ANNUAL REPORT 2004

Bank van de Nederlandse Antillen

1. REPORT OF THE PRESIDENT

1.1 General review

The economy of the Netherlands Antilles continued to grow in 2004 albeit at a slower pace than in 2003. Real Gross Domestic Product is estimated to have increased by 1.0% compared to 1.4% in 2003. The growth in 2004 was attributable entirely to domestic spending. Net foreign demand declined. The private sector in particular accounted for the increase in domestic spending, primarily because of a recovery of investment. The increase in government spending was entirely of a consumptive nature; investment declined. The decline in net foreign demand resulted from a higher growth in imports than in exports. According to the end-2004 business cycle survey of the Central Bureau of Statistics, economic growth was strongest in St. Maarten (4.5%) and Bonaire (2.1%). Curacao recorded only a marginal increase of 0.2%.

Because of the slow pace of economic growth, the labor market improved only slightly in 2004. The unemployment rate declined from 15.3% in 2003 to 15.0% in 2004, still unacceptably high. The slight improvement resulted from the developments in Bonaire and St. Maarten; Curacao's unemployment rate deteriorated. The slowing of the economy was accompanied by a deceleration of the inflation rate from 1.9% in 2003 to 1.5% in 2004. The lower inflation can be explained mainly by lower inflation rates of our main trading partners, particularly the Netherlands and Venezuela. Furthermore, the government absorbed a large part of the oil price increases.

An analysis of economic growth by sector reveals that 2004's expansion was attributable primarily to the growth in activities in the wholesale & retail trade, restaurants & hotels, construction, manufacturing, and financial sectors. The free zone contributed significantly to the growth in the wholesale & retail trade sector. However, the growth in this sector and in the restaurants & hotels sector also was attributable to the further expansion in tourism. Both stay-over and cruise tourism contributed to the expansion, but the developments differed significantly among the islands. St. Maarten recorded the strongest performance with marked growth rates in both the number of stay-over and cruise tourists. Bonaire recorded the highest growth rate in cruise tourism, but stay-over tourism grew only marginally. Curacao performed weakly, reflected by a significant decline in the number of cruise tourists and a small increase in the number of stay-over tourists. The weak development in stay-over tourism in Curacao and Bonaire can be explained in particular by the decline in airlift related to the demise of the national carrier, DCA, and Air Holland.

The increase in construction activities was related to various new and ongoing projects in the tourism, transportation, and utilities sectors, such as the construction of new hotels, the expansion of existing hotels, the renovation and expansion of the airports of Curacao and St. Maarten, and the construction of a water plant in Curacao. These projects will make an important contribution to the strengthening of our main pillars of economic activity like tourism and transportation & logistics, which can lead to greater growth in our economy.

The improved performance of the manufacturing sector was reflected in the favorable developments in oil refining and ship repair. The production of the oil refinery increased significantly despite various plant shutdowns due to technical problems and maintenance during 2004. The increase in production was attributable partly to the relatively low production level in 2003 in the aftermath of the temporary shutdown of the refinery related to the general strike in Venezuela at the end of 2002. The repairs and maintenance contributed to an increase in operational expenses and, hence, the refinery's contribution to our economy. Noteworthy were the increasing protests against the pollution caused by the refinery and its impact on public health. This issue is of crucial importance for the long-term viability of the refinery. Clearly, considerable investments are necessary to reduce its environmental impact to international acceptable standards. The Bank welcomes the studies currently being conducted on the refinery's future. Their results should form the basis for a broadly supported solution that takes into account the refinery's economic importance as well as its impact on the environment and public health.

The ship repair sector recorded an increase in activities, as measured in the number of man-hours sold. However, recent information indicates that the sector's main company, the government-owned Curacao Dry Dock Company, is experiencing increasing financial difficulties. A possible approach to secure the company's survival is to renew the efforts for privatization. A strong partner could bring in the necessary capital and investment to strengthen the company's long-term viability, which is important for safeguarding jobs and guaranteeing a more diversified economy.

The growth of the financial services sector was due primarily to the good performance of the domestic banking sector; the international financial and business services sector continued to perform weakly. The domestic banking sector recorded a strong growth in assets, higher profitability, and improved capitalization. The weak development in the international financial and business services sector was due mainly to the slow progress in negotiating new tax treaties, affecting the creation of new business in the sector. The conclusion of new tax treaties should compensate for the disadvantage created by the elimination of the distinction between onshore and offshore activities effectuated with the introduction of the new fiscal framework (NFR), which ended the low tax regime for offshore activities. However, tax revenues are temporarily boosted by the agreement in the tax arrangement for the Kingdom of the Netherlands (BRK). This agreement states that the withholding tax on dividends from the Netherlands to the Netherlands Antilles collected by the Dutch tax office is transferred entirely to the Antillean government. Nevertheless, to improve our attractiveness as a financial services center, a zero withholding tax on these dividend transfers in the upcoming revision of the BRK is necessary. This change is expected to increase business structurally in the sector. Since the tax collected is transferred to the Netherlands Antilles, an elimination of this tax will not have any implications for the Dutch budget. However, the persistence of our negotiating partner in maintaining this tax or a conditional elimination is unnecessarily putting the Antilles on unequal footing with its main competitors.

In contrast to the growth in the sectors mentioned above, overall activities in the transport, storage & communication sector declined in 2004. This result was dominated by the demise of the national carrier, Dutch Caribbean Airlines (DCA), in October. The bankruptcy of its transatlantic partner, Sobelair, and increasing delays and cancellation of flights due to technical problems of the aged fleet led to a steady deterioration of the company's already precarious financial position. Since the government refused to continue funding the company's accumulating losses in light of its own large deficit, the closing of DCA was inevitable. The Bank wants to emphasize in this respect that a well-managed local airline is an asset for our economy. It guarantees the maintenance of crucial regional connections, promotes competition and, hence, better service at competitive prices, creates jobs, and generates foreign exchange revenues. Therefore, the Bank welcomes the efforts to establish a new Curacao-based airline, under the condition that it will be run professionally and profitably without political interference. Airlift and competition will be strengthened also by the various private initiatives to start regional and transatlantic services. However, ultimately only the strongest companies will survive, resulting in a consolidation in the sector.

Because of its significance for the airports of Curacao and Bonaire, DCA's demise resulted in a decline in the number of passengers handled as it takes time for other airlines to fill the gap. DCA played a much less significant role in St. Maarten's airport activities, reflected by a strong increase in passengers handled in line with that island's buoyant tourism performance. The harbor sector performed well in 2004. Although the amount of freight handled by Curacao's harbor remained about the same, the number of ship calls increased. The harbors of Bonaire and St. Maarten also noted an increase in the number of ship calls. Furthermore, oil storage and transshipment activities recorded a growth.

The balance of payments improved for the fourth year in a row in 2004, although the surplus continued to diminish. As a result, our international reserves increased further, but the import coverage declined slightly to 2.5 months. The decline in the import coverage occurred because the import of goods grew faster than the official reserves, i.e, the reserves with the Bank.

The current account of the balance of payments deteriorated significantly in 2004 with all but the services balance contributed to this deterioration. The trade deficit increased because of the strong growth in imports related to the rise in domestic spending, the expansion of tourism, inventory buildup, and higher re-exports by the free zone. Furthermore, the surplus in the current transfers balance declined markedly because of fewer transfers by individuals from abroad and a smaller amount of dividend tax transferred by the Netherlands in light of the BRK tax arrangement. In contrast, the surplus on the services balance increased, owing primarily to the good performance of the tourist sector.

In line with the developments in the current account, the capital and financial account also deteriorated because the increase in foreign liabilities exceeded the increase in foreign assets. However, this deterioration remained contained because of a large transfer of development aid by the Netherlands to the foundation that approves and funds development projects (USONA). This transfer boosted reserves. This foundation, established in September 2004, operates independently of the Dutch and Antillean governments to facilitate a more effective and efficient use of development funds. The increase in foreign liabilities was accounted for primarily by more loans taken up abroad, among other things, to finance the expansion of St. Maarten's airport, a smaller net redemption of debt by Antillean companies to their foreign parent companies, and the takeover of Girobank by a foreign bank. The increase in foreign assets can be explained mainly by more portfolio investments abroad by institutional investors in light of the rising yields on the international securities markets.

The public finances continued their deteriorating trend in 2004 with a substantial increase in the deficit of the general government on a cash basis compared to 2003. The higher cash deficit was attributable almost entirely to an increase in spending because revenues remained about the same. The higher spending was facilitated by the abundant availability of finance on the domestic capital market, resulting in a record net borrowing in 2004. However, the government had to offer higher yields to compensate for the higher risks perceived by investors in light of the worsening public finances and the competition from the rising yields abroad.

The expansionary fiscal policy was reflected entirely by higher current expenditures. All expenditure categories contributed to the increase except subsidies, due largely to a reclassification of some items to goods & services. The increase in personnel costs can be explained by an increase in hiring and higher compensation related to promotions and performance evaluation. Moreover, transfers increased as a result of the funding of part of the deficit of the health care insurance fund for retired government employees (FZOG), more revenue-sharing with the island governments,[1] and a higher contribution to the Solidarity Fund. Revenues remained about the same because the increase in tax revenues was offset almost entirely by a decline in nontax revenues. The rise in tax revenues was attributable mainly to the collection of more import duties, sales tax, wage tax, and income tax, related to the growth in domestic spending and improved compliance. The drop in nontax revenues was accounted for mainly by a lower amount of dividend tax transferred by the Dutch tax service, fewer dividends paid out by government-owned companies, and the transitory settlement of claims and debts with the public housing foundation, FKP, in 2003.

The financing of the cash deficit and the build up of arrears resulted in a further accumulation of government debt in 2004, reaching 96% of GDP. Despite the unsustainability of such a high debt ratio, the rising share of tax revenues needed for interest payments, and the government's adoption of the recommendations of the Debt Commission in November 2003, no credible actions have been taken towards a balanced budget. To correct this fiscal situation, a first step would be a strong commitment by the central government and the island government of Curacao to a maximum combined deficit of NAf.215 million in 2005 by exercising strict fiscal discipline. This approach would usher in the much-needed turnaround in the trend of rising deficits and debt ratios.

The growth in the monetary aggregates accelerated in 2004 compared to 2003, attributable to both the domestic and external sectors. The domestic expansion was accounted for by the government sector as well as the private sector. The governments' expansionary impact resulted from the partial monetization of the cash deficits through the net purchase of debt securities by the banking sector. In addition, credit extended to the private sector improved considerably in line with the recovery of investments and the growth in

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[1] Excluding Curacao, which is included in the general government together with the central government.

consumption. Moreover, the surplus in the balance of payments contributed to the expansionary impact of the external sector.

During 2004, the Bank tightened its monetary stance in light of the strong growth in credit extension, continuing excess liquidity in the banking system, frequent pressure on the official reserves, and rising interest rates in the United States. First, the reserve requirement percentage was raised in five steps from 10.0% to 11.25% as of November 16. In addition, as of January 16, 2004, the period during which the reserve requirement percentage is fixed was reduced from three months to two months. This change was made to increase the effectiveness of this instrument of monetary policy, as corrective measures can be taken in a shorter time frame. Second, in line with the reversal of the declining trend of US interest rates in 2004 and the impact of this development on the domestic money and capital market, the Bank followed by increasing its official lending rate (i.e., the pledging rate) in two steps from 2.25% to 2.75% as of November 15, 2004. This raise was the first since March 1995. Finally, the Bank adapted the rate mechanism for auctions of Certificates of Deposit to increase the effectiveness of this policy instrument. Beginning July 14, 2004, the Bank announces for each auction the maximum rates it is willing to pay on the various terms offered instead of one maximum rate for all terms.

1.2 Policy considerations

After a period of increasing uncertainties, a new government took office in May 2004. The presentation of the government program in July and the establishment of a committee to monitor progress in the program's implementation created a sense of urgency and commitment. While the objective of the program was to implement more than 100 action-points within a period of 18 months, the number of policy-actions that exceeded their implementation deadline accumulated rapidly. This serves to emphasize the fact that despite a decade of adjustments, we have not succeeded in developing institutions to enable the government to set clear goals and objectives and deliver on them. Rather, the reforms of the past decade carried through during a period of severe fiscal stress weakened the government administrative apparatus - the backbone of an effective, efficient and result-oriented governance. Therefore, the Bank welcomes the recent establishment of a committee to evaluate the program's implementation, identify bottlenecks and suggest a new prioritization of the uncompleted actions.

The renewed government program should focus on quick and tangible results in the well-known policy areas of structural adjustment comprising fiscal consolidation, structural reform, growth promotion, and poverty alleviation.

Fiscal consolidation is clearly an area in which much still needs to be done. Although the combined governments committed to a maximum budget deficit of NAf.215 million in 2005, the fiscal outlook remains uncertain. One risk that may endanger the deficit target is the income support for the AOV. The unexpected windfall of approximately NAf.200 million in the transfer of dividend tax by the Dutch government may be seen as the solution, but it is temporary in nature while our problems are structural in nature. Moreover, our heavy debt burden makes us vulnerable to interest rate increases. There is no room for complacency. The Bank welcomes the suggestion to use most of the windfall to reduce the outstanding debt, thereby creating a structural saving in interest expenses.

In addition, the financing requirement in 2005 will be considerably higher than the budget deficit because of the carry-over of arrears and outstanding claims from 2004. The Bank wishes to emphasize that the ample domestic financing available on the local capital market in 2004 is not likely in 2005 in light of the rising interest rates abroad, the saturation of investment portfolios, and the spreading of risk. Moreover, to address the mounting government debt, a lasting turnaround towards a balanced budget is urgently needed. This turnaround can be facilitated by strict fiscal discipline, comprising (1) strict adherence to all laws, rules, and policy decisions regarding the budget, and (2) the legal anchoring of budgetary targets for, among other things, the budget balance and the debt ratio in a medium-term framework. This approach promotes the drafting of realistic budgets, including provisions for risks, and forces the taking of compensating measures in case of shortfalls. The Bank welcomes the progress made in the legislative process so that the law can become effective for the 2006 budget. However, such legislation also should be drafted by the island governments, using the central government's law as a model.

Our short-term policy agenda should be dictated by the need to balance the budgets. We should pay more attention on improving the quality of spending, matching public resource allocation to specific social and economic priorities and, hence, to structural developments affecting the public finances in the longer term. One of the main issues is the aging of our population, creating major challenges in the areas of pensions and health. Although the initiative to increase the AOV pension may be well-intended, the Bank advocates a more broad-based approach directed at guaranteeing an adequate pension for all citizens at reasonable costs for employees, employers, and the government. In addition to regular reforms, such as a rise in the retirement age, an increase in premiums, a longer contribution period, and benefits based on the average instead of the final wage, more structural changes also should be considered. One could think, for example, of the introduction of a three-tier pension system consisting of a basic state pension for everybody, obligatory pension insurance for employees, and voluntary supplementary pension insurance for individuals. Also a shift from the current defined benefit system to a defined contribution system should be considered.

Health care is another policy area that will be affected significantly by the aging of the population. Expenditures on health care are already very high, and aging will only make matters worse. With respect to the government budget, most initiatives to stem the rising expenditures on health care did not reach implementation, leaving this a major area for budgetary savings. Bold and consistent actions are urgently needed to realize the necessary savings and to guarantee an adequate level of health care for all of us in the future.

Progress in the area of structural reform has been disappointing. The privatization process has come to a halt, and measures have been introduced that roll back part of the recently phased-out market protection. To revive structural reform, we should begin by correcting the reversal of past reforms in the labor and product markets. This step should be complemented by the broadening and deepening of reforms with the objective of improving the functioning of our markets. Well-functioning markets promote a better match between demand and supply and more competitive prices, contributing positively to the strengthening of our investment climate.

The revival of structural reform is an important contributing factor to the development of a growth strategy. The Bank welcomes the progress made with the Caribbean Rim Investment Initiative of the OECD, a program aimed at promoting economic growth through the creation of an attractive investment climate. However, at the same time we have not made much progress with the recommendations of earlier studies on the promotion of investments and growth by the Inter-American Development Bank, the World Bank, and the Foreign Investment Advisory Service. All of these studies revealed the same, well-known weaknesses of our investment climate. These weaknesses include high utility and labor costs, rigid labor laws, a qualitative mismatch between labor demand and supply, complex and time-consuming licensing procedures, and a complex tax system with opaque tax incentive schemes. The delay in the implementation of these recommendations to a great extent explains the suboptimal growth we have been experiencing during the last few years.

The final policy area in which more progress is needed is poverty alleviation. After a long period of preparation, an agreement finally was signed with the United Nations Development Program and the World Bank to develop a poverty reduction program. In addition to the structural track, a quick scan will be executed that should result in targeted short-term actions to relieve some of the most urgent needs of the poor. Together with the current projects of neighborhood improvement and "Reda Social," these short-term actions are crucial to give those that have been marginalized a sense of hope for a better future.

The Bank's monetary policy will support attaining the goals of structural adjustment. The objectives of this policy include striving for a level of official reserves consistent with three months of merchandise imports, minimizing monetary financing of the government deficits, and promoting commercial banks' credit extension towards private sector foreign exchange-generating activities. During the first four months of 2005, our foreign reserves were boosted significantly when the Dutch government transferred most of 2005's development aid to the foundation charged with the approval and financing of projects, USONA, and dividend tax of 2004 related to the BRK. Although the high reserves warranted some easing of the reserve requirement from 11.5% to 11.375% as of March 16, 2005, these windfalls are largely transitory. Corrected for these high inflows, our import coverage is still below three months of merchandise imports, which does not warrant a significant loosening of monetary policy. Moreover, the continuing increase in US interest rates prompted the Bank to raise its pledging rate further in two steps from 2.75% to 3.0% on January 25 and to 3.25% on May 3, 2005.

The medium-term and long-term prospects of the Netherlands Antilles depend heavily on how well we are able to make progress with fiscal consolidation, structural reform, the promotion of growth, and poverty alleviation. The recent outcome of the referendum may have created a false sense that there are shortcuts to our fiscal problems. There are no roads we can travel alone. We need to seize the opportunity not to let the constitutional changes move the implementation of the structural adjustment agenda to the background. On the contrary, all efforts should be directed to build fiscal capacity, to invest in infrastructure, human capital and services that are crucial to growth with equity. This means a realignment of the government program to create a climate in which the recovery of the economy can gain speed. Only higher growth levels can produce the much-needed jobs, accelerate the fiscal consolidation process, and alleviate poverty.

E.D. Tromp
President

2. INTERNATIONAL ECONOMIC DEVELOPMENTS

Real GDP in the United States grew by 4.4% in 2004, up from 3.1% in 2003 (see table 1). The growth in 2004 was the strongest in five years, buoyed by consumer spending and nonresidential fixed investment. Consumer spending continued to benefit from favorable financing conditions, despite a three-quarter point increase to 1.75% in the Fed funds rate since June 2004. In addition, increases in employment and real disposable income accounted for the rise in personal consumption expenditure. Higher corporate profits and a favorable economic outlook led businesses to increase investments, mostly for new equipment and computer software. Unit labor costs rose, reflected by a deceleration in productivity growth, which usually happens when economic recovery gains momentum. Nevertheless, GDP growth was dampened by the deterioration in net foreign demand. Export gains lagged behind import growth, worsening the current account deficit to $665.9 billion (5.7% of GDP). The positive economic developments reduced the unemployment rate to 5.4%. In 2004, the higher inflation rate (2.7%) was fueled mostly by energy costs, which rose by 10.9%.

Table 1 Selected economic indicators of main trading partners (% change)

	United States			Netherlands			Venezuela		
	2002	2003	2004	2002	2003	2004	2002	2003	2004
Real GDP	1.9	3.1	4.4	0.6	-0.9	1.4	-8.9	-7.7	17.3
Consumer prices (%)	1.6	2.3	2.7	3.4	2.1	1.2	22.4	31.1	21.7
Unemployment rate (%)	6.0	5.7	5.4	4.2	5.5	6.3	15.7	14.6	10.9

Source: US Bureau of Economic Analysis, US Bureau of Labor Statistics, Dutch Central Bureau of Statistics, Banco Central de Venezuela, and Reuters.

The Dutch economy expanded by 1.4%, up from the decline of 0.9% in 2003. The economic rebound was backed by growth in exports and investments. Exports of goods and services as well as re-exports of goods expanded, with the highest rates in four years. Demand by its principal trading partners and the Asian countries expanded. After two years of decline, investment spending rose, particularly in infrastructure, machinery, and equipment. Household consumption showed a slight increase from 2003, stemming mostly from more spending on health care. Government consumption, however, posted a slight decline, following a continuous expansion since 1997. The Dutch government deficit of 2.3% of GDP in 2004 remained within the 3% EU limit. The economic revival did not translate into more jobs, leading to a higher jobless rate (6.3%). Meanwhile, Dutch inflation continued its decelerating trend, reaching 1.2% in 2004.

After a two-year slump brought on by a combination of nationwide strikes and political instability, Venezuela's economy recovered in 2004. Real GDP grew by 17.3%, with contributions from both the oil (8.7%) and non-oil sectors (17.8%). Performance in the non-oil sector was encouraging, particularly in the construction (32.1%) and manufacturing sectors (25.4%). The 2004 growth was due largely to significant government spending on housing, infrastructure, and social projects financed by the higher proceeds from oil exports. Moreover, Venezuela's current account surplus improved to $14.6 billion (13.3% of GDP) in 2004. The price and capital restrictions introduced in 2003 to control inflation and halt capital flight managed to bring down inflation to 21.7% in 2004. The robust economic recovery led businesses to increase hiring, resulting in a lower unemployment rate of 10.9% in 2004.

3 GENERAL ECONOMIC DEVELOPMENTS IN THE NETHERLANDS ANTILLES

3.1 Introduction

In the Netherlands Antilles, economic activity continued to grow in 2004, although at a slower pace than the year before. In contrast to 2003, domestic demand replaced foreign demand as the driving force behind the economic growth in 2004. Real GDP rose by 1.0%, supported mainly by government consumption and private investment (see table 2). However, a negative contribution was recorded by net exports, dampening the GDP growth. Inflationary pressures eased in 2004 as the inflation rate abated to 1.5%, owing to price developments in our imported merchandise. The labor market conditions continued weak as the jobless rate remained high at 15.0%,[2] reflecting the subdued economic growth in 2004.

Table 2 GDP growth by expenditures[a] (real percentage changes)

	2001	2002	2003	2004
Domestic expenditures, of which:	4.0	-1.2	-0.3	2.2
Private sector	5.1	-0.5	-0.5	1.5
- Investment	4.8	-1.1	-0.9	1.3
- Consumption	0.3	0.6	0.4	0.2
Government	-1.1	-0.7	0.2	0.8
- Investment	-0.1	-1.0	-0.3	-0.6
- Consumption	-1.0	0.4	0.5	1.4
Changes in inventory	0.1	-0.3	-0.3	0.1
Foreign net expenditures, of which:	-4.0	1.9	2.0	-1.2
Export of goods and services	-1.2	-2.9	4.5	7.4
Import of goods and services	2.7	-4.8	2.5	8.6
GDP by expenditures	0.2	0.4	1.4	1.0
Net primary income	-0.1	-0.8	-0.3	-0.1
Gross national income	0.0	-0.5	1.0	1.0
Net current transfers from abroad	-0.9	3.4	0.1	-0.8
Gross national disposable income	-0.8	2.9	1.1	0.1

Source: BNA estimates

[a] Expenditure categories data are weighted contributors to GDP growth

All domestic spending components, except for public investment, accounted for the economic growth in 2004. The government continued an expansionary budgetary policy, as public consumption showed an upturn. This upturn was the result of more outlays on goods & services, particularly medical expenses. Following two years of decline, private investment rebounded, reflected in more business loans and imports. Investment spending expanded mainly in the tourism-related sectors, transportation, and utilities. Consumer

[2] BNA estimate

spending posted a slight gain, due mainly to the growth in consumer loans because real disposable income increased only marginally and savings were higher. Moreover, the slack in the labor market may have affected consumption as a result of its negative impact on real income.

Foreign demand posted an increase but was offset by a significant growth in imports. Imports expanded strongly, owing to the increases in wholesale & retail and construction activities, which were related to the transportation and utilities sectors. As a result, investments were up because of its high import content.

3.2 Domestic production

In spite of the slowdown, economic conditions remained relatively favorable in 2004. The private sector recorded positive developments, reflected mainly in the financial services, wholesale & retail trade, and hotels & restaurants sectors (see table 3). Following a year of expansion, the real value added of the public sector declined in 2004. However, the lower added value in the public sector was mitigated by more activities in the private sector.

Real growth in the wholesale & retail sector (3.5%) was buoyed by the favorable developments in the free zone and tourism industry. In 2004, fewer visitors visited the free-zone, but exports showed an improvement compared to 2003. The pick-up of exports occurred predominantly in the Jamaican and Venezuelan markets. The economic rebound in Venezuela may explain the increase in visitors to the free zone from that country. The financial services sector grew for the fourth consecutive year, mainly because of the steady performance in the domestic financial services sector. The success of this sector was backed by higher credit growth and, hence, domestic demand.

Real value added of the hotels & restaurants sector was 3.5% in 2004 because of the growth in the tourism industry. The number of stay-over tourists in the Netherlands Antilles was up by 7.0% in 2004, compared to 9.3% in 2003. All markets contributed to the 2004 increase, but the expansion of the North American market was most pronounced. The impact of the political turmoil in the Middle East and the strong euro might have made the Caribbean a more attractive vacation destination. Visitors from North America comprised 47.1% of the total, while Europe’s share was 28.2%. The further weakening of the US dollar, which lowers the cost of a vacation in the Netherlands Antilles for European tourists, has raised the number of travelers from this region. Cruise tourism grew by 8.4%, up from 5.6% in 2003 (see table 9 in the appendix for a detailed overview).

An analysis by islands reveals that stay-over tourism expanded on all islands in 2004. St. Maarten’s tourism growth remained strong at 11.1% with all markets registering an increase. The North American and European markets were the largest contributors to the favorable performance in 2004. Stay-over tourism in Curaçao reported a gain of only 0.9% in 2004. This marginal growth was sustained by increases in the North American and South American markets, outweighing the drop in the European and Caribbean markets. In 2004, the reduction in the number of Dutch passenger arrivals was due to a decline in airlift, led by the bankruptcy of Air Holland and flight disruptions and the ultimate closing of Dutch Caribbean Airlines (DCA). Bonaire's expansion of 0.5% in stay-over tourism was weak, down from 19.5% in 2003, also due partly to the demise of DCA. Similar to 2003, the number of cruise passengers rose in both St. Maarten and Bonaire, while the opposite occurred in Curaçao in 2004.

Table 3 GDP by sector (real percentage changes)

Sector	2001	2002	2003	2004
Agriculture, fishery & mining	-0.4	-5.3	5.8	2.7
Manufacturing	-0.1	2.0	0.0	1.7
Electricity, gas & water	-0.4	2.4	1.3	0.8
Construction	13.3	-10.2	-3.7	2.5
Wholesale & retail trade	3.2	0.5	2.5	3.5
Restaurants & hotels	2.5	3.0	4.0	3.5
Transport, storage & communication	-2.1	-1.1	1.4	-1.5
Financial intermediation	3.0	3.8	1.9	4.0
Real estate, renting & business activities	-2.2	-0.5	1.6	0.5
Private households	-1.9	-0.1	-0.1	-3.1
Total private sector	1.4	0.2	1.4	1.6
Public sector	-7.3	1.3	1.7	-0.9
GDP	0.2	0.4	1.4	1.0

Source: BNA estimates

During 2004, total value added in the manufacturing sector rose by an estimated 1.7%, encouraged by more activities in the oil and ship-repair sectors. Total operational costs of the "Isla" refinery as well as the number of man-hours sold in Curaçao's ship-repair industry were up. The construction industry registered positive results, owing to several major ongoing nonresidential projects in the utilities, transportation, and hotels & restaurants sectors. Moreover, the value of completed projects in residential as well as non-residential projects increased noticeably in 2004.

The transportation, storage & communication sector mitigated the increase in GDP caused by a decline in air transportation. In 2004, the national carrier, DCA, encountered accumulating flight disruptions and ultimately ceased its operations in the fourth quarter. Airport-related activities in the Netherlands Antilles reported mixed results; total passenger traffic expanded, while the number of commercial landings shrank. The demise of DCA caused a decline in total passenger traffic in Curaçao and Bonaire, offset by the increase in St. Maarten. Moreover, the slack has been picked up partly by other airlines. Furthermore, the harbor sector performed well in 2004.

3.3 Labor market

The marginal improvement in labor market conditions during 2004 reflected largely the weak pace of economic activity. The unemployment rate in the Netherlands Antilles registered a slight reduction of 0.3 percentage point to 15.0%[3] in 2004 (see table 4). Despite its decline, the high unemployment level remains a cause for concern. The lower unemployment rate was accounted for by the islands of St. Maarten and Bonaire. Bonaire's jobless rate fell to 8.9% because both fewer men and women were unemployed. Conversely, Curaçao's unemployment rate worsened from 15.1% in 2003 to 16.0%[4] in 2004. More men were unemployed, but unemployment declined among women. The labor force in the Netherlands Antilles shrank in 2004, as both the number of employed and unemployed dropped due to the developments in Curaçao. The decrease in employment, combined with an increase in economic activity, may be due to an improvement in labor productivity. In 2004, migration did not have a significant impact on the developments in the total population or the labor force in the Netherlands Antilles.

Table 4 Labor market developments in the Netherlands Antilles (number of persons)

	2001	2002	2003	2004
Employed	69,682	70,366	75,076	73,741
Unemployed	11,876	12,023	13,577	13,045
Labor force	81,558	82,389	88,653	86,786
Total population	172,926	173,357	176,743	177,604
Participation rate	47.2%	47.5%	50.2%	48.9%
Unemployment rate	14.6%	14.6%	15.3%	15.0%

Source: Central Bureau of Statistics and BNA estimate

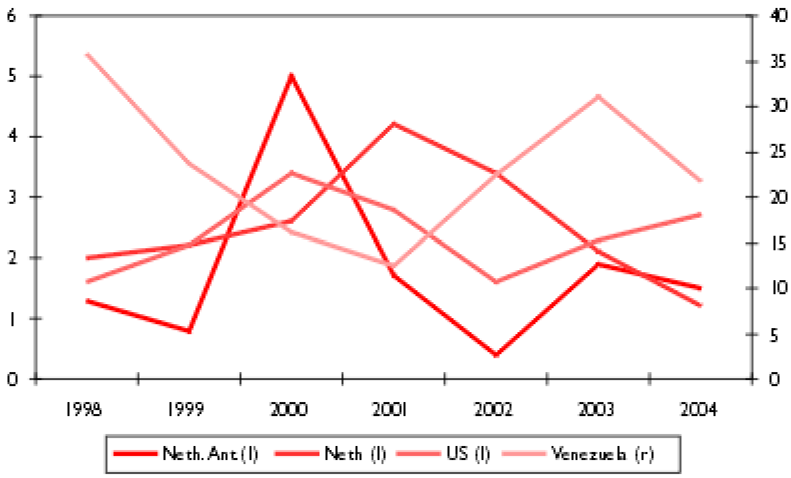
3.4 Inflation

The annual inflation rate of the Netherlands Antilles decelerated from 1.9% in 2003 to 1.5% in 2004. A breakdown of the inflation rate by subcategories indicates that the 2004 inflation stemmed largely from the categories "food" (4.4%) and "housing" (1.8%). The continual strong euro kept the price inflation of food high, while the housing component was affected by, among other things, higher energy costs. An analysis by islands reveals that St. Maarten experienced the highest annual inflation (2.1%), followed by Bonaire (1.8%) and Curaçao (1.4%). See table 10 in the appendix for a detailed overview.

[3] BNA estimate

[4] AKO ("Labor force survey") 2004, Central Bureau of Statistics

Graph 1 Developments in consumer prices (annual percentage change)



3.5 Public finances

3.5.1 Cash overview and financing

A rise in government spending, the result of higher government consumption, contributed partly to the economic growth in 2004 (0.8%)[5]. However, the increase in government spending was not matched by a rise in revenues, leading to a further deterioration of the budget deficit of the general government. With the debt-to-GDP ratio reaching 95.6%, the financial situation of the public sector worsened in 2004. See table 11 in the appendix for a detailed overview.

The budget deficit of the general government deteriorated by NAf.98.2 million in 2004 compared to 2003. As shown in table 5, this deterioration was the result of a large increase in expenditures (NAf.100.7 million), while revenues remained almost unchanged. The further deterioration of the public finances was reflected also in the primary balance (fiscal balance excluding interest costs), which turned negative in 2004. For the first time in eight years, the general government incurred a primary deficit, reflecting a loose fiscal stance.

Table 5 Selected key variables of the general government (in millions NAf.)

	2000	2001	2002	2003	2004
Revenues	1,261.3	1,266.1	1,243.4	1,346.7	1,349.1
% of GDP	26.4%	26.7%	26.4%	27.6%	27.0%
Tax revenues	1,095.4	1,144.6	1,145.9	1,140.2	1,204.9
Nontax revenues	165.9	121.5	97.5	206.5	144.2
Expenditures	1,362.4	1,262.2	1,460.3	1,589.5	1,690.2
% of GDP	28.6%	26.7%	30.9%	32.6%	33.8%
Current expenditures	1,296.6	1,212.5	1,409.1	1,505.4	1,625.5
Capital expenditures	65.8	49.7	51.2	84.1	64.7

[5] See table 2

Balance	-101.1	3.9	-216.9	-242.8	-341.0
% of GDP	-2.1%	0.1%	-4.6%	-5.0%	-6.8%
Primary balance	58.6	192.3	28.5	9.1	-84.2
% of GDP	1.2%	4.1%	0.6%	0.2%	-1.7%

A review of general government expenditures reveals that total expenditures increased due to a large rise in current expenditures (NAf.120.1 million), offsetting the drop in capital expenditures (NAf.19.4 million). A breakdown by level of government shows that the increase in current expenditures was caused by higher spending by the central government (NAf.64.0 million) as well as by the island government of Curaçao (NAf.40.6 million). The increased current expenditures of the central government were related to higher outlays for wages and salaries, pension premiums, and an increase in transfers to other government levels. Pension premium payments increased mainly due to back payments to the government pension fund (APNA). Higher transfers to other government levels were related mostly to expenses regarding the debt reform of the health care insurance fund for retired government employees (FZOG) and advance payments to the Solidarity fund.

The increase in current expenditures of the island government of Curaçao was led by higher expenses for goods and services and an increase in transfer payments. Higher outlays for goods and services were related mainly to medical expenses because the island government did not succeed in reducing these expenses, and the payment of health insurance premiums grew.[6] Part of the increased expenses on goods and services can be attributed also to a change in the accounting method: some outlays classified as subsidies are now classified as expenditures on goods and services. The increase in transfers stemmed from payments of claims and severance payments to former employees of the closed down government-owned airline, DCA. The abovementioned increases in expenditures more than offset the drop in subsidies and pension premiums. Subsidies declined due to a settlement with the public housing foundation (FKP) in 2003 and the reclassification mentioned earlier. Payments for pension premiums declined because the island government of Curaçao started to buildup arrears again with APNA.

Contrary to the increase in current expenditures, capital expenditures declined as a result of a drop in capital transfers by the central government. This drop was related to the payment of a guarantee on behalf of the government-owned airline, DCA, that occurred in 2003. The drop in capital transfers of the central government was compensated partly by an increase in capital transfers by the island government of Curaçao stemming from financial support to DCA in 2004.

A breakdown of general government revenues reveals that the increase in tax revenues (NAf.64.8 million) was offset almost entirely by a decline in nontax revenues (NAf.62.3 million). A review by level of government shows that tax revenues of both the central government and the island government of Curaçao increased. Sales tax revenues and import duties collected by the central government rose, owing to higher domestic

[6] Premiums for the coverage of family members of SVB insureds.

spending. In addition, the central government received higher proceeds from licenses. Tax revenues of the island government of Curaçao increased mainly as a result of higher proceeds from wage and income taxes, attributable to improved tax compliance and fewer refunds. The decline in nontax revenues was accounted for primarily by a decrease in dividend payments by government-owned companies and a drop in grants because of a lower amount of dividend tax transferred by the Dutch tax service related to the tax arrangement of the Kingdom of the Netherlands (BRK).

Contrary to 2003, the budget deficit of the general government was financed mostly monetarily in 2004, although the nonmonetary component also increased compared to 2003. A breakdown by level of government reveals that the central government financed its budget deficit mainly with the central bank and the public in 2004 through increased holdings of central government securities (see table 6). In addition, the advances taken up at the central bank increased.

The island government of Curaçao financed its budget deficit in 2004 through the net issuance of debt securities resulting in higher holdings by the central bank, the commercial banks, and the public. This increase in monetary financing through the expansion of government debt portfolios at the banking system was compensated partly by higher cash balances. Contrary to their investments in central government securities, institutional investors showed an increased appetite for securities of the island government of Curaçao, resulting in a notable rise in holdings of these securities with the public (NAf.49.9 million) compared to 2003.

Table 6 Financing of the cash balances (in millions NAf.)

	Central government		**Curaçao government**	
	2003	**2004**	**2003**	**2004**
Monetary financing	73.1	112.5	32.3	66.9
Central bank	12.2	74.1	-28.3	25.7
Commercial banks	59.3	38.2	60.6	41.2
Coins and notes	1.6	0.2	-	-
Nonmonetary financing	89.7	93.6	47.7	68.0
Government securities with the public	115.0	75.1	30.1	80.0
Other	-25.3	18.5	17.6	-12.0
Cash balance	-162.8	-206.1	-80.0	-134.9

3.5.2 Public sector debt

The total consolidated public debt of the Netherlands Antilles expanded considerably by NAf.412.2 million to NAf.4.8 billion, corresponding with 95.6% of GDP at the end of 2004. The accumulation of debt was the result of an increase of NAf.363.5 million in the total consolidated domestic debt and an increase of NAf.48.7 million in the outstanding foreign debt. See table 12 in the appendix for a detailed overview.

Further analysis by level of government reveals that the island government of Curaçao contributed the most to the higher domestic debt, caused largely by borrowing on the capital market. Net borrowing increased by NAf.204.9 million in 2004. In addition, the island government's debt to the government pension fund (APNA) and the central government increased. The debt accumulation of the central government also was attributable primarily to its net borrowing on the capital market (NAf.174.1 million), but the central government succeeded in reducing its debts to the government pension fund and the social security bank (SVB). The debt of the other islands increased due mostly to the accumulation of arrears with the government pension fund.

The increase in the foreign debt in 2004 was attributable mainly to the appreciation of the euro against the Netherlands Antillean guilder, causing a rise in the guilder equivalent of the euro-denominated debt of approximately NAf.50 million. The increase in this component was offset partly by the payment of the final installment of a loan guarantee for a hotel project in Bonaire.

3.6 Balance of payments developments

3.6.1 Introduction

In 2004, net export of goods and services, i.e., net foreign demand, contributed negatively to economic growth as the increase in import of goods and services more than offset the rise in exports. Increased domestic expenditure led to a growth in the import of non-oil products, while oil imports rose because world oil prices almost doubled in 2004. The drop in net foreign demand combined with the deterioration of the current transfers balance resulted in a current account deficit of NAf.204.6 million in 2004. In line with the developments on the current account, the combined capital and financial account worsened. However, this worsening remained contained because of an exceptional amount of development aid received from the Netherlands in 2004. Therefore, foreign exchange reserves increased, although by a lower amount than in 2003 (see table 7).

Table 7 Balance of payments summary (in millions NAf.)

	2000	2001	2002	2003	2004
Current account	-90.6	-377.4	-105.0	12.2	-204.6
Capital and financial account[a] of which:	66.5	306.1	14.0	-95.9	41.3
Change in reserves [b]	85.5	-415.1	-122.1	-89.2	-66.1
Statistical discrepancies	24.1	71.3	90.9	83.7	163.4
Memorandum items					
Change in reserves [b]	85.5	-415.1	-122.1	-89.2	-66.1
with commercial banks	77.8	-342.8	53.0	-135.8	10.0
with central bank	7.7	-72.3	-175.1	46.6	-76.1

Due to rounding figures may not add up
[a] A minus sign implies on improvement in the foreign financial position.
[b] A minus sign implies an increase.

3.6.2 Current account

The decline in net export of goods and services (NAf.108.7 million) resulted mainly from the worsening of the trade balance (NAf.295.2 million), which was offset partly by the improvement of the services balance (NAf.186.5 million). The trade balance deteriorated because merchandise import growth outpaced the rise in exports. Besides, higher oil imports due mainly to the increase in oil prices contributed to the worsening of the trade balance. Higher domestic spending, the favorable developments in the tourism industry, the build-up of inventories, and increased foreign demand caused a large increase in merchandise imports. Analysis by island shows that retail sector imports on the Windward Islands posted a remarkable increase in 2004 led by the increase in tourism-related activities. In addition, higher private investments also resulted in higher imports. On the Leeward Islands, the increase in imports of non-oil products was due to a rise in imports of free-zone companies to build-up their inventories and to meet the rise in foreign and domestic demand. Moreover, the increase in imports was related to the ongoing construction activities in the transportation and utility sectors. See table 13 in the appendix for a detailed overview.

Higher merchandise exports partly offset the increase in merchandise imports. As mentioned earlier, increased foreign demand for the goods exported by the free-zone boosted merchandise exports; especially exports to Venezuela picked up due to the strong recovery of its economy in 2004. Furthermore, the demand for ship repair services grew robustly in 2004 compared to 2003. Led by favorable developments in the maritime business, more ships entered the docking facilities, increasing the turnover and, hence, foreign exchange revenues. Finally, due to the higher oil prices, foreign exchange earnings from bunker sales increased.

The decline in net exports of goods was mitigated by an improvement of the services balance, related entirely to the sustained rise in tourism on the Windward Islands. Foreign exchange earnings from stay-over tourism increased by NAf.88.8 million, while those from cruise tourism rose by NAf.45.0 million. The foreign exchange earnings on the Leeward Islands remained almost unchanged as the higher earnings from stay-over tourism were offset by the decline in earnings from cruise tourism. Even though Dutch Caribbean Airlines ceased its operations in the fourth quarter of 2004, exports of transportation services increased in 2004 due to an increase in harbor activities. However, payments for transportation services more than offset the increase in earnings because of an increase in payments for services by foreign airlines.

Besides the drop in net export of goods and services, the worsening of the current account balance also was related to a large decline in current transfers from abroad. In 2004, less dividend tax was transferred by the Dutch government related to the tax arrangement for the Kingdom of the Netherlands (BRK). In addition, the net inflow of transfers by individuals declined, which may be explained by the weak economic recovery in the Netherlands. Consequently, the current account balance recorded a large deficit of NAf.204.6 million in 2004.

3.6.3 Capital and financial account

In line with the developments in the current account, the combined capital and financial account balance worsened in 2004. The financial account deteriorated because the increase in foreign liabilities (NAf.166.2 million) more than offset the increase in foreign assets (NAf.124.1 million). Despite the large amount of development aid received, the growth of our foreign exchange reserves decelerated for the third consecutive year, reaching 2.5 months of import coverage at the end of 2004.

The increase in foreign liabilities was the result of increases in all categories, but mainly in the direct investment account. The rise in liabilities related to direct investments was due to the expansion of capital by a direct investor in its local financial institution, the take-over of Girobank by a foreign bank, and the purchase of real estate by nonresidents. Furthermore, 2003's trend of companies paying off debt with their parent companies abroad did not continue in 2004, resulting in an increase in intercompany debt compared to 2003. Liabilities on the net lending and borrowing account, which include trade credit and foreign loans received, increased also because more foreign loans were received than repaid by resident companies. Worth mentioning is the extension of a foreign loan of NAf.181.0 million to Princess Juliana International Airport to finance phase 2 of the airport development plan. In addition, more foreign loans were extended to finance investment projects in the transportation and utility sectors. Higher repayments of foreign loans by companies operating in the financial and real estate sectors partly compensated for the increase in foreign loans received. Besides, the rise in liabilities on the net lending and borrowing account was mitigated also by a drop in net trade credit received because repayments outweighed new trade credit received. This development perhaps reflects the favorable developments in the wholesale and retail sector.

The increase in foreign liabilities was offset partly by an increase in foreign assets, due mainly to a rise in portfolio investments. Following a decline in 2003, portfolio investments showed a large increase in 2004 (NAf.178.4 million). Institutional investors in particular purchased more foreign bonds and equity, which may be explained by the buoyant international financial markets and solid global economic growth. The direct investment by an Antillean construction company in Aruba led also to an increase in foreign assets. The increase in foreign assets was mitigated by a drop in net trade credit extended because repayments exceeded new trade credit extended. Finally, the accumulation of reserve assets decelerated despite a large amount of development aid received from the Netherlands. It is worth mentioning that foreign reserves would have declined without the increase in aid due to, among other things, the reduction in net trade credit received, which was financed by using foreign reserves. See table 14 in the appendix for a detailed overview.

3.7 Monetary developments

3.7.1 Monetary policy and money supply

During 2004, the Bank tightened its monetary stance in light of the strong growth in credit extension, continuing excess liquidity in the banking system, frequent pressure on the official reserves, and rising interest rates in the United States. First, the reserve requirement percentage was raised in five steps from 10.0% to 11.25% as of November 16, 2004. In addition, the period during which the reserve requirement percentage is fixed was reduced from three months to two months as of January 16, 2004. This change was made to increase the effectiveness of this instrument of monetary policy, as corrective measures can be taken in a shorter time frame. Second, because of the impact of the rising US interest rates on the domestic money and capital market, the Bank decided to increase its official lending rate (i.e., the pledging rate) in two steps from 2.25% to 2.75% as of November 15, 2004. This raise was the first since March 1995. Finally, the Bank adapted the rate mechanism for auctions of Certificates of Deposit to increase the effectiveness of this policy instrument. Beginning July 14, 2004, the Bank announces for each auction the maximum rates it is willing to pay on the various terms offered instead of one maximum rate for all terms.

The money supply (M2) in the Netherlands Antilles expanded by 10.2% in 2004, an acceleration compared to the increase of 8.4% recorded in 2003. The monetary expansion in 2004 was the result of increases in both net domestic assets and net foreign assets. The expansion in net domestic assets was most pronounced, accounted for by the private sector as well as the government sector. Net foreign assets expanded at a slower pace compared to 2003 due to the lower surplus on the balance of payments.

3.7.2 Factors affecting the money supply

The increase of NAf.275.8 million in net domestic assets in 2004 implied a more than doubling of the increase of NAf.128.9 million recorded in 2003. The expansion in 2004 was due to both the private sector and the government sector. Loans extended to the private sector increased substantially (8.0%), in line with the expansion in private sector spending. Worth mentioning is that the increase in private credit extension was reflected in consumer loans and business loans, as mortgages extended dropped.

Net credit extension to the governments, i.e. the central government and the island government of Curaçao, continued to rise rapidly during 2004 (32.2%). Contrary to 2003, the expansionary impact of the government in 2004 was accounted for entirely by an expansion of the government securities portfolio of the banking system. This result indicates that the yield on domestic government securities is still more attractive compared to foreign investment alternatives, despite rising US interest rates.

Net foreign assets increased by NAf.141.2 million in 2004, a deceleration compared to the rise of NAf.187.3 million recorded in 2003. The increase in 2004 was due mainly to the increase in official reserves at the Bank (NAf.110.8 million). The commercial banks' net foreign assets position improved by a moderate NAf.30.4 million. These results can be explained by several developments. First, the commercial banks extended significantly more credit to the private sector in line with the recovery in private spending. Second, the increases in US interest rates did not yet compare favorably to local yields, contributing to higher investments in domestic government securities. Consequently, the relatively low demand for foreign exchange by the commercial banks facilitated the accumulation of reserves at the Bank. This accumulation was caused mainly by the advance of development aid to the foundation that approves and funds development projects (USONA) by the Netherlands. See table 15 in the appendix for a detailed overview.

3.7.3 Developments in domestic interest rates

Following the rise in US interest rates and its impact on the domestic money and capital market, the Bank increased its pledging rate in two steps from 2.25% to 2.75% in 2004. These increases were a turnaround from the decreasing trend that started in the beginning of 2002. Furthermore, the maximum one-month certificate of deposit (CD) rate more than doubled in 2004 to 2.64% after an adaptation of the rate mechanism for auctions as of July 14, 2004. This step was taken to increase the attractiveness of CDs to the commercial banks and, hence, the effectiveness of this instrument of monetary policy. Previously, one maximum rate was derived for all terms by reducing the pledging rate by 100 basis points. See table 16 in the appendix for more details.

Due to the continuing excess liquidity in the commercial banking sector, the average interest rates offered on savings and time deposits declined further in 2004. The lower cost of funding was transmitted in the commercial banks' average lending rates in 2004. The average rates on mortgages and time loans dropped by 0.6 and 0.5 percentage point, respectively. In addition, the lower demand for mortgages contributed also to the decrease in its average rate.

The average yield on domestic government bonds dropped slightly by 0.1 percentage point in 2004 compared to 2003. On the other hand, the average discount rate on 1-month treasury bills increased by 0.7 percentage point during this period. These opposite developments occurred because investors in government securities have shown more interest in bonds as these offered a more attractive yield compared to alternatives on the international financial markets. This was particularly the case during the first half of 2004 when US interest rates were still dropping but continued in the second half of the year when the Fed funds rate started to increase. Due to this development, the governments had to offer higher yields on short-term debt paper to increase their attractiveness and to compete with the interest rates on bonds. Especially at the end of 2004, investors demanded higher discount rates for the refinancing of maturing treasury bills.

3.8 Developments in the commercial banking sector

3.8.1 Balance sheet and income statement

Total assets of the commercial banks rose by 10.6% during 2004, an acceleration compared to the growth of 4.9% recorded in 2003. The rise in 2004 was mainly the result of increases in loans extended, investments, and interest-bearing cash holdings. The increase in loans and investments was due to higher credit extension to both the private sector and the government sector. The increase in interest-bearing cash was, among other things, due to an increase in Certificates of Deposit (CDs) in the commercial banks' portfolio.[7] The growth in assets was funded mainly through increases in demand and time deposits. Finally total capital increased markedly in 2004, owing primarily to the recapitalization of Girobank. See table 17 in the appendix for a detailed overview.

The commercial banking sector recorded an increased profitability in 2004 resulting in a positive contribution of this sector to the value added generated by the private sector. The

[7] CDs are negotiable securities issued by the Bank through biweekly auctions, providing a domestic investment alternative for the commercial banks.

increased profitability is revealed by the increases in both net operating income and net income after taxes of 22.7% and 32.3%, respectively. The improved net income was the result of increases in both net interest income and other income outweighing the rise in operational expenses. See table 18 in the appendix for a detailed overview.

3.8.2 Macroprudential indicators

The macroprudential indicators provide an indication of the general performance of the domestic commercial banking sector. These indicators cover the following areas: capital adequacy, asset quality, earnings, and liquidity. In general, these indicators reveal an increase in the commercial banks' soundness during 2004 compared to 2003 (see table 8).

The capital-to-total assets ratio improved by 0.4 percentage point to 8.1% in 2004, above the international accepted minimum standard of 8.0% again. The improvement of this ratio was mainly the result of the recapitalization of Girobank.

The ratios revealing asset quality indicate an improvement in 2004. The nonperforming loans ratio dropped by 2.3 percentage points to 3.6%, the result of a drop in non-performing loans and an expansion in loans extended. The ratio of provisions for loan losses-to-nonperforming loans increased to 93.5%, resulting from a larger sum of provisions for eventual future loan losses, on the one hand, and the drop in non-performing loans, on the other.

Two of the three earnings-related ratios reveal an increase in profitability during 2004. The net interest margin, defined as net interest income as a percentage of average earning assets, increased. This increase was due mainly to increased net interest income, the result of an increase in interest income, and a drop in interest expenses. The increase in interest income was mainly the result of the expansion of the loan portfolio, while the drop in interest expenses resulted from lower deposit rates. The return-on-assets ratio, expressing net income as a ratio of average total assets, improved also, owing to the increases in net interest income and other income. The only ratio that slightly worsened was the gross earnings-assets yield, reflecting interest income as a percentage of average earning assets. Because the average earning assets increased more than interest income, this ratio declined.

Table 8 Macroprudential indicators (in %, end of period)

	2001	2002	2003	2004
Capital adequacy				
Total capital/ total assets	8.2	8.2	7.7	8.1
Asset quality				
Nonperforming loans/ total loans	6.0	5.9	5.9	3.6
Provisions for loan losses/ non-performing loans	61.8	73.6	61.1	93.5
Earnings				
Gross earnings-assets yield	8.1	7.6	7.4	7.3
Net interest margin	5.1	4.8	4.7	4.9

Return on assets	0.7	1.1	1.5	1.7
Liquidity				
Total loans/ total deposits	68.7	67.6	66.3	64.9

The further decline in the total loans-to-total deposits ratio in 2004 indicates that the excess liquidity in the domestic banking sector has not abated.

APPENDIX

Table 9 Developments in stay-over tourism per island (% change)[a]

	Curaçao				St. Maarten				Bonaire			
	2003		2004		2003		2004		2003		2004	
North America, of which:	6.5	(0.4)	7.7	(0.5)	16.9	(6.0)	12.3	(4.6)	-3.7	(-0.1)	3.7	(0.1)
-U.S.A.	2.3	(0.1)	7.6	(4.9)	15.8	(4.9)	13.0	(4.3)	-4.7	(-0.2)	2.7	(0.1)
Europe, of which:	29.8	(3.8)	-1.8	(-0.2)	1.3	(0.2)	9.2	(1.2)	60.2	(2.5)	-3.4	(0.1)
-The Netherlands	37.5	(4.0)	-2.9	(-0.3)	40.6	(0.7)	20.4	(0.4)	56.0	(1.6)	-2.4	(-0.1)
South & Central America, of which:	-27.5	(-1.5)	4.6	(0.2)	-13.5	(-0.2)	12.9	(0.2)	0.9	(0.0)	-4.3	(0.0)
-Venezuela	-17.4	(-0.6)	10.1	(0.4)	-27.9	(-0.1)	10.9	(0.0)	-19.8	(0.0)	-6.0	(0.0)
-Other	-40.7	(-0.8)	-7.3	(-0.1)	-7.9	(-0.1)	12.4	(0.1)	---	---	---	---
Caribbean, of which:	-6.5	(-0.4)	-5.3	(-0.3)	19.6	(1.1)	12.5	(0.7)	7.9	(0.0)	11.4	(0.0)
-Aruba	4.8	(0.1)	4.3	(0.1)	---	---	---	---	15.3	(0.0)	12.4	(0.0)
-Dominican Republic	-18.7	(-0.2)	-8.2	(-0.1)	31.2	(0.2)	35.1	(0.3)	---	---	---	---
-Other	-7.8	(-0.2)	-10.0	(-0.3)	18.2	(0.9)	9.6	(0.5)	---	---	---	---
Total	1.6	(0.5)	0.9	(0.3)	12.3	(7.4)	11.1	(6.9)	19.5	(1.7)	0.5	(0.0)

Source: Curaçao Tourist Board, St. Maarten Tourist Bureau, and Tourism Corporation Bonaire

[a] Weighted growth rates between brackets

Table 10 Netherlands Antilles consumer prices (annual percentage change)

	2001	2002	2003	2004
Food	3.1	3.6	2.1	4.4
Beverages & tobacco	1.7	-0.1	-0.5	-0.4
Clothing & footwear	0.9	-1.6	0.2	-0.2
Housing	2.6	1.9	5.4	1.8
Housekeeping & furnishings	0.8	-1.0	2.1	0.5
Health	5.7	1.5	0.7	0.9
Transport & communication	1.2	-2.9	-1.1	0.8
Recreation & education	-0.2	-0.4	0.1	0.2
Other	1.1	1.2	0.7	0.6
General inflation rate	1.7	0.4	1.9	1.5

Source: Central Bureau of Statistics

Table 11 Budgetary overview (in millions NAf.)

	2001	2002	2003	2004
General government				
Revenues	1,266.1	1,243.4	1,346.7	1,349.1
Tax revenues, of which:	1,144.6	1,145.9	1,140.2	1,204.9
Taxes on income and profits	578.8	568.1	555.8	578.3
Taxes on goods and services	398.0	411.8	427.8	458.9
Taxes on international trade and transactions	122.7	127.7	119.5	127.0
Nontax revenues	121.5	97.5	206.5	144.2
Expenditures	1,262.2	1,460.3	1,589.5	1,690.2
Current, of which:	1,212.5	1,409.1	1,505.4	1,625.5
Wages and salaries	403.0	528.2	535.2	554.9
Goods and services	275.2	304.2	368.5	436.5
Transfers	345.9	331.3	349.7	377.2
Interest payments	188.5	245.4	251.9	256.8
Capital	49.7	51.2	84.1	64.7
Budget balance	3.9	-216.9	-242.8	-341.0
Central government				
Revenues	608.8	616.5	671.6	692.3
Tax revenues, of which:	512.3	533.6	535.5	577.2
Taxes on goods and services	369.9	382.4	391.0	420.7
Taxes on international trade and transactions	122.7	115.8	119.5	127.0
Nontax revenues	96.5	82.9	136.1	115.1
Expenditures	647.4	743.6	834.4	898.4
Current, of which:	616.6	704.2	777.1	868.1
Wages and salaries	199.9	252.4	251.3	292.9
Goods and services	82.6	86.2	104.6	107.2
Transfers	239.3	242.0	287.5	326.0
Interest payments	94.8	123.6	133.7	142.0
Capital	30.8	39.4	57.3	30.3
Budget balance	-38.6	-127.1	-162.8	-206.1
Island government of Curaçao				
Revenues	775.9	748.5	833.0	818.7
Tax revenues, of which:	632.3	568.1	604.7	627.7
Taxes on income and profits	578.8	568.1	555.8	578.3
Taxes on goods and services	28.1	29.4	36.8	38.2
Nontax revenues, of which:	143.6	136.2	228.3	190.9
Grants	118.6	121.6	157.9	161.8
Expenditures	733.4	838.2	913.0	953.6
Current, of which:	714.5	826.5	886.2	919.2
Wages and salaries	203.1	275.8	283.9	262.0
Goods and services	192.6	218.0	263.9	329.3
Transfers	225.2	210.9	220.1	213.0
Interest payments	93.7	121.8	118.2	114.8
Capital	18.9	11.8	26.8	34.4
Budget balance	42.5	-89.8	-80.0	-134.9

Table 12 Total outstanding consolidated public debt (in millions NAf.)

	2001	2002	2003	2004
Domestic consolidated debt	2,895.8	3,123.7	3,554.8	3,918.3
Central government, of which:	1,366.9	1,502.3	1,925.3	2,075.6
Long-term securities	956.2	963.4	1,586.1	1,700.0
Short-term securities	26.4	136.6	44.7	104.9
APNA	167.0	160.1	149.7	118.4
SVB	86.2	117.4	26.2	6.5
Curaçao, of which:	1,852.0	1,993.7	1,951.0	2,194.3
Long-term securities	497.7	528.1	586.8	733.3
Short-term securities	32.2	111.7	86.2	144.5
APNA	806.4	814.5	807.8	827.2
Central government	334.6	398.6	362.3	411.0
Other islands	220.6	274.7	307.2	333.9
Foreign debt	593.6	718.0	806.7	855.4
Total debt (consolidated)	3,489.3	3,841.7	4,361.5	4,773.7
(% of GDP)	73.7%	81.4%	89.5%	95.6%

Table 13 Detailed overview balance of payments (in millions NAf.)

	2001	2002	2003	2004
Trade balance	-1,994.5	-1,838.0	-1,795.5	-2,090.7
-Exports	1,142.4	1,030.3	1,219.5	1,431.7
-Imports	3,136.9	2,868.3	3,014.9	3,522.3
Services balance	1,580.1	1,537.0	1,600.8	1,787.3
Receipts, of which:	2,952.6	2,914.5	3,053.6	3,307.1
-Travel	1,344.0	1,380.1	1,513.4	1,644.8
-Transportation	317.0	303.4	247.6	261.7
-Other services, of which:	1,219.7	1,231.0	1,292.6	1,400.6
- Int. fin. & bus. services sector	491.1	484.0	411.0	406.2
Expenses, of which:	1,372.5	1,377.4	1,452.8	1,519.8
-Travel	479.6	498.9	576.3	528.9
-Transportation	196.3	181.4	140.0	168.8
-Other services, of which:	696.6	697.1	736.4	822.1
- Int. fin. & bus. services sector	154.2	157.2	157.5	150.6
Income balance [a]	35.5	1.3	-12.9	-18.6
Current transfers balance [b]	1.4	194.7	219.8	117.3
Current account balance	**-377.4**	**-105.0**	**12.2**	**-204.6**
Capital & financial account balance [c]	**306.1**	**14.0**	**-95.9**	**41.3**
Net errors & omissions	**71.3**	**90.9**	**83.7**	**163.4**

Due to rounding, figures may not add up.
[a] Labor and investment income.
[b] Public and private transfers.
[c] A minus sign implies on improvement in the foreign financial position.

Table 14 Breakdown of net changes in the financial account (in millions NAf.)

	2001	2002	2003	2004
Direct investment	-9.3	12.1	-142.6	-98.2
- Abroad [a]	-0.8	-1.9	1.7	-45.0
- In the Netherlands Antilles [b]	-8.5	14.0	-144.3	-53.2
Portfolio investment [a]	-56.8	-67.1	7.4	-171.0
Other investment, of which:	349.8	287.3	128.6	184.1
- Assets [a]	57.5	62.2	-30.4	-29.7
- Liabilities [b]	292.3	225.1	159.0	213.8
Net lending/borrowing, of which:	370.9	-145.8	-46.8	50.6
- Assets [a]	78.2	-19.4	-183.2	-106.0
- Liabilities [b]	292.7	-126.4	136.4	156.6
Reserves [c]	-415.1	-122.1	-89.2	-66.1
Total assets [a]	-336.7	-149.9	-302.7	-426.8
Total liabilities [b]	576.2	114.4	160.0	326.2
Balance	239.5	-35.5	-142.7	-100.6

Due to rounding, figures may not add up.
[a] A minus sign implies an increase in assets.
[b] A minus sign means a decrease in liabilities.
[c] A minus sign means an increase in reserves.

Table 15 Monetary survey (in millions NAf.)

	2001	2002	2003	2004
Money supply (M2)	3,380.9	3,776.7	4,092.9	4,509.9
Money (M1)	1,309.7	1,497.2	1,525.3	1,596.6
Coins & notes with the public	218.2	235.2	232.9	231.3
Total demand deposits, of which:	1,091.5	1,262.0	1,292.4	1,365.3
- Netherlands Antillean guilders	866.1	1,019.6	989.3	1,050.7
- Foreign currency	225.4	242.4	303.1	314.6
Near money	2,071.2	2,279.5	2,567.6	2,913.3
Time deposits	1,209.7	1,324.0	1,501.4	1,742.5
Savings	861.5	955.5	1,066.2	1,122.8
Factors affecting the money supply				
Net domestic assets	2,369.8	2,643.6	2,772.5	3,048.3
General government	156.1	351.6	470.1	621.3
- Central government	8.5	189.4	272.4	363.9
- Island governments	147.6	162.2	197.7	257.4
Private sector	2,691.5	2,782.5	2,834.4	3,059.7
Net foreign assets	1,011.1	1,133.1	1,320.4	1,461.6
Central bank	677.9	853.0	904.5	1,015.3
Commercial banks	333.2	280.1	415.9	446.3
Memorandum items				
Government loans by commercial banks	198.2	410.2	489.5	620.1
- Central government	67.5	227.4	282.3	331.4
- Island governments	130.7	182.8	207.2	288.7
Private sector loans - Leeward Islands	1,905.9	1,988.3	1,981.4	2,129.5
- Mortgages	740.3	790.7	778.1	778.2
- Consumer loans	479.4	505.8	541.5	626.6
- Business loans	686.2	691.9	661.8	724.7
Private sector loans - Windward Islands	674.6	693.5	755.0	828.5
- Mortgages	311.7	343.6	373.1	306.0
- Consumer loans	143.2	108.9	145.4	195.6
- Business loans	219.7	240.9	236.5	326.9

Table 16 Developments in domestic interest rates (in %)

	2002	2003	2004
Central bank			
- Pledging rate	3.50	2.25	2.75
- Maximum CD rate (1 month)	2.50	1.25	2.64
Commercial bank borrowing rates			
- Passbook savings	3.6	3.4	2.8
- Time deposit (12 months)	5.5	4.9	4.1
Commercial bank lending rates			
- Mortgages	9.4	9.5	8.9
- Time loans	12.4	12.5	12.0
Government securities			
- Government bonds (5-year effective yield)	7.3	6.9	6.8
- Treasury bills (1 month)	2.9	3.0	3.7

Table 17 Aggregate balance sheet of domestic commercial banks (in millions NAf.)

	2001	2002	2003	2004
Assets				
Non-interest-bearing cash	457.7	395.6	431.5	440.0
Interest-bearing cash	1,494.9	1,371.5	1,431.1	1,590.6
Investments	261.9	582.8	611.3	744.0
Loans	3,417.8	3,500.9	3,697.5	4,049.1
Investments in unconsolidated subsidiaries and affiliates	19.5	12.2	13.5	12.2
Fixed assets	162.7	170.0	169.6	190.7
Other assets	159.4	166.6	147.2	165.3
Total assets	5,973.9	6,199.6	6,501.7	7,191.9
Liabilities				
Demand deposits	1,606.9	1,798.0	1,839.4	2,061.8
Savings deposits	2,176.7	2,148.7	2,334.8	2,378.5
Time deposits	1,276.5	1,302.0	1,473.7	1,810.8
Total deposits	5,060.1	5,248.7	5,647.9	6,251.1
Borrowings	158.8	183.1	125.4	29.9
Other liabilities	266.3	274.6	246.7	240.7
Total liabilities	5,485.2	5,706.4	6,020.0	6,521.7
Minority interest	5.3	6.6	6.4	6.4
Subordinated debentures	6.2	9.7	9.4	7.5
General provisions	134.3	161.7	140.3	144.4
Capital & reserves	342.6	315.2	325.5	423.3
Total capital	488.4	493.2	481.6	581.6
Total liabilities and capital	5,973.6	6,199.6	6,501.6	7,103.3

Table 18 Aggregate income statement domestic of commercial banks (in millions NAf.)

	2001	2002	2003	2004
Interest income	415.2	418.7	427.2	460.4
Interest expenses	156.4	153.8	161.2	156.8
Net interest income	258.8	264.9	266.0	303.6
Other income	118.9	140.3	162.1	173.9
Total operational income	377.7	405.2	428.1	477.5
Salaries & other employee expenses	161.0	186.4	194.4	215.9
Occupancy expenses	48.2	52.4	51.9	57.3
Other operating expenses	59.7	70.9	58.3	50.1
Net addition to general provisions	39.1	28.9	28.1	37.1
Total operational expenses	308.0	338.6	332.7	360.4
Net operating income	69.7	66.6	95.4	117.1
Net extraordinary items	25.6	3.2	0.5	7.5
Applicable profit taxes	17.5	23.0	22.6	27.6
Net income after taxes	26.6	46.8	73.3	97.0

4 DOMESTIC FINANCIAL MARKET DEVELOPMENTS

4.1 Introduction

The monetary and financial conditions that shaped developments in the domestic financial market in 2003 prevailed until mid-2004. The first half of 2004 sustained a continued demand for government paper as a result of the net capital inflow caused by the decreasing interest rates in the US money market. The demand for long-term government paper resulted in an interest rate decline in the local market. This demand led eventually to an annual net borrowing of NAf.377.9 million, compared to NAf.557.3 million in 2003. The amount of net borrowing in 2003, however, included a debt conversion of NAf.341.6 million.[8] There were no additional debt conversions in 2004.

The second half of 2004 was marked by expectations of the introduction of tax-free government bonds at 5%, which influenced investors' behavior. However, little information was available on the terms involved. Meanwhile, the Federal Reserve started to increase the interest on short-term loans. Investors did not demand higher interest rates on the local market, seeming satisfied with the local yield curve compared to the historic low rates in the United States.

In the money market, the interest rates on certificates of deposit (CD) issued by the Bank also were at their historic low during the first half of 2004. However, rates increased during the second half of 2004 by 140 basis points: the one-month deposit rate increased from 1.25% in January to 2.65% at the end of December 2004.

4.2 Financial instruments and the money market

The certificates of deposit (CD) issued by the Bank are the only tradable nongovernmental instrument available in the local market. CDs are a monetary tool used by the Bank to control the liquidity in the local market through bi-monthly auctions according to a set schedule. Commercial banks did not trade in CDs but preferred to use uncollateralized interbank instruments.

As indicated in table 19, the average monthly balance of outstanding CDs decreased by NAf.49.4 million (34.1%) in 2004. In the first half of the year, subscriptions were low because the CD-rates offered by the Bank were not competitive enough to stimulate the swapping of US dollar funds to Antillean guilder-denominated instruments. During the second half of the year, rates started to increase in line with the US money market rates.

The average monthly balance of the non-interest-bearing reserve requirement increased by NAf.43.3 million (12.9%). The base amount equals the commercial banks' domestic debt excluding interbank and long-term deposits. In addition to a higher base amount, the increase was due also to increases in the reserve requirement percentage set by the Bank from 9.50% to 11.25% during 2004. Unlike 2003, the average outstanding demand deposits of the commercial banks increased by NAf.10.5 million in 2004.

[8] This debt conversion comprised the settlement of accumulated funds deficits and arrears in premium payments of the central government with the SVB.

Table 19 Average monthly balances of certificates of deposit, non-interest-bearing reserve requirement, and demand deposits of commercial banks with the central bank (in millions NAf.)

	2002	2003	2004	Change 2003-2004
Certificates of deposit	193.6	144.7	95.3	-34.1%
Non-interest-bearing reserve	277.0	336.6	379.9	12.9%
Demand deposits	45.3	42.5	53.0	24.7%
Total	515.9	523.8	528.2	0.8%

Government issues of securities in the money market consisted of treasury bills with maturities of 1, 3, 6, and 12 months. During 2004, treasury bills were auctioned twice a month. In an effort to enhance market transparency, financial market information is provided to market participants on a monthly basis. The financial market information provides data, such as the prices of securities, the local yield curve, the net debt position of both governments, and the maturity schedule. Market transparency is intended to promote activity in the secondary market.

Activities in the secondary market remained stable during 2004. This was especially true in the second half of 2004, when parties in the market perceived the possibility of an interest rate decrease for refinancing maturing debt on the local market, they held firm to their higher yielding bonds, causing activities in the secondary market to decline.

Treasury bills were traded mainly in the primary market, perhaps because the primary market trades about every two weeks. During the first half of 2004, the yield on a 1-month treasury bill was at a low of 1.93%, the 3-months bill at 2.49%, while the 1-year treasury bill was at 4.50%. At the end of the year, the situation changed in that the 1-month treasury bill was trading at 3.00%, the 3-months treasury bill at 4.00%, and the 1-year treasury bill at a discount rate of 5.35%. Table 20 provides information on the size and the activity in the market for local treasury bills.

Table 20 Treasury bill issuance, outstanding balances, and average maturity as of December 31, 2004 (in millions NAf.)

	2002	2003	2004	Change 2002-2003
Issuance	**674.1**	**489.1**	**509.6**	**4.2%**
Central government	361.2	203.5	307.0	50.9%
Island government of Curacao	312.9	285.6	202.6	-29.1%
Outstanding amount	**248.3**	**130.8**	**249.4**	**90.7%**
Central government	136.6	44.6	104.9	135.2%
Island government of Curacao	111.7	86.2	144.5	67.6%
Average maturity (months)	**3.9**	**2.3**	**3.7**	**61.7%**
Central government	2.8	1.8	4.1	126.7%
Island government of Curacao	5.0	2.8	3.4	20.0%

4.3 The market for government securities

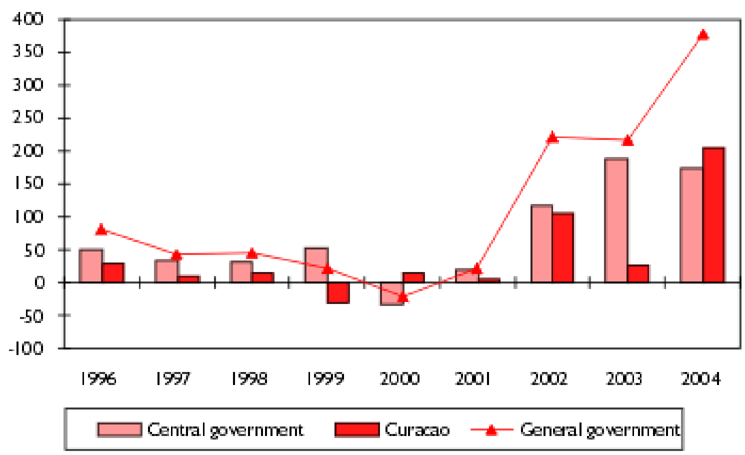
As in previous years, a large demand for government bonds continued in the local market. The decline in US interest rates during the first half of 2004 made local bonds even more attractive. This trend persisted even after US interest rates started to rise. Therefore, investors increased their holdings of government paper considerably. The Bank had no restrictions with respect to financing the governments. The Bank has been able to sell a substantial part of its local portfolio on the secondary market, which unlike the market in treasury bills, has been fairly active.

Gross general government debt issuance totaled NAf.1.029.6 billion during 2004, of which NAf.509.6 million was related to treasury bills and NAf.519.9 million to bonds. Gross bond issuance amounted to NAf.525.3 million in 2003, excluding the debt conversion of NAf.341.6 million, and NAf.284.7 million in 2002. In 2004, bonds issued by the island government of Curacao increased, while decreasing at the central government level. Treasury bill issuance increased at both levels of the government, mainly as a result of more liquidity in the market.

The central government issued three new public loans during 2004: a 10-year bond yielding 8.0% in February, a 4-year bond yielding 7.0% in May, and a 7-year bond yielding 7.5% in September. In addition, two private placements were issued, one in July and one in December. The island government of Curacao had a total of five public issues and one private issue during 2004: a 10-year bond yielding 8.0 % and a 3-year bond yielding 6.5% in January, a 10-year sinking-bond[9] yielding 7.625% in July, and a 9-year bond yielding 7.625% in December. A private placement of a 5-year bond yielding 7.250% took place in March.

Demand for government securities was high in 2004, reflected by an oversubscription of tenders enabling the government to reduce its borrowing costs. This situation changed during the second half of the year, when interest rates started to hike back to their previous levels. Graph 2 shows that net borrowing excluding debt conversion, was higher in 2004 than in 2003, setting a new record high.

Graph 2 General government annual net borrowing excl. debt conversion (in millions NAf.)



[9] The island government of Curacao issued this bond on July 1, 2004. The bond matures in 10 years; redemption will commence in July 2010 in five annual installments.

Table 21 indicates that net borrowing by the central government was concentrated in public issues, with an increase of 23.5%. Private placements decreased by 23.4%, because maturing debt was refinanced by public placements. The issuance of treasury bills increased, due to the liquidity in the market.

Table 21 Outstanding negotiable loans of the central government (in millions NAf.)

	2002	2003	2004	Change 2003-2004
Total, of which:	1,100.0	1,630.7	1,804.9	10.7%
Private placement	180.7	200.8	153.9	-23.4%
Public issues	451.9	719.9	889.2	23.5%
Treasury bills	136.6	44.6	104.9	135.2%
Debt conversions	330.8	665.2	656.7	-1.3%
Net borrowing	117.4	530.8	174.0	-67.2%

The island government of Curaçao registered an increase in its net borrowing of 646.5% in 2004 (see table 22), resulting mainly from the higher issuance of treasury bills and public issues. The ample availability of funds in the market contributed in part to this result. The outstanding amount of debt conversions matured in July and was refinanced with a public placement of a 14-year sinking-fund bond.

Table 22 Outstanding negotiable loans of the island government of Curaçao (in millions NAf.)

	2002	2003	2004	Change 2003-2004
Total, of which:	1,063.5	1,089.9	1,287.7	18.2%
Private placement	133.8	106.6	122.3	14.8%
Public issues	333.7	420.2	611.0	45.4%
Treasury bills	111.7	86.1	144.5	67.8%
Debt conversions	60.6	60.0	-	-100.0%
6.5%-annuity	423.7	417.0	409.9	-1.7%
Net borrowing	103.6	26.5	197.8	646.5%

The maturity schedule in table 23 indicates that 22% of the outstanding loans will mature within the next two years, while 63% is in the 3 – 10 year maturity bracket. The high maturity rate of the island government of Curacao in the more than 10-year bracket is due to the 6.5% 30-year annuity loan maturing in December 2028.

Table 23 Maturity schedule of negotiable government securities excluding treasury bills as per December 31, 2004 (% share)

	0-2 years	3-10 years	over 10 years
Central government	21	73	6
Island government of Curaçao	22	53	24

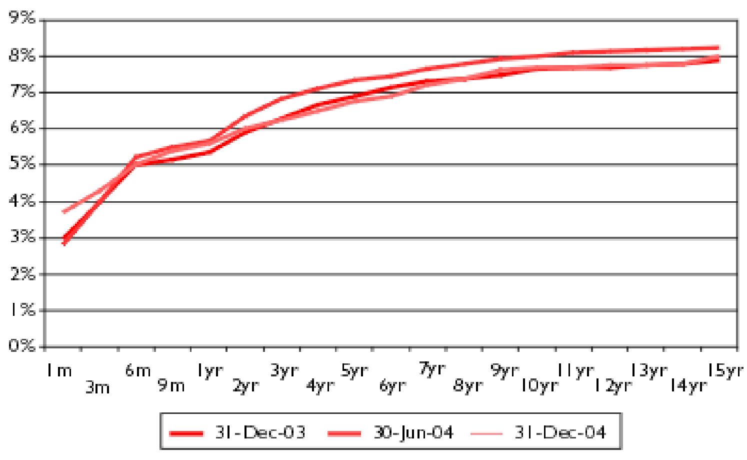
General government	22	63	15

4.4 Domestic yield curve developments

The first half of 2004 showed a steeper yield curve because the short-term rates decreased while the long-term rates increased (see graph 4.2). Institutional investors placed their funds mainly in loans that refinanced maturing bonds. The refinancing was at lower rates but higher on the curve than in previous years when the market was more liquid.

During the second half of 2004, the rates at the short-end of the yield curve started to ascend as the government needed to refinance maturing treasury bills. Rates at the longer-end of the curve declined compared to the first half of the year but did not become lower than in 2003. As a result, the yield curve started to flatten.

Graph 3 Local yield curve



5 INSTITUTIONAL INVESTORS

5.1 Introduction

In March 2004, Parliament enacted a new Civil Code referred to as Book Two: Company Law and the Law of Other Legal Persons. The enactment of the new Code has implications for all companies incorporated in the Netherlands Antilles as limited liability companies. These implications include, among other things, the outlining and amplification of board accountability and requirements regarding increased disclosure of financial statements.

The disclosure of financial figures by insurance companies licensed in the Netherlands Antilles, however, is laid down in the National Ordinance on Insurance Supervision (N.G. 1990, no. 77). This Ordinance stipulates that the information that should be disclosed by these institutions will be specified in a national decree. This decree has been drafted and submitted to the government.

The Netherlands Antilles took another step in its commitment to increase transparency in the marketplace as companies must now make available a complete copy of their audited annual accounts at their offices for inspection by interested parties.

In August and September 2004, four hurricanes struck the Caribbean region and the United States, making the year 2004 one of the costliest and most destructive in terms of natural disasters. The damage caused by the hurricanes was limited in the Netherlands Antilles. Claims totaling NAf.6 million were incurred by insurance companies licensed in the Netherlands Antilles. Of this amount, 46 % was recovered from reinsurers, indicating once again the importance of having adequate reinsurance in place.

While the Caribbean region is grouped together with North America by reinsurers, some of the major reinsurance companies operating in the Caribbean market have indicated that they intend to reduce their exposure in this region in addition to increasing premiums and catastrophe deductibles. This reduced capacity, as evidenced in the past, will mean eventually that reinsurance will be more difficult to obtain and some insurers may be forced to accept increasingly greater amounts for their own account. Stricter underwriting and adjusted terms and conditions will become inevitable and may force some insurers to reduce their property insurance portfolios or exit the market.

If other insurance product lines are not profitable and capital cannot be raised to mitigate the negative results on a company's equity, then risk management becomes an issue to deal with at a strategic level.

The development of Solvency II in the European Union recognized the need for a different regulatory approach, influenced by the Basel II - type model developed for the banking sector. The Solvency II model uses a three-pillar approach that addresses capital requirements, regulatory supervision, and market issues. Insurance regulation worldwide is gradually moving toward a more risk-based approach, whereby capital adequacy requirements are matched with the risk exposure of insurance companies. The Bank is following these developments closely and will adapt its supervisory approach accordingly. The Bank's database containing historical data on the insurance industry will be operational shortly and support this effort. Reports generated from this database will enable the Bank to analyze the performance of the industry more in depth and take the necessary policy actions.

In September 2004, the Bank introduced a comprehensive on-site examination process for all insurance companies conducting business in the Netherlands Antilles. Prior to this date, the Bank conducted targeted examinations on a priority basis. Initial emphasis has been directed toward domestic insurers. After these examinations are concluded, the scope will be expanded to companies conducting business internationally.

This process as well as the introduction of the international accounting standard IFRS 4, which relates specifically to the insurance industry, caused an up-grade of the examination procedures and audit guidelines. IFRS 4 is in its first phase, with the second phase to be introduced in mid-2005 or early 2006. With the introduction of this standard, the Bank will be reviewing and drafting revised valuation guidelines and reporting procedures for the insurance industry.

The insurance sector servicing the local market experienced positive results after taxes for the year 2003. The solvency requirements as stipulated by the law have been met on an aggregate basis for the life and the nonlife insurance companies operating locally as well as internationally.

With respect to the pension industry, the aggregate equity position showed a decline during the past three years. The pension industry has been under pressure due to decreasing investment income, increasing pension benefits, and decreasing contributions. The decrease in contributions may be the result of the migration of participants or the possibility for early retirement, limiting the period during which individuals are active in the labor force. On the other hand, the increase in life expectancy undoubtedly leads to longer benefit term payments resulting in increased expenses.

In the Netherlands, early retirement plans are currently being evaluated by the government. Beginning January 1, 2009, these arrangements will no longer be tax deductible making their financing very costly. The Netherlands Antilles also is facing certain challenges regarding the pension industry. Questions including whether to raise the pension age, increase the state pension, and finance health benefits for pensioners have been raised and not yet answered. Another issue relates to how best to accommodate participants of a corporate pension fund with respect to the transfer of their vested pension rights when there is a change of employer.

In accordance with the National Ordinance on Insurance Brokerage Business (N.G. 2003, no. 113), the Bank had received almost 100 applications from intermediaries for registration as an insurance broker by the end of 2004. These applications currently are being processed. However, the brokerage sector is faced with the problem that professional liability insurance, a requirement to maintain one's registration as a broker, is locally unavailable. Liability insurance can be bought outside the Netherlands Antilles but at a relatively high premium. This matter will be brought to the attention of the government to come up with a practical solution.

Finally, as a member of the International Association of Insurance Supervisors (IAIS), the Bank will further upgrade and revise its supervisory and monitoring system to comply with the core principles, which have been increased from 23 to 28.

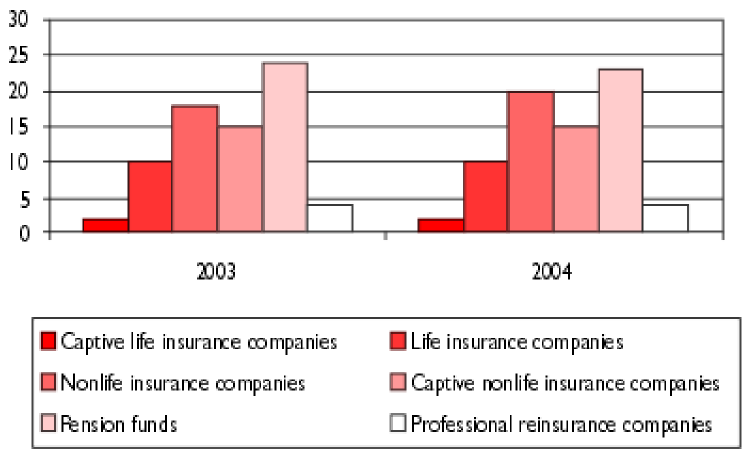
5.2 The institutional investors' sector

The number of institutional investors operating in the Netherlands Antilles in 2004 was 53, of which 10 were life insurance companies, 20 nonlife insurance companies, and 23 pension funds. In addition, the process of registering funeral service insurers with a minimum of 200 insureds is still ongoing.

The number of insurance companies servicing the international markets was 21 at the end of 2004. Of this number, 2 were involved in the life insurance business, 15 in the nonlife business, and 4 were professional reinsurers. Most of the internationally operating insurance companies have European parents.

The overview in graph 4 does not include the number of companies and pension funds in the process of liquidation. However, these institutions remain subject to supervision by the Bank.

Graph 4 Composition of the institutional investors' sector (number of companies)



5.3 Life insurance industry

5.3.1 Balance sheet

According to table 24, total assets of the local life insurance industry increased by 8.1% in 2003, compared with a 8.3% growth in 2002. The increase in total assets in 2003 can be attributed mainly to an increase of NAf.131.1 million (12.3%) in invested assets. Of the total assets in 2003, 76.9% was related to investments and 17.7% to current assets. Total liabilities increased mainly as a result of an increase of NAf.101.7 million (9.3%) in technical provisions.

The equity position of the local life insurance companies, consisting of capital, surplus, and subordinated instruments, increased by NAf.17.1 million (13.2%) in 2003. This increase can be attributed to an increase of NAf.22.5 million (33.7%) in the surplus account. The 2003 equity position of the local life insurance companies represents about three and a half times the amount needed to meet the 4% solvency requirement, which was equivalent to NAf.40.8 million in 2003.

Table 24 Consolidated balance sheet of life insurance companies (in millions NAf.)

	2001		2002		2003	
	Local	**Int'l[a]**	**Local**	**Int'l**	**Local**	**Int'l**
ASSETS						
Intangibles	-	-	0.1	-	0.1	-
Total investments	904.5	82.3	1,064.4	76.3	1,195.5	95.9
Current assets	251.1	22.7	271.3	45.0	274.8	62.7
Other assets	10.3	-	5.4	-	6.0	-
From separate accounts statement	162.5	-	98.0	-	79.1	-
Total admissible assets	1,328.4	105.0	1,439.2	121.3	1,555.5	158.6
EQUITY, PROVISIONS, AND LIABILITIES						
Capital	10.8	7.7	57.4	7.7	57.4	11.7
Surplus	94.9	26.4	66.7	32.5	89.2	31.8
Subordinated instruments	-	-	5.5	-	0.1	-
Technical provisions	875.4	57.5	1,089.0	72.7	1,190.7	90.7
Other provisions & liabilities	8.8	-0.3	7.5	-7.9	10.1	2.7
Current liabilities	165.9	13.7	106.3	16.3	118.9	21.7
Contingent liabilities	10.1	-	8.8	-	10.0	-
From separate accounts statement	162.5	-	98.0	-	79.1	-
Total equity, provisions, and liabilities	1,328.4	105.0	1,439.2	121.3	1,555.5	158.6

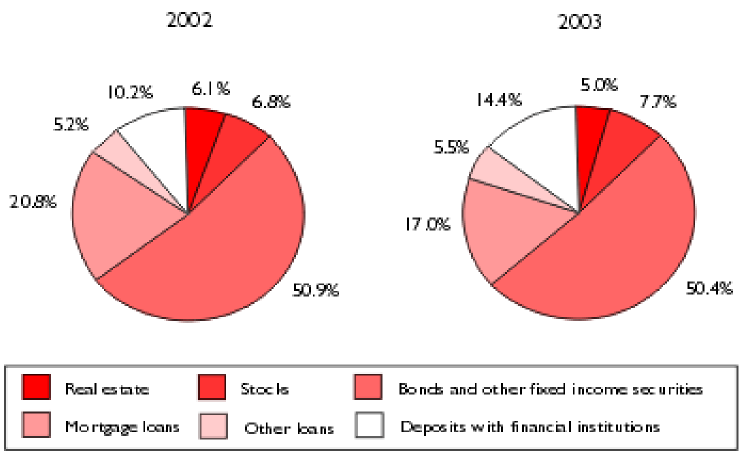
[a] International life insurance companies are captive insurance companies and professional reinsurers.

Total assets of the international life insurance companies increased by NAf.37.3 million (30.8%), reaching NAf.158.6 million at the end of 2003. This increase can be attributed to an increase of NAf.19.6 million in total investments and an increase of NAf.17.7 million in current assets. The 2003 equity position increased by 8.2% to an amount of NAf.43.5 million, well above the legally required solvency margin of NAf.15.5 million.

5.3.2 Investments

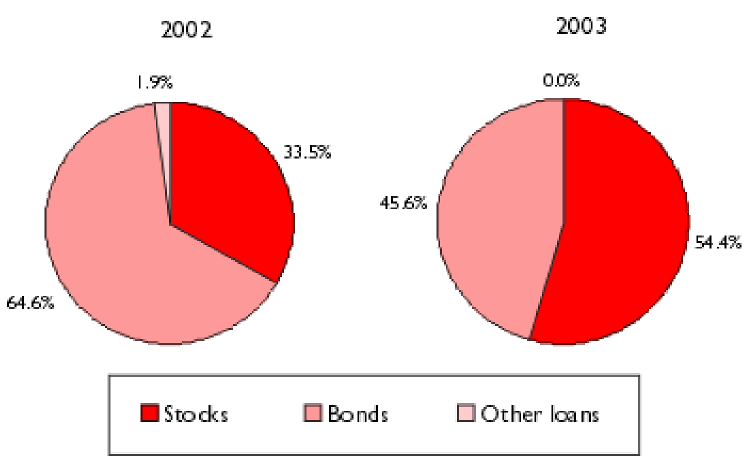
As indicated above, total investments of the local life insurance industry increased by NAf.131.1 million (12.3%) in 2003. This increase is due mainly to an increase in bonds and deposits with financial institutions (in absolute terms). The composition of the consolidated 2002 and 2003 investment portfolios of the local life insurance companies is presented in graph 5. This graph indicates that the shares of deposits, stocks, and other loans increased by, respectively, 4.2, 0.9, and 0.3 percentage points in 2003 compared to 2002. These increases were at the expense of the shares of mortgage loans, real estate, and bonds, which declined by 3.8, 1.1, and 0.5 percentage points, respectively. Note that the decrease in the percentage share of bonds is due to a change in the composition of the investment portfolio. As indicated, the amount of bonds increased in absolute terms.

Graph 5 Composition of the investment portfolio of local life insurance companies



The composition of the consolidated 2002 and 2003 investment portfolios of the international life insurance companies are presented in graph 6. The total investment portfolio of the international life insurance companies increased by NAf.19.6 million (25.7%) in 2003 compared to 2002, due to an increase in the share of stocks. From the graph, it can be deduced that the share of stocks increased by 20.9 percentage points to 54.4%, at the expense of the share of bonds and other loans, which decreased by 19.0 and 1.9 percentage points, respectively.

Graph 6 Composition of the investment portfolio of international life insurance companies



5.3.3 Profit and loss statement

The operating results of the life insurance industry are presented in table 25. The net result of the local life insurance companies before corporate taxes increased by NAf.1.5 million (10.5%) in 2003, compared with the NAf.2.0 million (12.3%) decrease in 2002. The net result after taxes increased by NAf.3.5 million (43.8%) to NAf.11.5 million in 2003, due to lower corporate taxes incurred.

Net premium income of the local life insurance companies increased by NAf.19.9 million (11.4%) in 2003, compared to 2002. Of the net premium income in 2003, 65.6% was related to individual life and 34.4% to group life business.

The net operational loss amounted to NAf.26.5 million in 2003 and represents a slight improvement compared to 2002 (NAf.27.5 million). This improvement was attributable to an increase of NAf.21.6 million in operational income, which exceeded the increase of NAf.20.6 million in operational expenditures. Since 2001, the industry has been experiencing large negative operational results.

Net premium income in the international life insurance industry showed an increase from NAf.14.9 million in 2002 to NAf.18.5 million in 2003. Nevertheless, the net operational result turned around from a NAf.0.9 million surplus to a NAf.7.7 million loss, due primarily to a large increase in net benefits incurred.

As a result of the relatively high net investment income allocated to surplus, the net loss after corporate taxes of the international life insurance industry improved by NAf.0.7 million in 2003, an improvement of NAf.1.0 million compared to 2002.

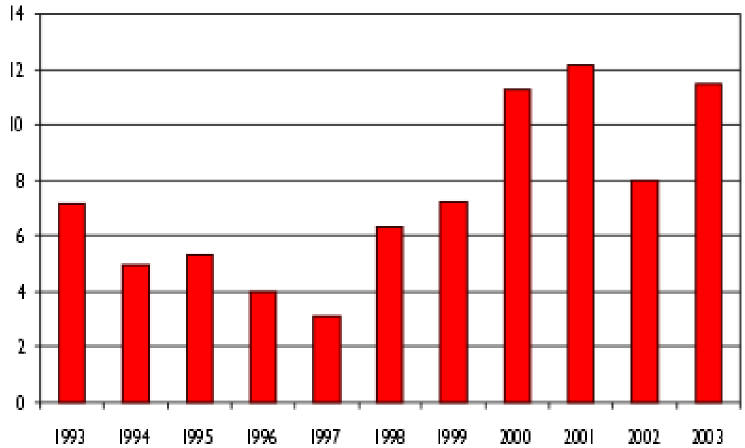
Table 25 Consolidated profit and loss statement of life insurance companies (in millions NAf)

	2001		2002		2003	
	Local	**Int'l[a]**	**Local**	**Int'l**	**Local**	**Int'l**
INCOME						
Total net premium income	143.6	16.3	174.4	14.9	194.3	18.5
Net investm. income allocated to technical provisions	26.4	3.6	28.0	3.0	30.0	1.6
Net other operational income	0.3	1.5	6.2	2.3	5.9	0.0
Total operational income	170.3	21.4	208.6	20.2	230.2	20.1
EXPENSES						
Net benefits incurred	67.2	6.3	94.9	6.7	88.9	22.1
Change in net techn. prov.	78.6	10.6	74.3	10.4	99.2	2.7
Policyholders' dividends	10.7	1.5	12.4	-0.1	12.4	0.6
Insurance expenses and non-corporate taxes	25.5	0.7	28.7	0.8	36.2	1.0
Commission and other acquisition costs	14.9	0.3	14.5	0.9	14.9	0.9
Net other operational expend.	0.4	0.3	11.3	0.6	5.1	0.5
Total operational expend.	197.3	19.7	236.1	19.3	256.7	27.8
Net operational result	-27.0	1.7	-27.5	0.9	-26.5	-7.7
Net investment income allocated to surplus	43.6	-1.0	52.6	-2.6	51.2	6.1
Other income and expenses	0.2	-2.5	0.1	2.0	0.6	0.5
Net result from separate accounts	0.0	-	-2.4	-	-5.2	-
Extraordinary results	-0.5	0.4	-8.5	-1.8	-4.3	0.6
Net result before corp. taxes	16.3	-1.4	14.3	-1.5	15.8	-0.5
Corporate taxes incurred	4.1	0.1	6.3	0.3	4.3	0.2
Net result after corp. taxes	12.2	-1.5	8.0	-1.7	11.5	-0.7

[a] International life insurance companies are captive insurance companies and professional reinsurers.

Graph 7 presents an overview of the consolidated net results after taxes of the local life insurance companies during the period 1993 - 2003. This graph depicts declining net results until 1997, when net results started to rise but then declined in 2002. A recovery is noted in 2003.

Graph 7 Net results after corporate taxes of the local life insurance sector (in millions NAf.)



5.4 The nonlife insurance industry

5.4.1 Balance sheet

Table 26 reveals that the 2003 balance sheet total of the nonlife insurance companies operating in the domestic market increased to NAf.472.0 million, an increase of NAf.12.2 million (2.7%) compared to 2002. An increase in investments of NAf.18.6 million (8.7%) contributed primarily to the balance sheet expansion of 2003.

Due to the short-term nature of the nonlife business in comparison with the life business, a smaller percentage of total assets was invested, namely, 49.3% in 2003. This is a small increase compared to 2002, when 46.6% of total assets was invested. Consequently, a larger portion of total assets comprises current assets (49.7%), compared to 17.7% in the life business.

No remarkable movements were noted on the liabilities side of the balance sheet. The equity position of the local nonlife insurance industry increased by NAf.14.9 million (13.8%), totaling NAf.106.9 million at the end of 2003. In 2002, an increase of 23.8% was recorded. The equity position at the end of 2003 was well above the 15% solvency margin (NAf.40.9 million) required by law.

Compared to 2002, the balance sheet total of the nonlife insurance companies servicing the international market reflects an increase of NAf.382.3 million (16.4%) to approximately NAf.2.7 billion at the end of 2003. This increase was caused mainly by a NAf.267.6 million (12.6%) increase in investments. On the liabilities side, the largest increase of NAf.229.2 million (16.6%) was noted in the technical provisions. The industry disposed of NAf.996.8 million in equity at the end of 2003. As a result, the consolidated solvency position of the internationally operating nonlife insurance companies significantly exceeded the required solvency margin of NAf.90.5 million.

Table 26 Consolidated balance sheet of the nonlife insurance industry (in millions NAf.)

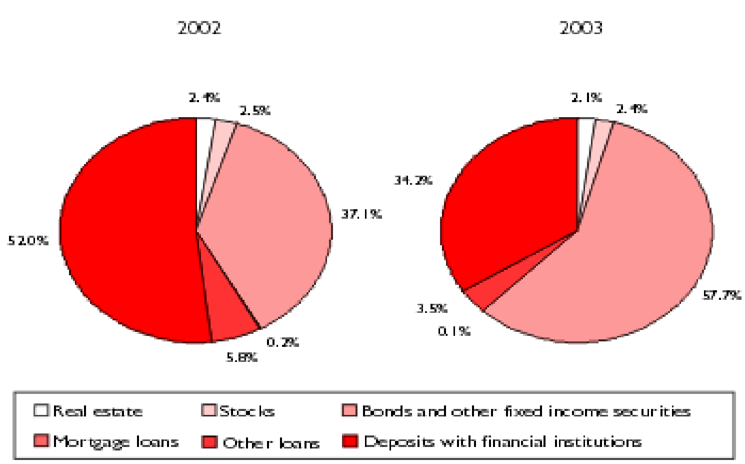
	2001		2002		2003	
	Local	**Int'l[a]**	**Local**	**Int'l**	**Local**	**Int'l**
ASSETS						
Intangibles	-	-		-	-	-
Total investments	139.7	1,932.2	214.1	2,128.8	232.7	2,396.4
Current assets	116.9	118.4	242.3	197.7	235.0	312.4
Other assets	3.8	0.4	3.4	0.1	4.3	0.1
Total admissible assets	260.4	2,051.0	459.8	2,326.6	472.0	2,708.9
EQUITY, PROVISIONS, AND LIABILITIES						
Capital	29.2	165.0	68.1	192.6	75.2	208.6
Surplus	41.0	618.0	23.9	676.6	31.7	788.1
Subordinated instruments	1.2	-	1.0	-	1.0	-
Technical provisions	145.5	1,204.8	181.2	1,379.9	186.1	1,609.1
Other provisions & liabilities	6.3	7.2	17.4	15.4	7.9	12.1
Current liabilities	37.2	56.0	168.2	62.1	170.1	91.0
Contingent liabilities	-	-	-	-	-	-
Total equity, provisions, and liabilities	260.4	2,051.0	459.8	2,326.6	472.0	2,708.9

[a] International nonlife insurance companies consist of captive insurance companies and professional reinsurers.

5.4.2 Investments

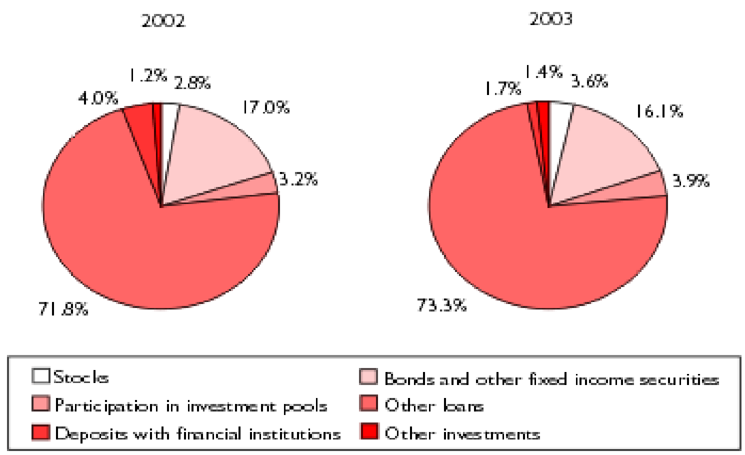
The composition of the investment portfolio of the local nonlife insurance companies is presented in graph 8. This graph indicates that the share of bonds and other fixed income securities increased from 37.1% in 2002 to 57.7% in 2003, reflecting a shift into long-term investments. The higher share of bonds and other fixed income securities was primarily at the expense of the share of deposits with financial institutions, which decreased from 52.0% to 34.2% in 2003.

Graph 8 Composition of the investment portfolio of the local nonlife insurance companies



The composition of the investment portfolio of the international nonlife insurance companies is illustrated in graph 9. The graph indicates that in both 2002 and 2003, the biggest share of total investments consisted of other loans. In 2003, approximately NAf.1.8 billion guilders were invested in other loans.

Graph 9 Composition of the investment portfolio of the international non-life insurance companies



5.4.3 Profit and loss statement

Table 27 shows that net earned premium of the local nonlife insurance industry increased by NAf.4.7 million (2.4%) in 2003, compared to an increase of NAf.23.1 million (13.6%) in 2002. The net claims incurred during 2003 increased by NAf.2.9 million (3.4%), while an increase of NAf.9.8 million (12.5%) was noted in 2002. Nevertheless, total operational expenses declined mainly because of a decrease in net other operational expenditures (NAf. 5.1 million). The year 2003 closed with an underwriting profit of NAf.10.6 million, compared to NAf.2.7 million in 2002. Compared to 2002, net investment income increased by NAf.3.1 million to NAf.15.7 million in 2003. The industry ended up with a net profit of NAf.11.8 million in 2003, an improvement compared to the NAf.2.2 million profit in 2002.

Table 27 Consolidated profit and loss statement of the nonlife insurance industry (in millions NAf.)

	2001		2002		2003	
	Local	**Int'l[a]**	**Local**	**Int'l**	**Local**	**Int'l**
INCOME						
Total net earned premium	170.6	554.3	193.7	535.9	198.4	567.5
Net other underwriting income	-	0.6	0.3	0.7	0.2	2.3
Total operational income	170.6	554.9	194.0	536.6	198.6	569.8
EXPENSES						
Net claims incurred	77.7	302.2	87.5	364.7	90.4	461.9
Change in various provisions	0.3	82.0	2.5	61.5	1.1	150.2
Claim adjustment expenses	4.5	2.3	5.1	0.4	5.0	1.1
Net other underwr. expend.	71.2	47.3	90.1	53.1	90.4	55.1

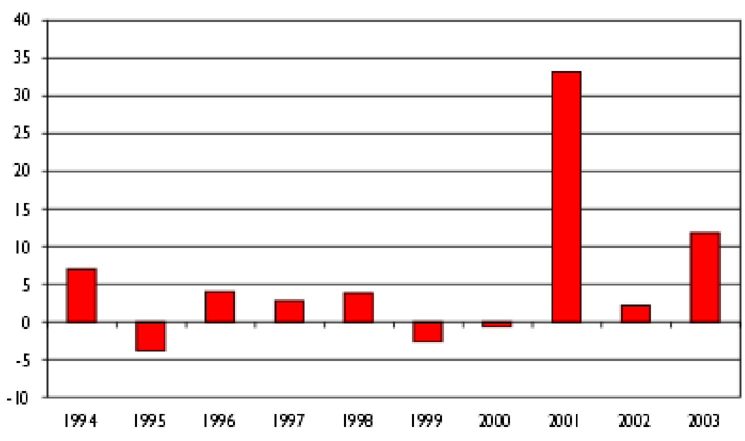
Net other operational expend.	4.4	2.0	6.1	1.8	1.0	2.9
Total operational expend.	158.1	435.8	191.3	481.5	188.0	671.2
Underwriting results	12.5	119.1	2.7	55.1	10.6	-101.4
Net investment income	27.4	93.7	12.6	85.8	15.7	97.0
Other results	-3.3	-21.2	-7.8	26.9	-4.2	43.5
Extraordinary results	0.2	1.8	-0.1	-5.9	-4.6	-
Net result before corp. taxes	36.8	193.4	7.4	161.9	17.5	39.1
Corporate taxes incurred	3.5	2.1	5.2	2.1	5.7	11.3
Net result after corp. taxes	33.3	191.3	2.2	159.8	11.8	27.8

[a] International nonlife insurance companies consist of captive insurance companies and professional reinsurers.

The total net earned premium of the internationally operating nonlife insurance companies increased by NAf.31.6 million (5.9%) in 2003 compared to 2002. On the other hand, the net claims incurred increased by NAf.97.2 million (26.6%), and the changes in various provisions increased by NAf.88.7 million (144.1%) in 2003. The increases in net claims incurred and changes in various provisions contributed largely to the decline of NAf. 156.5 million (284.2%) in the underwriting result to an unprecedented loss of NAf.101.4 million.

The industry experienced a NAf.11.2 million (13.1%) increase to NAf.97.0 million in investment income and an increase of NAf.16.6 million (62.1%) to NAf.43.5 million in other results in 2003. Despite the underwriting loss, the sector's net result after corporate taxes remained positive (NAf.27.8 million) but deteriorated by NAf.132.0 million (82.6%) compared to 2002.

Graph 10 Net results after corporate taxes of the local nonlife insurance sector (in millions NAf.)



Graph 10 presents an overview of the consolidated net results after taxes of the local nonlife insurance companies from 1994 to 2003. The positive net result in 2001 was due mainly to the relatively high net investment income.

5.5 Overview of developments in the pension industry

Compared to 2001, total assets of the pension industry increased by NAf.79.4 million (1.8%) to NAf.4.6 billion in 2002 (see table 28). In 2002, investments accounted for 88.9% of the industry's total assets, of which bonds accounted for 43.0% of total assets. Total investments decreased slightly by 0.8% compared to 2001. The equity position of the pension industry continued to decrease to NAf.138.0 million in 2002. This decrease was the result of the lower-than-expected performance of the investment portfolio of the industry.[10] The ratio of investments to technical provisions also decreased in 2002.

During the period 2000-2002, the average amount of premium contributions received by the pension funds equaled NAf.138.4 million, while the average amount in benefits paid amounted to NAf.149.1 million (see table 29). Premium contributions decreased by NAf.32.9 million (20.8%) in 2001, but increased by NAf.7.7 million (6.2%) in 2002. Investment income increased by NAf.41.6 million (18.6%) in 2002 compared to a decrease of NAf.77.3 million (25.7%) in 2001.

Total expenses of the pension industry increased by NAf.48.7 million (13.4%) in 2002 compared to 2001. The benefit payments and additions to the technical provisions amounted to 93.6% of total expenses in 2002. The industry continued to experience losses due to the large negative unrealized results on the investment portfolio during 2000-2002. In 2002, the reported loss amounted to NAf.122.4 million, 6.4% lower than in 2001.

[10] The pension sector consists of large as well as small pension funds, and not all pension funds had a bad performing investment portfolio.

Table 28 Consolidated balance sheet of the pension industry (in millions NAf.)

	2000[a]	2001[a]	2002
Admissible assets			
Investments, of which:			
- Real estate	99.2	90.8	84.4
- Participations	309.4	318.9	327.7
- Stocks	721.4	675.8	740.5
- Bonds and other fixed income securities	1,950.2	2,019.3	1,972.9
- Participations in investment pools	145.1	116.2	106.0
- Mortgage loans	87.9	100.3	121.7
- Other loans	141.2	185.1	158.7
- Deposits with financial institutions	146.8	186.1	165.6
- Other investments	7.6	417.3	399.9
Current assets	631.6	320.5	422.0
Other assets	66.6	79.0	89.4
Total	**4,307.0**	**4,509.4**	**4,588.8**
Equity, provisions and liabilities			
Equity:			
- Foundation capital	0.1	0.1	0.1
- Surplus	338.4	287.4	138.0
Technical provisions, of which:			
- Provisions for pension obligations	3,919.6	4,165.1	4,402.8
- Other technical provisions	12.9	3.7	0.6
Other provisions and liabilities	7.1	21.0	10.9
Current liabilities	28.9	32.1	36.4
Contingent liabilities			
Total	**4,307.0**	**4,509.4**	**4,588.8**

[a] 2000 and 2001 figures have been adjusted, since draft figures were replaced by audited figures.

Table 29 Consolidated profit and loss statement of the pension industry (in millions NAf.)

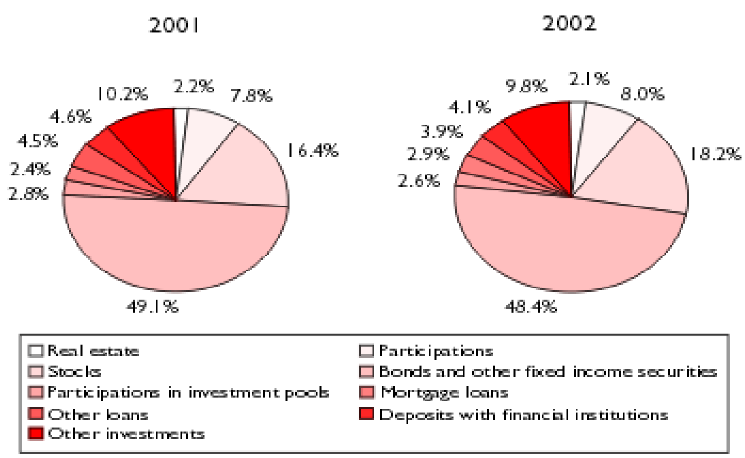
	2000[a]	2001[a]	2002
Income			
Contributions	157.7	124.8	132.6
Transferred pension obligations received	-	5.4	5.4
Net investment income earned and net realized capital gains and losses	300.9	223.6	265.2
Benefits received from reinsurer	1.9	0.1	1.4
Profit sharing from reinsurer	3.1	2.0	0.4
Other income	7.6	3.7	8.4
Total income	**471.2**	**359.6**	**413.4**
Expenses			
Pension benefits incurred	144.6	144.4	158.3
Change in net technical provisions	223.7	170.3	228.1
Pension obligations transferred	1.7	1.7	0.6
Reinsurance premiums incurred	10.0	3.0	3.5
Operational expenses incurred	14.1	17.4	19.5
Other expenses incurred	5.6	27.6	3.1
Total expenses	**399.7**	**364.4**	**413.1**
Extraordinary results	-4.7	-3.4	-4.4
Net operational results before unrealized gains or losses	**66.8**	**-8.2**	**-4.1**
Net unrealized gains or losses for:			
Invested assets	-197.3	-122.6	-117.5
Noninvested assets	-	-	-0.8
Foreign exchange	0.1	-	-
Net profit or loss	**-130.4**	**-130.8**	**-122.4**

[a] 2000 and 2001 figures have been adjusted, since draft figures were replaced by audited figures.

5.5.1 Investments

Graph 11 indicates that bonds and other fixed income securities form the largest part of the investment portfolio of the pension industry in the years 2001 and 2002 with shares of 49.1% and 48.4%, respectively. Stocks formed the second largest part of the investment portfolio. It is further noted that the share of bonds decreased by 0.7 percentage point, and the share of stocks increased by 1.8 percentage points.

Graph 11 Composition of the investment portfolio of the pension industry



6 POLICIES AND ACTIVITIES OF THE BANK

6.1 Training and seminars

Bank staff attended a variety of courses, seminars, and conferences in 2004 as part of the Bank's continuing education policy and to enable its personnel to keep abreast of the latest developments in their fields of expertise.

Staff in the department of Supervision on Institutional Investors attended, among other things, the World Captive Forum and several locally organized seminars and workshops on fraud, money laundering & corruption, supervision & responsibilities of pension fund directors, and insurance.

Staff in the Banking Supervision department attended various seminars, among other things, on anti money laundering and counter terrorism under the US Patriot Act organized by the US State Department, integrated and consolidated supervision hosted by the Financial Stability Institute, the implications of the EU savings guideline organized by Ernst & Young, and hit and run money laundering organized by the Dutch HARM team and the Antillean reporting unit of unusual transactions (MOT). Staff also participated in a course on loan analysis and attended the annual conference of the Caribbean Group of Banking Supervisors.

Furthermore, staff in the Statistical Information and Reporting department participated in the yearly seminar organized by the IMF to evaluate the 2003 and prepare the 2004 Coordinated Portfolio Investment Survey. The Netherlands Antilles also participates in the survey, which is conducted among companies operating in the domestic and international financial sectors. Staff also attended a meeting of the Irving Fisher Committee on central bank statistics of the International Statistical Institute.

Moreover, Research Department staff participated in a seminar on the development of local capital markets organized by Centro de Estudios Monetarios Latino Americanos (CEMLA), a course on exchange rates and capital flows organized by the Centre for Central Banking Studies of the Bank of England, and a course on monetary economics hosted by Study Center Gerzensee.

During 2004, the Bank continued to support "The Financial Institute", an institution geared towards educating employees in the local financial sector. The Bank helped organize workshops and examinations, which were participated in by Bank staff. Workshop topics included financial markets, insurance, and balance sheet analysis.

Apart from "The Financial Institute", the Bank organized the Regional Central Banks' Information System Specialists Conference which covered various topics in the field of ICT. In addition, the Bank hosted the annual seminar of the Offshore Group of Collective Investment Schemes Supervisors.

6.2 International financial sector developments

In June 2003, the Financial Action Task Force (FATF) finalized the revision of its 40 recommendations on money laundering and terrorist financing. The Netherlands Antilles, as a member of the FATF, endorsed these 40 revised recommendations. During

2004, both the National Committee on Money Laundering and Terrorist Financing (CIWG) and the Bank have worked continuously to implement the new obligations.

First, the National Committee on Money Laundering and Terrorist Financing (CIWG) established working groups to draft amendments to the legislation on the reporting of unusual transactions (MOT) and identification in conducting financial services (LIF) to make the Netherlands Antilles compliant with the new obligations of the FATF 2003 revised recommendations. This is a time-consuming exercise as the scope of the framework for anti money laundering and combating of terrorism financing has been broadened substantially.

Second, the Bank started a revision of the Provisions and Guidelines on the Detection and Deterrence of Money Laundering and Terrorist Financing that was issued in June 2003. This revision updates the current provisions and guidelines to the new obligations of the FATF 2003 revised recommendations.

Finally, the IMF report "Detailed Assessment of Observance of Standards and Codes" was finalized in 2004 and published on the websites of the Bank and the IMF. The report reflects positively the supervision policies of the Bank. The Bank currently is working on the implementation of the recommendations.

6.3 Monetary policy

The reserve requirement is the main monetary policy instrument of the central bank. This instrument is designed to control the liquidity in the banking system and, hence, the potential for credit extension. Under the reserve requirement, commercial banks are required to deposit a fixed percentage of their domestic liabilities at the central bank, which is non-interest-bearing. The reserve requirement is supplemented by the bi-weekly auctions of Certificates of Deposit (CDs) for the commercial banks, influencing their liquidity in the shorter run. Furthermore, the Bank can initiate open-market operations through buying or selling government securities, and commercial banks are not allowed to have a negative net foreign assets position to prevent them from accumulating net foreign debt.

During 2004, the Bank tightened its monetary stance in light of the strong growth in credit extension, continuing excess liquidity in the banking system, regular pressure on the official reserves during January–August, and rising interest rates in the United States. In addition, the Bank adapted several of its policy instruments to enhance their effectiveness.

The monetary tightening was reflected by further increases in the reserve requirement. The reserve requirement percentage was raised five times in 2004, by 0.25 percentage point to 10.25% on March 16, to 10.375% on May 16, to 10.625% on July 16, to 11.0% on September 16, and to 11.25% on November 16. In addition, as of January 16, 2004, the period during which the reserve requirement percentage is fixed was reduced from three months to two months. This change was made to increase the effectiveness of this instrument of monetary policy, so that corrective measures can be taken in a shorter time frame.

Furthermore, the trend of declining international interest rates was reversed in 2004 after the Fed's decision to increase its Fed's fund rate and the impact of this development on the domestic money and capital market. Therefore, the Bank decided to increase its official lending rate (i.e., the pledging rate) from 2.25% to 2.50% on July 14, 2004. This increase was the first raise since March 1995 and was followed by a second raise to 2.75% on November 15, 2004. As a result, the marginal lending rate -- a mark-up on the pledging rate of 100 basis points applicable on commercial banks' borrowing exceeding NAf.20 million-- rose to 3.75%.

Finally, to increase the attractiveness of Certificates of Deposit (CDs) to the commercial banks and, hence, the effectiveness of its monetary policy, the Bank adapted the rate mechanism for auctions as of July 14, 2004. Beginning on this date, the Bank announces for each auction the maximum rates it is willing to pay on the different terms offered. Prior to that change, one maximum rate was derived for all terms by lowering the pledging rate with a margin of 100 basis points.

7 FOREIGN EXCHANGE REGULATIONS AND LICENSE FEE

7.1 Introduction

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

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

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

1. to promote the Netherlands Antilles as an international financial center; for this reason, the Ordinance contains special provisions for companies engaged in international financial and business transactions;

2. to gather 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.

7.2 Foreign exchange licenses

Compared to 2003, the number of foreign exchange licenses issued by the Bank in 2004 declined by 106 (7%) to 1,311 (see table 30). This decline can be attributed primarily to the drop in the number of foreign exchange exemptions granted to international financial and business companies (86), continuing its downward trend. In contrast, the total capital flow related to the licenses granted increased by NAf.106.5 million (42%) to NAf.360.0 million. This increase is explained by the licenses granted for borrowing abroad by the airport of St. Maarten to finance its expansion (NAf.218 million), the World Trade Center in Curacao for the construction of a hotel (NAf.27 million), the utility company GEBE of St. Maarten for the purchase of new generators (NAf.22 million), and the construction of a hotel in St. Maarten (NAf.9 million).

Table 30 Overview of foreign exchange licenses issued (in millions NAf.)

Description	2003 Number	2003 Amount	2004 Number	2004 Amount
Establishment company by nonresident	106	15.9	165	3.5
Transfer to own account abroad	9	6.8	7	1.3
Portfolio investment abroad	10	10.4	13	24.9
Borrowing abroad	176	215.4	112	323.0
Lending abroad	11	3.4	5	7.3
Request for foreign bank account	4	1.6	8	-
Request for local nonresident account	23	-	6	-
Granting guarantee abroad	-	-	4	-
Exemption int. fin. & bus. companies	1,077	-	991	-
Other	1	-	-	-
Total	1,417	253.5	1,311	360.0

7.3 License fee

Starting January 1, 1996, a fee was introduced for the license to operate as a foreign exchange bank. This license fee is assessed on the international transactions of foreign exchange banks and 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 the re-investment of funds abroad, the re-exports of the free-zone companies, payments in Aruban florins, and payments by the central government.

Table 31 provides an overview of the license fees collected monthly from 2002 through 2004. From the total amount of license fees collected in the Netherlands Antilles in 2004, NAf.30,424.7 thousand (63%) was generated on Curacao, NAf.17,004.2 thousand (35%) on St. Maarten, and NAf.727.7 thousand (2%) on Bonaire. The remaining NAf.124.4 thousand (<1%) of license fees was paid through the Bank.

Table 31 License fees collected from 2002 through 2004 (in thousands NAf.)

	2002	2003	2004*
January	3,103.1	3,775.6	3,883.7
February	2,698.2	2,976.2	3,788.3
March	3,070.9	3,596.8	4,524.9
April	3,072.9	3,183.6	3,820.4
May	3,568.6	3,204.8	3,831.8
June	3,260.5	3,676.4	3,956.7
July	3,510.7	3,998.4	3,877.8
August	3,294.0	3,485.5	3,920.5
September	3,266.3	3,681.5	3,625.0
October	3,637.1	3,434.6	3,590.1
November	3,337.3	3,434.6	4,180.2
December	4,355.2	4,460.2	5,281.6
Total	40,174.8	42,908.2	48,281.0

*Preliminary

8 FINANCIAL STATEMENTS FOR THE YEAR 2004

Table 32 Balance Sheet as of December 31, 2004

	2003	2004
ASSETS		
Gold	237,045,638	271,727,664
Receivables and securities in foreign currency	670,750,885	748,774,585
Advance account central government	-	15,724,560
Government bonds	110,587,021	195,702,783
Other long-term receivables	23,320,911	22,469,538
Fixed assets	103,356,940	100,322,616
Other current assets	19,645,420	23,521,719
Total Assets	1,164,706,815	1,378,243,465
LIABILITIES		
Bank notes in circulation	275,939,166	272,661,598
Residents' current accounts		
- in guilders	491,466,877	594,053,055
- in foreign currency	43,222,357	30,215,474
Residents' time deposits		
- in guilders	77,700,000	167,500,000
Nonresidents' current accounts		
- in guilders	552,634	423,145
Money in custody	981,113	714,162
Other current liabilities	17,266,962	13,150,866
Undistributed earnings	17,346,044	24,783,655
Special reserves	180,231,662	214,741,510
Reserve fund	30,000,000	30,000,000
Capital	30,000,000	30,000,000
Total Liabilities	1,164,706,815	1,378,243,465

The 2003 en 2004 figures are extracted from the audited financial statements.

Table 33 Profit and Loss Account 2004

	2003	2004
INCOME		
Interest income	28,750,083	28,881,727
Foreign exchange results	1,118,732	878,874
Miscellaneous earnings	5,003,142	7,450,433
Subtotal	34,871,957	37,211,034
License fee	42,841,063	48,781,882
Total income	77,713,020	85,992,916
EXPENSES		
Interest expenses	2,680,778	1,702,021
Depreciation of fixed assets	5,119,766	5,162,814
Depreciation of printing costs bank notes	350,323	1,000,085
General expenses	25,460,383	28,104,377
Total expenses	33,611,250	35,969,297
Operating profit	44,101,770	50,023,619
Extraordinary income/loss	-	-
Net income	44,101,770	50,023,619
Distribution of net income:		
Net income	44,101,770	50,023,619
Paid to the central government	-42,883,466	-42,586,008
Change in undistributed earnings	1,218,304	7,437,611

The 2003 and 2004 figures are extracted from the audited financial statements.

8.1 Notes to the balance sheet as of December 31, 2004

8.1.1 Gold

Gold is valued at the average market price in the three years preceding the date of valuation. Gold is revalued every year. Unrealized gains from revaluations are added to the special reserves after approval by the Minister of Finance. Unrealized losses are deducted from the special reserves. If these losses are greater than the reserves, the difference will be deducted from the result.

8.1.2 Receivables and securities in foreign currency

The receivables represent balances in current account and time deposits with foreign financial institutions. The securities represent investment portfolios. These are valued at market price. Unrealized gains from revaluations are added to the special reserves after approval by the Minister of Finance. Unrealized losses are deducted from the special reserves. If these losses are greater than the reserves, the difference will be deducted from the result.

8.1.3 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. The advance account is not interest-bearing.

8.1.4 Government bonds

Government bonds reflect the Bank's portfolio of bonds issued by the central government and the island government of Curaçao. The Bank holds this portfolio mainly for monetary purposes. The bonds are valued at their amortized purchase price.

8.1.5 Other long-term receivables

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

8.1.6 Fixed assets

These assets, which also include printing cost of bank notes, 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.

8.1.7 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.

8.1.8 Bank notes in circulation

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

8.1.9 Residents' current accounts

These include the balances in current accounts 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.

8.1.10 Residents' time deposits

These include the balances in time deposits (i.e., certificates of deposit) of domestic banks and government institutions. The balances are interest-bearing.

8.1.11 Nonresidents' current accounts

This amount represents the balances in current accounts 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.

8.1.12 Money in custody

This amount represents the 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).

8.1.13 Other current liabilities

This item includes accrued interest and accounts payable.

8.1.14 Undistributed earnings

This section discloses the accumulated earnings of the Bank for the current and previous years, less the amounts paid to the central government.

8.1.15 Special reserves

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.

Unrealized gains from revaluations are added to the special reserves after approval by the Minister of Finance. Unrealized losses are deducted from the special reserves. If these losses are greater than the reserves, the difference will be deducted from the result.

The 2004 revaluation resulted in a net increase in reserves of NAf.34.5 million. Gold and foreign exchange recorded unrealized gains of NAf.34.7 million and NAf.0.2 million, respectively, while investments recorded an unrealized loss of NAf.0.4 million.

8.1.16 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).

8.1.17 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).

8.2 Notes to the profit and loss account 2004

8.2.1 Interest income

Interest income is generated mainly from government bonds, gold investments, and deposits and securities in foreign currency.

8.2.2 Foreign exchange results

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.

8.2.3 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 on Foreign Exchange Tax was revoked as of that same date. The license fee is calculated as 1% 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.