The debt relief program brings financial and economic opportunities, but also poses major challenges for the domestic financial sector

According to the 2008 Annual Report of the Bank of the Netherlands Antilles (the Bank), the debt relief program is expected to mitigate the economic slowdown projected for 2009. However, the inflow of debt relief funds will pose major challenges for the domestic financial sector.

The effect of the international financial and economic crisis on the Netherlands Antilles has been relatively contained so far. The international financial services sector and the tourism sector are the most afflicted, as these sectors depend heavily on developments in international markets. However, the effects of the global recession on our economy are expected to become more widespread, resulting in an economic slowdown from 2.0% in 2008 to approximately 1.0% in 2009. This relatively mild slowdown is owing to several factors, in particular, the debt relief program.

The debt relief program started in January 2009 for the central government and in April 2009 for the island government of Curaçao, after each respective entity met the qualifying requirements. These requirements included, among other things, balanced budgets and the strengtening of financial management. The Board of financial supervision, or College Financieel Toezicht (CFT), was established to temporarily supervise the finances of the different government entities. Under the debt relief program the Dutch government will pay 70% of interest costs and 100% of maturing principal until approximately 70% of the outstanding debt at the end of 2005 is settled. For 2009, this entails that the Netherlands Antilles will receive approximately NAf.926 million to make payments of interest and principal on government securities. In addition, the Dutch government will settle a total of NAf.500 million in accumulated arrears. As a result of this relief the public debt-to-GDP ratio would decline from 82% to around 63% during 2009.

Figure 1. Netherlands Antilles: Total Public Debt to GDP ratio

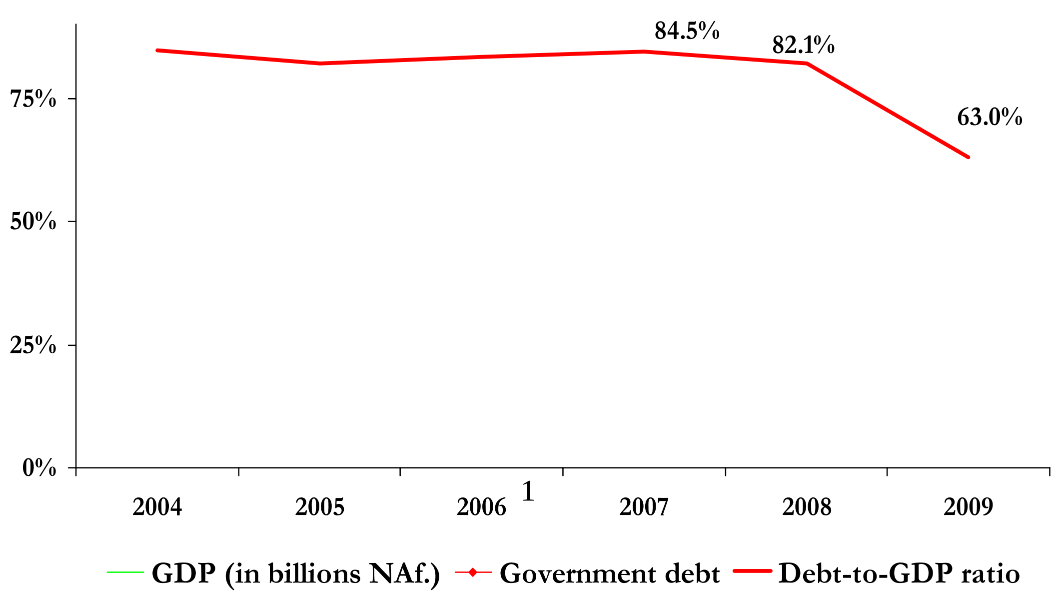
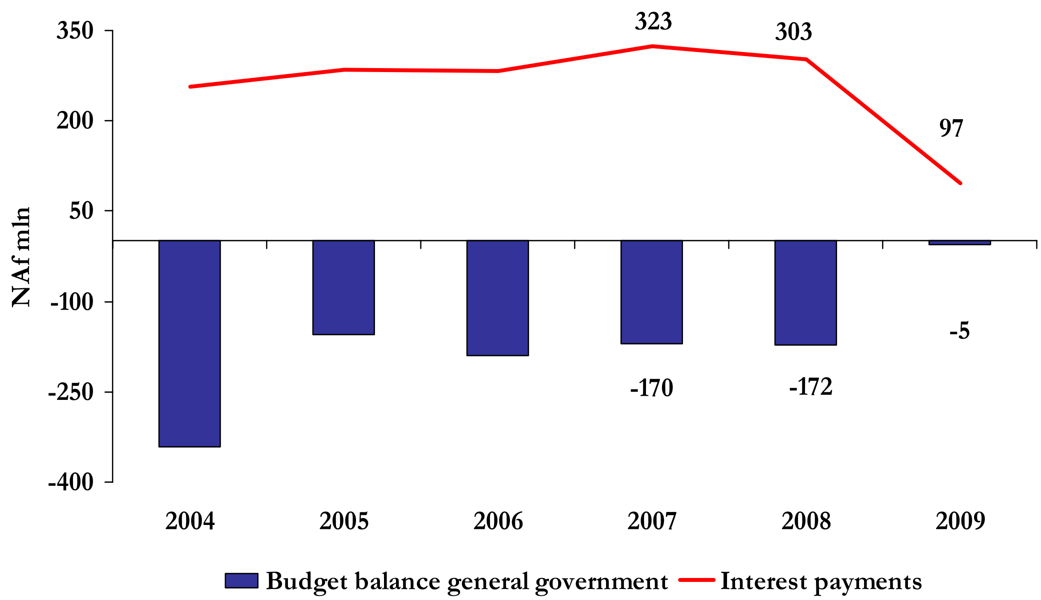


Figure 2. Netherlands Antilles: Interest burden (cash basis)



The debt relief puts the public finances of the Netherlands Antilles on a sound and sustainable path, a feat the country would never have been able to attain without huge social and economic sacrifices. Moreover, the prospect of balanced government budgets will facilitate the implementation of policies directed at stimulating the economy whenever this is deemed necessary.

However, the Bank's monetary policy agenda for 2009 will have to be focused on dealing with the challenges posed by the receipt of debt relief funds from the Netherlands. These funds add to the existing liquidity surplus in the domestic money market, pushing down interest rates even further. Consequently, local financial institutions obtain lower interest income, which forces them to reduce deposit rates, tap other sources of income, and improve cost efficiency to remain profitable. In order to facilitate these changes and in light of the increasing globalization, the Bank advocates a further consolidation of the financial sector. Furthermore, for institutional investors, the Bank has eased the investment rule as of January 1, 2009, allowing them more flexibility to invest the funds received from the debt relief abroad.

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