

The introduction of a nationwide health care system could have serious consequences for companies underwriting this line of business, especially since this business is rather labor-intensive. The issue is whether the system will be centralized with only one executive body or whether market forces will continue to rule this industry to a great extent.

Free market competition is based on the possibility of making free choices. Justifiable choices can be made only if the customer has access to information with respect to services and their providers. With the introduction of the new filing system, transparency will be increased to the benefit of the public.

The potential exists to further develop the Netherlands Antilles as a domicile for international insurance activities. Marketing the country for this purpose remains a weakness. The efforts of the recently incorporated captive association aim to change this in the near future.

9.3.2 Life insurance industry

9.3.2.1 Balance sheet

According to table 9.1, total assets of the local life insurance industry increased by 6.9% between 1996 and 1997, compared with the 11.8% growth from 1995 to 1996. This increase of 6.9% is 42% less than the growth of the previous year. Of the total assets, 68.2% relate to investments and 16.9% to current assets.

Table 9.1
Consolidated balance sheet of life insurance companies (in millions NAf.)

	1995		1996		1997	
	Local	**Int'l**	**Local**	**Int'l**	**Local**	**Int'l**
ASSETS						
Intangibles	0.4	-	-	-	-	-
Total investments	604.2	27.0	626.3	29.2	654.8	27.5
Current assets	117.0	5.2	133.6	7.7	162.1	10.2
Other assets	15.4	-	15.6	-	13.9	-
From separate accounts statement	66.4	-	122.5	-	129.4	-
Total admissible assets	803.4	32.2	898.0	36.9	960.2	37.7
LIABILITIES						
Capital	10.4	5.9	14.0	4.1	12.9	5.9
Surplus	28.5	17.2	34.3	22.7	28.5	22.4
Subord. instruments	-	-	6.2	-	6.6	-
Technical provisions	521.2	6.6	572.5	4.8	634.4	5.3
Other provisions and liabilities	65.0	1.2	17.4	1.2	11.5	1.3
Current liabilities	111.9	1.3	123.6	3.8	128.5	2.8
Contingent liabilities	-	-	7.5	0.3	8.3	-
From separate accounts statement	66.4	-	122.5	-	129.5	-
Total equity, provisions, and liabilities	803.4	32.2	898.0	36.9	960.2	37.7

Total liabilities increased mainly as a result of an increase of NAf.56.9 million (10.2%) in technical provisions.

The equity position of the local life insurance companies, consisting of capital, surplus, and subordinated instruments, decreased by NAf.6.5 million (11.9%). This decrease is the result of a decrease of NAf.1.1 million in capital (7.8%), a decrease of NAf.5.8 million in surplus (16.9%), and an increase in subordinated instruments of NAf.0.4 (6.5%).

The equity position of the local life insurance companies represents more than twice the amount needed to meet the 4% solvency requirements.

Total assets of the international life insurance companies increased by NAf.0.8 million (2.2%), reaching NAf.37.7 million at the end of 1997. The equity position improved by

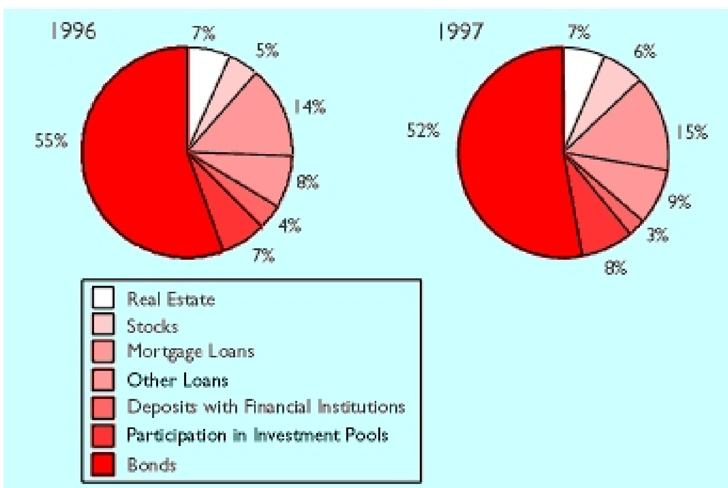
NAf.1.5 million (5.6%), totaling NAf.28.3 million by the end of 1997, well above the legally required solvency margin.

9.3.2.2 Investments

As noted, total investments of the local life insurance industry increased by NAf.28.5 million (4.6%), due mainly to the increases in stocks, mortgages and other loans.

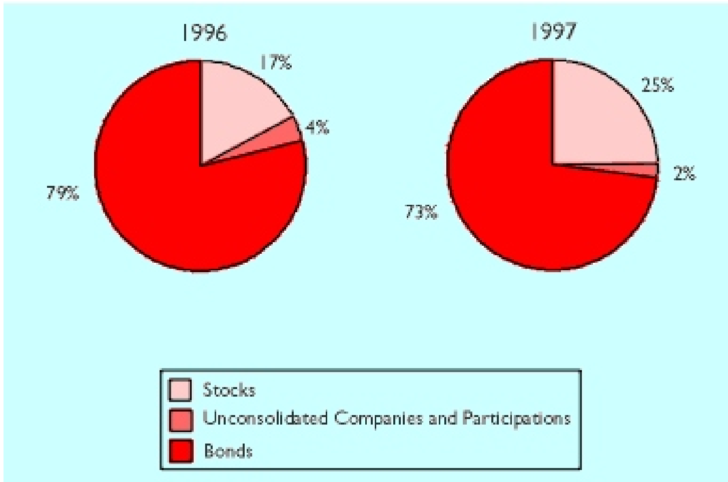
The composition of the consolidated investment portfolio of the local life insurance companies is shown in graph 9.2. This graph shows that, as a percentage of total investments, the shares of stocks, mortgages, other loans, and participations in investment pools increased by 1 percentage point in 1997, compared to 1996. These increases were primarily at the expense of the share of bonds, which declined by 3 percentage points.

Graph 9.2
Composition of the investment portfolio of local life insurance companies



The composition of the international life insurance companies' investment portfolio changed significantly in 1997, compared to 1996 (graph 9.3). This was reflected by a higher share of stocks at the expense of, primarily the share of bonds.

Graph 9.3
Composition of the investment portfolio of international life insurance companies



9.3.2.3 Profit and loss statement

The operating results of the local life insurance industry are presented in table 9.2. The net result before corporate taxes increased by 13.3% between 1996 and 1997, compared with the 22.1% growth from 1995 to 1996. However, the net result *after* taxes declined by NAf.1.5 million (50.0%).

A continued increase in both premium income and investment income were responsible for the positive results. In 1997, both categories increased by NAf.7.8 million (7.0%) and NAf.6.2 million (13.2%), respectively.

Of the total net earned premium, 59.6% was related to individual life and the remaining 40.4% to group business. Premium income for individual life increased for the fifth consecutive year. However, group life showed a slight (less than 10%) setback in one year.

Total operational expenditures increased by NAf.13.8 million (9.8%), due mainly due to an increase in net benefits incurred and changes in technical provisions.

The net operational result showed an improvement of NAf.0.5 million (5.3%), totaling NAf.9.9 million in 1997. This improvement was offset partially by increases in both the negative result from separate accounts and corporate taxes incurred, which led to a decline of NAf.1.5 million in the net result after corporate taxes.

Table 9.2
Consolidated profit and loss statement of life insurance companies (in millions NAf.)

	1995		1996		1997	
	Local	**Int'l**	**Local**	**Int'l**	**Local**	**Int'l**
INCOME						
Total net earned premium	98.7	6.4	111.4	6.2	119.2	5.7
Net investm. income allocated to technical provisions	36.0	-	38.0	0.9	43.8	-
Net other operational income	0.1	-	0.2	-	0.9	-
Total operational income	134.8	6.4	149.6	7.1	163.9	5.7
EXPENSES						
Net benefits incurred	34.3	0.4	39.7	1.4	43.8	1.7
Change in net techn. prov.	54.6	1.4	60.6	-	65.2	-0.5
Policyholders' dividends	7.7	1.8	7.3	1.5	8.0	1.3
Insurance expenses and noncorporate taxes	15.5	0.4	16.7	-	16.6	0.3
Commission and other acquisition costs	13.9	0.6	14.9	-	15.0	-
Net other operational expend.	1.0	0.1	1.0	0.9	5.4	-
Total operational expend.	127.0	4.7	140.2	3.8	154.0	2.8
Net operational result	7.8	1.7	9.4	3.3	9.9	2.9
Net investm. income allocated to surplus	7.3	3.6	9.1	2.6	9.5	-0.5
Other income and expenses	-5.7	-	-8.1	-1.2	-7.4	-
Net result from separate accounts	-2.5	-	-2.0	-	-2.5	-
Extraordinary results	-0.1	-0.6	-0.1	-0.8	-0.1	-0.7
Net result before	6.8	4.7	8.3	3.9	9.4	3.1

corp. taxes						
Corporate taxes incurred	2.5	-	5.3	-	7.9	-
Net result after corp. taxes	4.3	4.7	3.0	3.9	1.5	3.1

The net earned premium in the international life insurance industry decreased by NAf.0.5 million (8.1%) to NAf.5.7 million in 1997. Net benefits incurred increased by NAf.0.3 million, resulting in a decrease in the net operational result.

Although the industry experienced positive extraordinary results, the decrease in the net operational result was not offset by net investment income. The net result after corporate taxes was NAf.0.8 million (20.5%) less than in 1996.

The net result after taxes for the internationally operating life insurance companies has now declined for the fourth consecutive year.

Graph 9.4
Net results after corporate taxes of the local life insurance sector (in millions NAf.)

9.3.3 The non-life insurance industry

9.3.3.1 Balance sheet

The balance sheet total of the non-life insurance companies operating in the domestic market increased by NAf.16.8 million (3.8%), totaling NAf.456.0 million at the end of 1997. Current assets decreased by NAf.15.2 million (4.3%). Furthermore, total investments increased by NAf.33.6 million (40.9%). Due to the short-term nature of the non-life business in comparison with the life business, a smaller percentage of total assets is invested, namely, 25.4%. Consequently, a larger portion (73.4%) relates to current assets, compared to 16.9% in the life business.

On the liability side, the growth in the balance sheet total was reflected mainly in a NAf.7.5 million (5.8%) increase in technical provisions and a NAf.7.2 million (2.9%) increase in current liabilities.

The equity position of the local non-life insurance industry decreased slightly by NAf.0.2 million (0.4%) totaling NAf.50.2 million by the end of 1997. This latter amount is well above the 15% margin required by law to cover the industry's solvency margin.

The balance sheet total of the insurance companies operating in the international markets showed a significant increase of NAf.429.9 million (35.8%), totaling NAf.1.6 billion at the end of 1997.

The increase in total assets can be attributed entirely to the growth in investments, because the other categories did not change significantly.

On the liability side, the technical provisions increased by NAf.142.5 million (25.8%), while current liabilities increased by 17.3 million (70.9%) in 1997.

Table 9.3
Consolidated balance sheet of the non-life insurance industry (in millions NAf.)

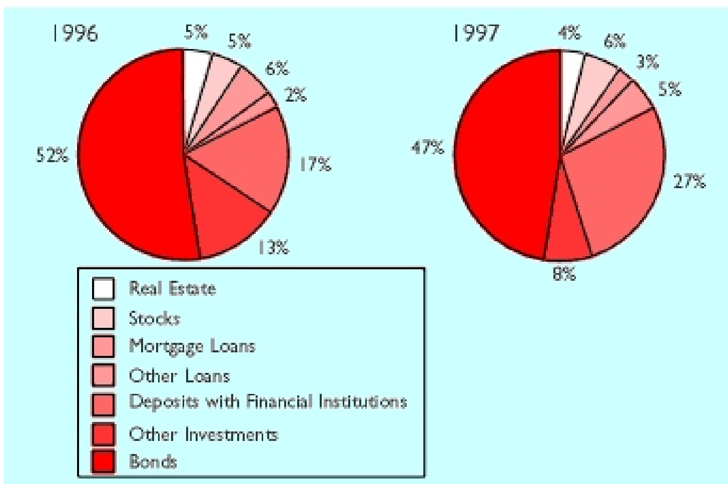
	1995		**1996**		**1997**	
	Local	**Int'l**	**Local**	**Int'l**	**Local**	**Intl**
ASSETS						
Intangibles	0.4	-	0.9	-	-	-
Total investments	72.3	802.1	82.2	1,110.9	115.8	1,526.3
Current assets	316.3	120.8	349.9	89.9	334.7	104.4
Other assets	6.6	0.6	6.2	0.1	5.5	0.1
Total admissible assets	395.6	923.5	439.2	1,200.9	456.0	1,630.8
LIABILITIES						
Capital	34.2	133.2	33.6	120.1	40.3	155.8
Surplus	12.1	375.9	16.8	504.2	9.9	738.6
Subordin. instruments	0.3	-	9.7	-	9.8	-
Technical provisions	152.9	389.0	129.8	552.1	137.3	694.6
Other prov. & liabilities	1.4	10.0	1.5	0.1	2.0	0.1
Current liabilities	194.5	12.0	247.8	24.4	255.0	41.7
Contingent liabilities	0.2	3.4	-	-	1.7	-
Total equity, provisions, and liabilities	395.6	923.5	439.2	1,200.9	456.0	1,630.8

The equity position was further strengthened by an increase of NAf.270.1 million (43.3%), reaching NAf.894.4 million in 1997, primarily through an increase in the surplus. As a result, the consolidated solvency position of the internationally operating insurance companies exceeded the legal requirements by a significant margin.

9.3.3.2 Investments

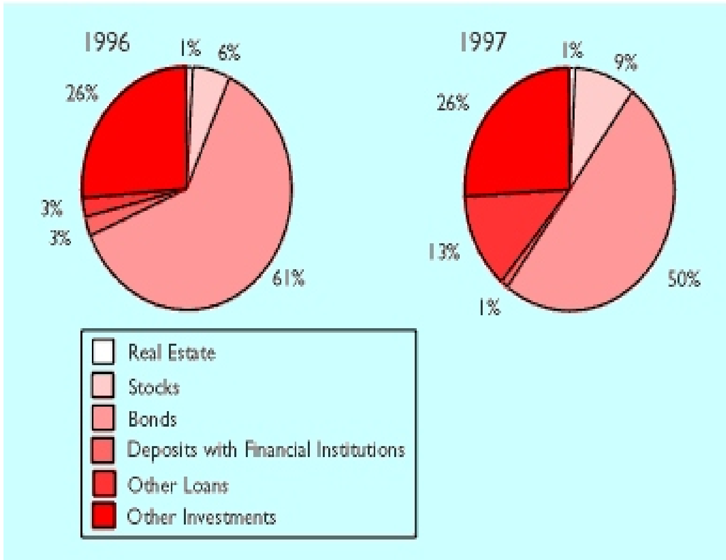
The composition of the investment portfolio of the local non-life insurance companies is presented in graph 9.5. This graph indicates that the share of deposits increased considerably from 17% in 1996 to 27% in 1997. This increase was largely at the expense of the shares of bonds and other investments, which declined from 52% to 47% and from 13% to 8%, respectively.

Graph 9.5
Composition of the investment portfolio of the local non-life insurance companies



The composition of the investment portfolio of the international non-life insurance companies is illustrated in graph 9.6 This graph shows that the share of other loans increased markedly from 3% in 1996 to 13% in 1997. Mentioned increase was largely at the expense of the share of bonds, which declined from 61% to 50%.

Graph 9.6
Composition of the investment portfolio of the international non-life insurance companies



9.3.3.3 Profit and loss statement

Net earned premium of the local non-life insurance industry increased by NAf.13.1 million (8.2%) in 1997. On the other hand, net claims incurred, including other operational expenditures, also increased, resulting in an underwriting loss of NAf.0.4 million. This loss was offset by the net investment income and other positive results, which led to a positive net result after corporate taxes amounting to NAf.9.0 million.

Table 9.4
Consolidated profit and loss statement of the non-life insurance industry (in millions NAf.)

	1995		1996		1997	
	Local	**Int'l**	**Local**	**Int'l**	**Local**	**Int'l**
INCOME						
Total net earned premium	148.2	169.8	159.6	207.7	172.7	272.6
Net underwriting income	0.1	1.6	0.1	0.7	-	1.6
Total operational income	148.3	171.4	159.7	208.4	172.7	274.2
EXPENSES						
Net claims incurred	97.0	88.4	88.3	120.0	97.3	170.6
Change in various provisions	2.7	-	1.0	-	0.5	0.4
Claim adjustment expenses	2.4	0.4	6.9	-	6.0	-
Net other underwr. expend.	37.4	8.2	36.0	10.7	41.0	13.6
Net other	24.2	1.6	27.5	3.1	28.3	5.8

operational expend.						
Total operational expend.	163.7	98.6	159.7	133.8	173.1	190.4
Underwriting results	-15.4	72.8	0.0	74.6	-0.4	83.8
Net investment income	7.4	58.2	7.5	74.9	8.0	85.0
Other results	-0.2	-10.8	1.5	-14.7	1.4	-35.5
Extraordinary results	-0.1	-0.1	-0.1	-7.8	-0.1	-
Net result before corp. taxes	-8.3	120.1	8.9	127.0	8.9	133.3
Corporate taxes incurred	-2.5	1.8	3.4	2.2	-0.1	1.9
Net result after corp. taxes	-5.8	118.3	5.5	124.8	9.0	131.4

Total net earned premium of the internationally oriented non-life insurance companies increased by NAf.64.9 million (31.2%) in 1997, 9 percentage points more than in 1996. The growth in income was offset partially by a NAf.50.6 million (42.2%) increase in the net claims incurred. The overall improvement in underwriting results amounted to NAf.9.2 million (2.5%).

Although investment income increased by 13.5% (NAf.10.1 million) in 1997, it was less than half of the growth in 1996 of 28.7%. Net results before and after corporate taxes continued to improve, by NAf.6.3 million (4.9%) and NAf.6.6 million (5.3%), respectively.

10 POLICY AND ACTIVITIES OF THE BANK

10.1 Introduction

This chapter summarizes the main policies and activities of the Bank during 1998.

10.2 Training and seminars

From September 21 - October 2, 1998, the Bank hosted a course under the auspices of the Center of Monetary Studies in Latin America (CEMLA) on the economic and operative aspects of central banking. Lecturers were from the CEMLA and several Caribbean Central Banks. The 20 participants were representatives of the various Central Banks in the Caribbean. Topics included national accounting & flow of funds, macroeconomics for small open economies, fiscal policy, monetary policy, external sector & adjustment policies, and management and organization of the Central Bank. In addition, special topics were presented on offshore banking, Year 2000 problems, safeguarding the integrity of the financial system, the Euro, and money laundering. Some case studies of Caribbean economies also were discussed.

During 1998, the Bank continued to offer courses on professional writing in the Dutch language for its medium and higher ranked staff. The purpose of these courses, which are provided by the Language Teachers Institute, is to make the Bank's staff more familiar with modern Dutch grammar and spelling, thereby improving the quality of internal reporting and external correspondence.

Furthermore, staff of the banking supervision department attended various seminars and conferences in the region to keep up with the latest developments in their field. Issues covered included banking and credit risk analysis, information technology, electronic payments, and money laundering.

Staff members of the Central Bank participated intensively in the activities of the Caribbean Action Task Force (CFATF) during 1998. The CFATF is a regional organization for the prevention and combating of money laundering. The Netherlands Antilles participated in all the Plenary and Council Meetings and continues to play a dynamic role as a member of the Steering Committee of this organization. In January 1999, the Netherlands Antilles was examined for the second time by the Financial Action Task Force (FATF). The Mutual Evaluation Report will be discussed during the upcoming FATF meeting in Tokyo in June 1999.

10.3 Monetary policy measures

In 1998, the MCR remained the main instrument of monetary policy until September 15, when the Bank introduced its new monetary policy. For 1998, the maximum allowed growth of NDC private sector was 2.25%, while the ceiling for net domestic credit to the government was maintained at the level of October 31, 1996.

The new monetary policy, which became effective on September 15, 1998, implies a shift from direct to indirect, more market-oriented instruments. From October 1998 the cash reserve percentage was gradually reduced, thereby reducing the penalty on excess credit. Effective January 1, 1999, the Bank lifted the direct limit on credit extension to the private sector through a reduction of the cash reserve percentage for private sector credit to 0%. From this date, excessive domestic spending through credit extension will be controlled by an active reserve requirement policy. However, the ceiling on government net domestic credit was maintained to minimize monetary financing of the budget deficits.

The reserve requirement has become the Bank's main monetary policy instrument since the introduction of the new monetary policy in September 1998. This instrument is aimed at reducing over-liquidity in the banking system and, hence, the potential for excess credit extension. This is achieved by requiring the banks to deposit a fixed percentage of their domestic debt at the Bank. The current reserve requirement policy determines the reserve requirement percentage monthly, based on the developments in the free reserves of the commercial banks and the official foreign exchange reserves vis-à-vis benchmarks determined by the Bank. This resulted in an increase from 4% to 6% in September 1998, to 6-½% in October 1998, and a further increase to 8% in November 1998. A maximum of 25% of the reserve requirement may be held in interest-bearing certificates of deposit. The remainder is non-interest-bearing.

Another element of the Bank's new monetary policy is the elimination of the limit on net foreign assets of the commercial banks (i.e., the B-9 limit). However, the commercial banks are not allowed to have a negative net foreign assets position. Any negative position is subject to a penalty equal to the amount of the negative position multiplied by the Bank's pledging rate (currently 7%). In addition, a penalty is charged for late reporting, equal to NAf 1,000 per day.

11 FOREIGN EXCHANGE REGULATIONS AND LICENSE FEE

The foreign exchange regulations in the Netherlands Antilles are based on the National Ordinance Foreign Exchange System of 1981. According to that Ordinance, current transactions are in principle free, while capital transactions require a foreign exchange license.

Although capital transactions are bound to a license, over time several foreign exchange notifications have been issued that liberalized certain capital transactions. The Bank applies a liberal licensing system with respect to capital transactions: licenses are normally granted upon request.

The main purpose of the foreign exchange regulations as embodied in the Foreign Exchange Ordinance of 1981 are:

1. to promote the Netherlands Antilles as an internationally recognized financial center; for this reason, the Ordinance contains special provisions for companies engaged in international financial and business transactions;
2. to obtain the necessary information and data essential for compiling the balance of payments;
3. to support the monetary and economic policy efforts of the monetary authorities, whereby the maintenance and safeguarding of the monetary reserves, and thus exchange rate stability, are considered of primary importance; and
4. to prevent the use of Antillean Guilders as a means of payment in the international payment system.

The general foreign exchange policy is vested with the government of the Netherlands Antilles. The Bank is charged with executing the foreign exchange regulations and managing the available foreign exchange reserves for account and risk of the government. Therefore, the Bank is empowered to grant licenses and exemptions by virtue of the Foreign Exchange Ordinance of 1981.

Table 11.1 compares the total amounts invested by residents abroad during the financial years 1996, 1997, and 1998, based on foreign exchange licenses granted.

TABLE 11.1
Investments abroad by residents 1996 through 1998 (in millions NAf.)

	1996	1997	1998
January	1.3	-	-
Februar	-	17.9	-
March	-	-	0.5
April	0.9	2.0	-
May	-	1.8	-
June	-	-	0.7
July	2.0	0.4	-
August	-	0.1	1.4
September	0.9	0.9	1.3
October	1.6	0.6	-
November	-	1.3	-
December	3.6	0.3	0.5
Total	10.3	25.3	4.4

Note: In the figures, investments made by natural persons in amounts less than NAf.100,000 annually have not been included, because no license is required for these amounts. Some institutional investors are not included, because they have a general license to make investments abroad within certain limits.

Starting January 1, 1996, the foreign exchange banks have to pay a license fee to the Central Bank on international transactions. This license fee replaced the foreign exchange tax, in force until December 1995. The license fee is calculated on the basis of the payments made by residents to nonresidents, with the exception of those payments related to re-investment of funds abroad and the re-exports of the "Free-Zone" companies.

TABLE 11.2
License fees collected during 1996 through 1998 (in thousand NAf.)

	1996	1997	1998*
January	3,643.3	3,007.4	2,825.3
February	2,806.9	2,553.2	2,578.1
March	3,201.1	2,634.5	3,088.2
April	2,904.1	2,927.2	2,614.1
May	3,213.8	2,623.8	2,694.7
June	3,184.0	2,701.6	2,983.3
July	3,180.5	2,959.0	2,853.7
August	2,946.8	2,712.2	2,623.0
September	2,674.1	2,612.2	2,307.1
October	3,173.8	2,818.2	2,943.0
November	2,683.9	2,531.1	2,522.6
December	3,167.2	3,224.1	3,320.3
Total	36,779.7	33,304.5	33,353.4

* Preliminary

Table 11.2 gives an overview of the license fees collected monthly during 1996 through 1998.

From the total amount of license fees generated in the Netherlands Antilles in 1998, NAf.21,876.6 thousand was generated on the island of Curaçao, NAf.10,745.1 thousand on St. Maarten, and NAf.685.6 thousand on Bonaire. The remaining NAf.46.1 thousand of license fees was paid through the Central Bank.

12 FINANCIAL STATEMENTS FOR 1998

Table 12.1
Balance Sheet as of December 31, 1998

ASSETS	**1997**	**1998**
Gold and gold receivables	188,954,171	179,775,652
Receivables and securities in foreign currency	409,555,098	449,718,573
Advance account Central Government	29,593,971	29,183,250
Government bonds	35,175,000	50,175,000
Other long-term receivables	10,925,228	10,913,763
Fixed assets	18,576,987	20,152,795
Printing costs banknotes	298,210	1,490,175
Other current assets	13,721,286	13,813,101
TOTAL ASSETS	706,799,951	755,222,309
LIABILITIES	**1997**	**1998**
Bank notes in circulation	238,958,980	227,191,802
Residents' current accounts		
- in guilders	218,658,564	257,459,537
- in foreign currency	23,246,599	14,901,399
Residents' time deposits		
- in guilders	5,391,967	44,889,105
- in foreign currency	716,000	716,000
Nonresidents' current accounts		
- in guilders	15,097,366	2,496,532
Money in consignation	786,893	892,325
Other current liabilities	15,734,470	12,957,856
Undistributed earnings	5,853,390	11,362,031
Special reserves	122,355,722	122,355,722
Reserve fund	30,000,000	30,000,000
Capital	30,000,000	30,000,000
TOTAL LIABILITIES	706,799,951	755,222,309

Table 12.2
Profit and Loss Account 1998

	1997	1998
INCOME		
Interest income	25,537,367	26,751,658
Foreign exchange earnings	1,085,032	811,507
Miscellaneous earnings	1,465,092	2,101,545
Subtotal	28,087,491	29,664,710
License fee	33,369,293	32,398,553
TOTAL INCOME	61,456,784	62,063,263
EXPENSES		
Interest expenses	578,011	1,122,640
Depreciation of fixed assets	2,495,107	3,628,602
Depreciation of printing costs bank notes	499,349	545,919
General expenses	20,201,587	21,206,792
TOTAL EXPENSES	23,774,054	26,503,953
OPERATING PROFIT	37,682,730	35,559,310
Extraordinary income	-	2,533,331
Extraordinary expenses	500,000	500,000
NET INCOME	37,182,730	37,592,641
Distribution of net income		
Net income	37,182,730	37,592,641
Paid to the Central Government	38,800,000	32,084,000
Change in undistributed earnings	-1,617,270	5,508,641

12.1 Notes to the balance sheet as of December 31, 1998

12.1.1 Gold and gold receivables

Until 1997, this category included gold bars, as well as the Bank's share in the remaining gold stocks of the Goldfund of the Netherlands Antilles and Aruba. This fund was instituted with the separation of Aruba to divide the available gold between the two respective central banks. The Goldfund distributed its remaining assets in 1998.

Gold and gold receivables are valued at the average of the lowest London market price in the three years preceding the date of valuation, less a margin of 30%. Gold and gold receivables are revalued every three years. Changes resulting from revaluations are debited or credited to the special reserves after approval from the Minister of Finance.

12.1.2 Receivables and securities in foreign currency

The receivables and securities represent balances in current accounts, time deposits, and investment portfolios, including accrued interest maintained in foreign currency with foreign financial institutions. Valuation in guilders is made at the official mid-rate prevailing at the balance date.

12.1.3 Advance account Central Government

In conformity with paragraph 1 of Article 15 of the National Ordinance constituting the Central Bank Charter (P.B. 1985, no. 183), this advance is at all times bound to a maximum of 10% of the revenues of the Central Government during the previous fiscal year. This advance account is not interest-bearing.

12.1.4 Government bonds

In 1989, an agreement was signed with the Minister of Finance whereby the old advance account of the Central Government of the Netherlands Antilles was converted into bonds. The bonds are valued at their purchase price or lower nominal value.

12.1.5 Other long-term receivables

These loans are valued at their nominal value, less a provision for possible losses.

12.1.6 Fixed assets

These assets are valued at cost after deduction of accumulated depreciation, computed on the basis of the expected useful life of the assets following the straight-line method.

In 1990, a piece of land was purchased for the construction of the new office building. This asset is valued at cost.

12.1.7 Printing costs of bank notes

This amount represents the printing costs of bank notes, after deducting accumulated depreciation, computed on the basis of expected useful life of the bank notes following the straight-line method.

12.1.8 Other current assets

This item includes, among other things, license fee receivables, accrued interest, prepaid expenses, coins and currency held as petty cash, and other short-term receivables. These assets are valued at their nominal value.

12.1.9 Bank notes in circulation

This balance represents the nominal value of the bank notes issued by the Bank that are in circulation at year end.

12.1.10 Residents' current accounts

These include the balances in current account of domestic banks, Central and Island Government Collectors, and other government institutions within the Netherlands Antilles. Most of the balances are denominated in guilders. Foreign currency balances are translated into guilders at the Bank's official mid-rates prevailing at year end.

12.1.11 Residents' time deposits

These include the balances in time deposits of domestic banks and government institutions. The balances are interest-bearing. Foreign currency balances are translated into guilders at the Bank's official mid-rates prevailing at year end.

12.1.12 Nonresidents' current accounts

This amount represents the balances in current account of foreign banks and/or foreign government institutions. Foreign currency balances are converted into guilders at the Bank's official mid-rates prevailing at year end.

12.1.13 Money in consignation

This amount represents nominal value of the Bank's liability on account of money received in custody from third parties in conformity with the National Ordinance on Money held in Consignation (P.B. 1886, no. 22).

12.1.14 Other current liabilities

This balance includes accrued interest and accounts payable.

12.1.15 Undistributed earnings

Under this heading appears the accumulated earnings of the bank for the current and previous years, less the amounts paid to the country's treasury. After official approval of the figures for 1998 and an official decision concerning the distribution of the net income, this balance will be allocated accordingly.

12.1.16 Special reserves

This reserve was formed originally by a reserve created by revaluation of gold stock in the years 1971, 1973, 1994, and 1997. The profits made by the sale of numismatic coins during 1990 also were added to the balance of this account.

Article 5 of the National Ordinance constituting the Central Bank Charter (P.B. 1985, no. 183) stipulates that the Bank can form these reserves with the consent of the Minister of Finance.

12.1.17 Reserve fund

The National Ordinance constituting the Central Bank Charter (P.B. 1985, no. 183) introduced a Reserve Fund of NAf. 30,000,000 (Article 4).

12.1.18 Capital

The enactment in 1986 of the National Ordinance constituting the Central Bank Charter (P.B. 1985, no. 183) also introduced a Capital of NAf. 30,000,000 (Article 3).

12.2 Notes to the the profit and loss account 1998

12.2.1 Foreign exchange earnings

These earnings result from the margin between the buying and selling rates applied by the Bank when trading in foreign currencies and from the differences in exchange rates arising from conversions and translations.

12.2.2 License fee

As of January 1, 1996, the Bank charges the foreign exchange banks a monthly license fee, based on amendments to article 12 of the National Ordinance constituting the Central Bank Charter (P.B. 1985, no. 183). The National Ordinance Foreign Exchange Fee was revoked as of that same date. The license fee is calculated as a percentage of the gross outflow of money due to transfers from residents to nonresidents and foreign currency cash transactions, as stipulated by a National Decree holding general orders.

12.2.3 Extraordinary income

The completion of the Goldfund's stock distribution resulted in an additional profit of NAf. 2,533,331 following intermediate profits already recognized in earlier years.

12.2.4 Extraordinary expenses

These expenses relate to costs incurred for preparation and verification of information systems' readiness for the new millenium.