# ANNUAL REPORT 2011

# CENTRALE BANK VAN CURACAO EN SINT MAARTEN

# 1 REPORT OF THE PRESIDENT

## 1.1 General review

World economic growth slowed down in 2011 as economic activities moderated in most of the advanced, emerging, and developing economies. In the advanced economies, output growth remained weak due to the increased uncertainties in the financial markets, the European sovereign debt crisis, higher fuel prices, and the natural disasters in Japan. Economic growth in the emerging and developing economies was affected by restrictive fiscal measures among other things.

Against these international developments, the Curaçao economy expanded by 0.4% in 2011 after a growth of 0.1% in 2010. In contrast to two of its main trading partners, i.e., the United States and the Netherlands where inflationary pressures rose because of increased international fuel and commodity prices, consumer price inflation eased in Curaçao in 2011. Curaçao registered an inflation rate of 2.3% in 2011 compared to 2.8% in 2010. The lower inflation rate was due mainly to a reduction in domestic electricity prices, mitigated by increased food and fuel prices.

The lack of data, in particular national accounts data and quarterly government statistics for the period 2009 – 2011, made an estimate of real GDP growth for Sint Maarten in 2011 rather tenuous. Based on the available indicators of private sector activity, Sint Maarten's economy is estimated to have contracted by 1.5% in 2011. The annual inflation rate accelerated from 2.3% in 2010 to 4.6% in 2011. The increased inflationary pressures were driven largely by higher international oil and food prices and the increase in the turnover tax rate in February 2011.

The economic expansion in Curaçao was fueled solely by a growth in net foreign demand, as domestic demand contracted. The growth in net foreign demand was the result of a surge in the export of goods and services, mitigated by a rise in imports. Domestic demand dropped because of a decline in public spending. This decline is attributable to a contraction in public consumption, reflecting lower expenditures on goods & services and wages & salaries. Meanwhile, private spending rose as both private consumption and investment increased.

A review of Curaçao's sectoral performance in 2011 reveals that the economic growth was driven largely by the manufacturing, transport, storage, & communication, wholesale & retail trade, and hotels & restaurants sectors. After a sharp decline in 2010, output in the manufacturing sector rebounded in 2011 due mainly to increased activities at the Isla refinery after a prolonged shut-down in 2010. Also, ship repair activities rose in 2011.

The rise in stay-over tourism contributed to the expansion in the hotels & restaurants, and wholesale & retail trade sectors. In particular, the number of stay-over visitors from North and South America rose, reflecting increased airlift and more marketing efforts. In addition, the number of cruise tourists grew. Activities in the wholesale & retail trade sector also were backed by increased consumer spending.

The transport, storage, & communication sector performed well as the growth in stay-over tourism contributed to more passengers handled at the airport. Moreover, air transportation activities rose because the domestic airlines transported more passengers. Harbor activities posted some mixed results with a growth in the number of ship calls but a decline in cargo movements, oil storage, and transshipment activities.

The financial services sector also contributed positively to 2011's growth because of the increase in net income from domestic financial services. Net income rose because more revenues were collected from fees, commissions, and extraordinary items instead of interest income earned. In addition, income expenses dropped. The capitalization of the domestic banking sector improved in 2011, indicating a larger capital buffer. However, assets grew very little, while the ratio of nonperforming loans-to-total loans increased. The change in this ratio indicates a further worsening of the quality of the domestic banks' credit portfolio. Meanwhile, real value added by the international financial and business services sector contracted in 2011.

Activities in the construction sector continued to decline, reflecting a drop in construction investment activities. However, the contraction in the construction sector was less pronounced in 2011 than in 2010. The real estate, renting, and business services sector also contributed negatively to growth as residents purchased fewer properties in 2011.

In Sint Maarten, activities in the hotels & restaurants and wholesale & retail trade sectors declined, owing to a drop in stay-over tourism. The drop in the number of stay-over tourists was related to, among other things, a decline in time-share capacity and airlift during 2011. In contrast, cruise tourism expanded, but at a slower pace than in 2010.

The transport, storage, & communication sector in Sint Maarten showed mixed results. The harbor of Sint Maarten performed well because more ships, in particular freighters, were piloted into the port. In line with the decline in stay-over tourism, passenger traffic at the airport dropped. Consequently, airport-related activities declined in 2011. The utility sector also posted mixed results as the production of electricity declined, while that of water rose. In addition, both water and electricity consumption dropped. Meanwhile, the performance of the financial services sector was weak as reflected by a decline in net income of the domestic commercial banks.

Both the Curaçao and Sint Maarten governments experienced substantial delays in their administrative and financial reporting processes. In Curaçao, the focus was primarily on transforming the old two-tier administrative system into an institutional framework befitting the country's new autonomous status. Sint Maarten's main challenge was the creation of several new government institutions to enable it to function as an autonomous country.

Preliminary data reported by the Curaçao government indicate that the country registered a cash deficit of NAf.169.3 million in 2011. Hence, Curaçao did not comply with the balanced budget rule as agreed upon in the dissolution accord that included the debt relief for the entities of the former Netherlands Antilles. The failure of the Curaçao government to implement crucial reforms to reduce health care spending was one of the major causes of the deficit in 2011. Non-tax revenues remained subdued in 2011 due to low dividend payouts by state-owned enterprises and tax revenues were lower than expected.

After a lengthy process to draft a balanced budget, Sint Maarten's budget was finally approved in April 2011 by the independent supervisory board (CFT[1]) and subsequently signed into law in July 2011 after Parliamentary approval. Nevertheless, public sector figures indicate that Sint Maarten recorded a small cash surplus of NAf.1.1 million in 2011 as government revenues slightly surpassed expenditures. This positive outcome was largely ascribable to a rise in turnover tax proceeds as a result of the increase in the turnover tax rate in 2011. Revenues from other tax categories including wage tax, property tax, and excise on gasoline also rose. However, profit tax proceeds dropped in line with the slowdown in economic activities in Sint Maarten during 2011.

[1] College Financieel Toezicht.

In 2011, the balance of payments of the monetary union recorded a deficit as reflected by a decline in net foreign assets. For the first time in eleven years, net foreign reserves dropped as the current account deficit was not fully covered by external financing and capital transfers. The average import coverage decreased from 4.0 months of merchandise imports in 2010 to 3.7 months in 2011. Nevertheless, the import coverage remained well above the Bank's target of three months.

The current account deficit widened in 2011 compared to 2010 due mainly to a decline in net current transfers received from abroad. The decline in net current transfers is attributable to the conclusion of the debt relief program in 2010. Consequently, no debt relief funds were transferred from the Netherlands to either Curaçao or Sint Maarten during 2011. In contrast, net exports of goods and services rose, as the rise in exports offset the import growth. The gain in exports was related to, among other things, an increase in the refining fee in Curaçao after a prolonged shutdown of the Isla refinery during most of 2010. In addition, foreign exchange revenues from bunkering activities rose, reflecting higher average international fuel prices. Increased foreign exchange earnings from re-exports by the free-zone companies and from ship repair activities in Curaçao also contributed to the surge in exports. Moreover, foreign exchange revenues from the tourism sector rose in both Curaçao and Sint Maarten. However, the export growth was mitigated by a decline in foreign exchange receipts from international financial services, reflecting mainly a drop in international banking and trust services provided to abroad. The import bill of the monetary union expanded due to higher average oil prices on the international markets and more merchandise imports by the free-zone companies and wholesale and retail trade sectors.

The higher current account deficit was covered mainly by external finance to the private sector reflecting a deterioration of the loans and credits, portfolio investment, and direct investment balances. The increase in net loans and credits extended to Curaçao and Sint Maarten was related largely to the rise in net trade credits received on imports, the repatriation of funds abroad by local financial institutions, and the net decline in domestic companies' foreign bank balances. Net portfolio investments abroad declined as matured foreign debt securities were not fully reinvested abroad by the institutional investors. Meanwhile, net direct investments into the monetary union rose reflecting increased liabilities of resident companies with their foreign parents or affiliates and the purchase of real estate by nonresidents. Capital transfers from abroad dropped significantly in 2011 compared to 2010 reflecting the conclusion of the debt relief program in 2010 and less development aid received from the Netherlands.

The monetary aggregates expanded in 2011 after a contraction in 2010, due solely to a growth in net domestic assets. In contrast, net foreign assets dropped as a result of a deficit on the balance of payments. The growth in net domestic assets was attributable primarily to a growth in private sector credit. All loan components in Curaçao contributed to the growth. In contrast, Sint Maarten registered a contraction in all private sector loan components. Net domestic assets grew also because of an expansion in net credit to the government reflecting mainly a drawdown of deposits.

The Bank tightened its monetary policy during 2011, motivated by the increasing deficit on the current account of the balance of payments and private sector credit growth exceeding GDP growth. As a consequence, the Bank raised the reserve requirement percentage by 2 percentage points to reach 9.75% in September 2011. Subsequently, the reserve requirement percentage was increased each month by 0.25 percentage points reaching 10.50% at the end of 2011. During the biweekly auctions of Certificates of Deposit (CDs), the Bank focused on refinancing the maturing CDs. The Bank's official lending rate, the pledging rate, remained unchanged at 1.00% in line with the monetary policy stance of the US Federal Reserve aimed at maintaining a low policy rate.

## 1.2 Policy considerations

As part of the process of dismantling the Netherlands Antilles, the governments of the Netherlands, the former Netherlands Antilles, and the island territories of Curaçao and Sint Maarten agreed in 2006 that the Dutch government would take over the debt of the entities of the Netherlands Antilles up to the level corresponding with an interest burden rule. The aim of the debt relief was to provide the governments of Curaçao and Sint Maarten the opportunity to enter their new autonomous status with a sound financial position.

The implementation of the debt relief program, however, was bound by strict conditions and control, including a balanced budget rule and financial supervision by an independent supervisory board (CFT) to prevent a build-up of unsustainable debt levels by the new countries in the future. After merely two years and one fully completed budgetary process, the Curacao budget--contrary to the projected surplus--is unbalanced, a situation likely to persist as interacting weaknesses continue to amplify each other. The importance of timely and reliable public finance data is critical not only for policymaking but also in the investment climate equation. A large gap appears to exist between the projections presented in the approved budget and the budget's realization. The existence of such a gap points to a failing financial management system. Clearly, this weakness must be corrected quickly to prevent the frequent introduction of unexpected compensating measures that create a climate of uncertainty putting a drag on economic growth. Moreover, little room exists for further tax increases given the 2011 tax-to-GDP ratio of Curacao of 26%.

Sint Maarten's budget for 2011 was approved by the CFT after a lengthy process that required several budgetary adjustments. With a tax-to-GDP ratio of 23%, Sint Maarten still has some room for broadening its revenue base, which should be attained primarily by improving the collection of taxes. In addition, improving the government's cost efficiency could contribute to maintaining a balanced budget.

As was made abundantly clear, the debt relief will lead to sustainable budgets only if it is complemented with policies aimed at structurally healthy public finances. Indeed, it did provide the governments of the two countries with a sound starting position but was not a solution for the many socioeconomic challenges these countries face. One of these challenges is the aging of the population, which is putting an upward pressure on public spending on health care and the old age pension system (AOV), particularly in Curaçao. The Social Security Bank of Curaçao has indicated that if structural measures are not taken soon, the AOV fund will be depleted by 2014.

Reforming the health care and old age pension systems will require some unpopular measures, including augmenting efficiency in the provision of health care services and increasing the retirement age. Over the years, several studies have been conducted on these subjects and numerous recommendations made to the governments. Regretfully, the much-needed reforms have not been implemented, thus aggravating the scope of the problems and their impact on the budget.

To maintain sustainable public finances and achieve macroeconomic stability, these crucial reforms cannot be delayed any longer in the hopes of better times. Relying only on ad hoc measures, which could have undesirable effects, is not an option. Failing to act on all fronts ultimately will erode confidence and increase the risks to macroeconomic and financial stability. Ad hoc measures make structural or fiscal adjustments seem less urgent. In addition, monetary policy also may be constrained by this approach.

The Curaçao and Sint Maarten governments have yet to achieve the goal of a strong and stable environment to stimulate sustainable economic growth. Both countries have experienced very moderate, if not negative GDP growth over the past few years. Also the 2012 growth prospects of the two countries remain weak, due mainly to the gloomy economic outlook for our main trading partners. On numerous occasions, the Bank has indicated that improvement of the investment climate is crucial for both Curaçao and Sint Maarten to achieve higher economic growth once the world economic climate starts to improve.

A more attractive investment climate will promote more private sector investment, which is ultimately the driver of sustainable economic growth. In this context, it is very important for the government to improve transparency and reduce red tape. Moreover, the education system should provide graduates with skills currently needed in the labor market. The recent decision by the Curaçao government to make education more accessible to everyone is commendable. However, it is worrisome that no attention seems to be given to the quality of education. The rigidities in the labor market also need to be addressed to boost job creation. The government's recent decision to promulgate the so-called 80/20-rule, prescribing a minimum share of 80% local workers for companies established in Curaçao, is not conducive to addressing those rigidities. An unfettered implementation of this rule may make our labor market less flexible and hence erode our competitive position.

Sustainable economic growth can reduce poverty, contributing to broad-based prosperity in our communities. Sustainable economic growth and poverty reduction constitute two sides of a coin. On the one side, sustainable economic growth will increase employment, resulting in income improvement and higher domestic demand. On the other side, failure to address poverty effectively will negatively affect a country's ability to achieve higher economic growth.

Poverty reduction can be achieved through passive income support, such as government subsidies. However, evidence suggests that it is very difficult for people dependent on income support from the government to escape poverty on a lasting basis. In addition, if the government chooses to provide subsidies or direct income support, it should have money in the budget to do so. The budget clearly has no room to fully subsidize the education system in Curacao in the short to medium term without cutting government expenditures in other areas or increasing the income base of the government. Increasing government income in a time of weak economic growth would imply reducing the purchasing power of consumers, which will stifle economic recovery. Therefore, the government should be aware that actions directed at increasing the tax and premium burden to attain its policy objectives risk condemning the economy to slower growth and higher unemployment.

The experiences in other countries in recent decades show that active social policies help achieve lasting reductions in poverty. Such policies help people overcome obstacles to obtaining a job, including education, training, provision of childcare, and public transportation. In our case as well, these areas need to be addressed to reduce poverty in a lasting way.

Besides the challenges in the public finances, the situation on our balance of payments also needs to be addressed. For the first time in eleven years, the balance of payments recorded a deficit in 2011. The Bank has addressed this issue through a tightening of monetary policy. In addition to increasing the reserve requirement percentage, a temporary credit freeze was introduced in February 2012 to curb private sector credit extension and, hence, import growth to limit a further widening of the current account deficit. As the recently published public finance data clearly indicate, the government of Curaçao contributed also to the large current account deficit through the monetary financing of its budget deficit by drawing down its bank deposits. Looking ahead, the credit measure should be adjusted to bring it in line with our new realities.

However, the monetary policy measures will alleviate the situation in the short run only. As small open economies, increased oil and commodity prices will always fuel the import bills of Curaçao and Sint Maarten. Therefore, masking domestic prices from international price changes provides wrong signals to companies and consumers, resulting in a misallocation of resources. For a lasting improvement of the current account of the balance of payments, we need to increase our exports to counterbalance the import growth. One of the important sectors that need our attention is the international financial services industry. The foreign exchange revenues generated by this sector have been dropping persistently. Despite many efforts, particularly by the sector itself, the industry has not regained its position as an international financial center. To revitalize the international financial services sector, which has always been an important pillar of the Curaçao economy in terms of high level employment and foreign exchange revenues, the representative organization of the sector, the government, and the central bank should combine their forces to create the necessary conditions under which the sector can flourish again.

Sustainable economic growth is key to achieving macroeconomic stability, reducing poverty, and creating broad-based well-being for the people of the young countries of Curaçao and Sint Maarten. However, the measures to attain these objectives should be aligned with the budgetary restrictions, be economically feasible, and have a lasting effect.

E.D. Tromp
President

## 2 INTERNATIONAL ECONOMIC DEVELOPMENTS

Global activities weakened to 3.8% in 2011, the result of a slower growth in the advanced, emerging, and developing economies. On the one hand, the slowdown reflected the weak recovery of the advanced economies. Especially in the United States, confidence was depressed because of fears of pending insolvencies, the escalating sovereign debt crisis in Europe, and the potential outcome of falling financial markets. On the other hand, the less favorable results in the emerging and developing countries were caused mainly by restrictive fiscal measures.

In 2011, the growth rate of the U.S. economy decelerated to 1.7%, compared to 3.0% in 2010 (see Table 1). The weaker growth in 2011 was due to gains in consumer spending, nonresidential fixed investment, and exports, dampened by declines in public spending and private inventory investments. Private consumption rose by 2.2%, slightly higher than in 2010. Household disposable income stagnated, as a result of higher energy prices. Higher nonresidential investment was backed by more investment spending in structures and equipment & software. By contrast, the contraction in public spending by the state and local governments moderated the gain in domestic private demand. Net exports improved, as the growth of export demand outpaced that of imports of goods & services. However, the current account deficit worsened slightly by 0.8% to $483 billion, due to a decline in net current transfers. The unemployment rate remained elevated at 8.5% because a lot still needs to be done to recover the jobs lost during the recession that ended in June 2009. Consumer price inflation accelerated to 3.2% in 2011, driven by rising energy and food prices. To support the economy, the Federal Reserve kept its fed funds rate close to zero, despite the higher inflation rate and lower jobless rate.

**Table 1 Key indicators of selected countries**

| | United States | | Netherlands | | Venezuela | |
|---|---|---|---|---|---|---|
| | 2010 | 2011 | 2010 | 2011 | 2010 | 2011 |
| Real GDP (% change) | 3.0 | 1.7 | 1.7 | 1.2 | -1.5 | 4.2 |
| Consumer prices (%) | 1.6 | 3.2 | 1.3 | 2.4 | 28.2 | 26.1 |
| Unemployment rate (%) | 9.4 | 8.5 | 4.3* | 4.9* | 6.5 | 6.5 |

Sources: US Bureau of Economic Analysis, US Bureau of Labor Statistics, Central Bureau of Statistics Netherlands, Banco Central de Venezuela, and Instituto Nacional de Estadistica Venezuela.
*International definition

Throughout 2011, the Euro area struggled with renewed market volatility and heightened risks to financial stability. As the financial strains deepened, contagion spread to banks in the euro area periphery, raising the sovereign risk premiums of economies that had not been affected before. The ongoing financial turbulence lowered confidence, resulting in an economic slowdown of 1.4% in 2011. Rising oil and other commodity prices raised inflationary pressures to 2.7% in 2011, up from 1.6% in 2010.

Real GDP growth in the Netherlands decelerated to 1.2% in 2011, down from 1.7% in 2010. This slowdown can be explained by the decline in consumer spending and fewer export activities, moderated by a gain in gross fixed investment. Private consumption suffered a contraction due to the erosion of spending power related to (1) higher inflation; and (2) higher contributions to health care insurance and pension schemes. Re-exports were mainly responsible for lower exports of goods and services, coinciding with a lower demand for imports. From a sectoral perspective, almost all sectors recorded a weaker growth with the exception of the construction sector, which matched the gain in investments. The slower pace of economic growth was accompanied by a higher unemployment rate of 4.9%. The number of unemployed was up among all age categories. The 2011 inflation rate of 2.4% was led mainly by higher prices of natural gas, electricity, and food.

The 2011 budget deficit was lower at 4.7% of GDP. Meanwhile, the public debt-to-GDP ratio of the Netherlands rose further to 65.2% in 2011. The fiscal data show that the Netherlands has exceeded the EU norms for deficit and debt for three consecutive years.

During the year 2011, the pace of economic growth slackened in the Latin American and Caribbean region. During the first half of the year, the external conditions were moderate for the region, but as the year advanced, the euro zone situation and outlook worsened, causing the global and regional economies to slow down. As a result, the region's real GDP growth rate decelerated to 4.5% in 2011, down from 6.2% in 2010. Growth was accounted for largely by the commodity-exporting countries in the region. Also, the resurgence in Central America gathered momentum, led by gains in domestic demand and agricultural exports. Meanwhile, the growth of the highly indebted and tourism-dependent Caribbean countries lagged behind. The region's annual inflation rate rose to 6.6%, driven mostly by rising world food and fuel prices.

Following an economic contraction in 2010, Venezuela posted real GDP growth of 4.2% in 2011, backed by higher oil prices and sizeable public spending. The expansion was seen largely in the non-oil sector, as all sectors recovered from 2010's production decline. The increase in government spending was funded by the windfall of oil revenues, as oil prices neared $100 per barrel in 2011. The government's economic policy encouraged domestic spending but also created shortages, leading to a soaring inflation. Consumer price inflation eased, but remained high at 26.1% in 2011, caused mainly by supply shortages of consumer goods and a devaluation of the Venezuelan bolivar that occurred in late 2010. Also, the government eliminated the dual exchange rate system and unified the exchange rate to 4.3 bolivar per US$ on January 1, 2011. The rising oil prices widened the current account surplus markedly to US$27.2 billion. Despite the economic rebound, the jobless rate in Venezuela remained unchanged at 6.5%.

# 3 GENERAL ECONOMIC DEVELOPMENTS IN THE MONETARY UNION

## 3.1 General economic developments in Curaçao

### *3.1.1 Introduction*

The indicators reveal that the economy of Curaçao grew by 0.4% in 2011, after growth of 0.1% in 2010. The rebound in net exports contributed largely to the stronger pace of GDP growth, sustained by robust export of goods & services yet moderated by a higher import demand. In addition, output was driven by a positive performance in the private sector but was mitigated by a decline in the public sector (see Table 2). In 2011, consumer price inflation rose by 2.3%, due mostly to higher food and petrol prices, but tempered by a reduction in electricity prices.

Among the expenditure components, foreign demand exerted considerable expansionary stimuli in the oil refinery, stay-over tourism, and oil bunkering. The import growth of goods & services stemmed mostly from surging oil and food costs. Domestic demand shrank, due to a cutback in public spending. Unlike 2010, public demand contracted, the result of a retrenchment in public consumption, due to a decrease in spending on goods & services and wages & salaries. With more activities in the private sector, private consumption held up well, as demonstrated by the expansion in the imports of wholesale & retail trade merchandise. As opposed to the decline in 2010, private investment increased, but remained fairly subdued in 2011.

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

| | 2010 | 2011 |
|---|---|---|
| Domestic expenditures, of which: | 1.1 | -0.2 |
| Private sector | -0.1 | 1.3 |
| - Investment | -0.7 | 0.2 |
| - Consumption | 0.6 | 1.1 |
| Government | 1.2 | -1.5 |
| - Investment | 0.0 | 0.0 |
| - Consumption | 1.2 | -1.5 |
| Changes in inventory | 1.0 | -1.0 |
| Foreign net expenditures, of which: | -2.0 | 1.6 |
| Export of goods and services | -1.3 | 7.0 |
| Import of goods and services | 0.7 | 5.3 |
| GDP by expenditures | 0.1 | 0.4 |
| Net primary income | -0.4 | 1.1 |
| Gross national income | -0.3 | 1.6 |
| Net current transfers from abroad | -3.6 | -2.6 |
| Gross national disposable income | -3.9 | -1.0 |

Source: Estimates by the Central Bank of Curaçao and Sint Maarten.

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

### *3.1.2 Domestic production*

Much of the output growth in 2011 was concentrated in the sectors manufacturing, wholesale & retail trade, and transport, storage, & communication. The growth in the manufacturing sector was bolstered mostly by an increase in real value added by the Isla refinery. After a prolonged shutdown of the refinery beginning in March 2010, the refinery became operational again in the first quarter of 2011. The restarting of the refinery was also reflected by the perceptible rise in operational costs. The gain in the number of man-hours sold suggests more activities in the ship repair sector, adding to the positive performance in manufacturing.

The encouraging outturn in stay-over tourism and consumer spending triggered the growth in the wholesale & retail trade and hotels & restaurants sectors. The positive performance in the free zone was related mostly to price rises of some merchandise. Also, the rise in the number of free-zone visits by 7.4%, caused mostly by the Haitian and Venezuelan markets, contributed to the positive performance.

In contrast to the decline in 2010, stay-over tourism was up by 14.2% in 2011, caused in particular by the North American and South American markets. The buoyant growth in U.S. arrivals (27.1%) was attributable to more airlift and promotion in the United States. As of December 2010, Continental Airlines launched a twice-weekly nonstop service from Newark to Curaçao. The gain in the South American market was caused by the perceptible increase in the number of Venezuelan travelers (38.6%), due to more marketing efforts targeting the higher-income groups. Nevertheless, this rise should be seen in the context of a vast decrease in the number of Venezuelan tourists in 2010. In line with the rising number of stay-over tourists, the hotel occupancy rate went up by 4.5 percentage points to 76.2% in 2011. Higher stay-over tourist arrivals also were accompanied by more time spent on the island: the number of visitor nights expanded by 8.4%. (See Table 10 in the appendix for more details.) The promotion during the annual cruise conferences resulted in an increase in the number of cruise calls, contributing to the rise in cruise ship visitor arrivals (4.7%).

**Table 3 GDP by sector (real percentage changes)**

| Sector | 2010 | 2011 |
|---|---|---|
| Agriculture, fishery, & mining | -3.8 | -2.1 |
| Manufacturing | -7.0 | 10.0 |
| Electricity, gas, & water | -1.1 | 0.5 |
| Construction | -4.2 | -2.9 |
| Wholesale & retail trade | 1.1 | 2.2 |
| Restaurants & hotels | -0.7 | 3.5 |
| Transport, storage, & communication | -0.7 | 3.5 |
| Financial intermediation | 2.0 | 0.5 |
| Real estate, renting, & business services | 0.2 | -3.5 |
| Other community, social, & personal services | 3.6 | 0.2 |
| Private households | 1.5 | 1.0 |
| | | |
| Total private sector | -0.1 | 0.9 |
| Public sector | 4.8 | -2.3 |
| | | |
| GDP | 0.1 | 0.4 |

Source: Estimates by the Central Bank of Curaçao and Sint Maarten.

The course of development in the transport, storage, & communication sector was favorable in 2011, with increases in air transportation and airport-related activities. Output in air transportation grew, as more passengers were transported by the domestic airlines. The positive result in airport-related activities was consistent with the expansion in the number of Curaçao's stay-over arrivals. Developments in the harbor were mixed, as more ships were piloted into the harbor, but cargo movements, oil storage, and oil transshipment activities all recorded a downturn.

Real value added in the financial services sector expanded slightly in 2011, solely because of a growth in net income of the domestic commercial banks. This growth was due to a gain in income earned, whereas expenses dropped. The growth in income earnings was related largely to higher fees and commission charges.

The construction sector continued to have a slowing impact on GDP growth. Imports of construction merchandise contracted, suggesting a further decline in construction investment activities throughout 2011. The real estate, renting, & business services sector suffered a setback in 2011, as residents purchased fewer properties.

### *3.1.3 Inflation*

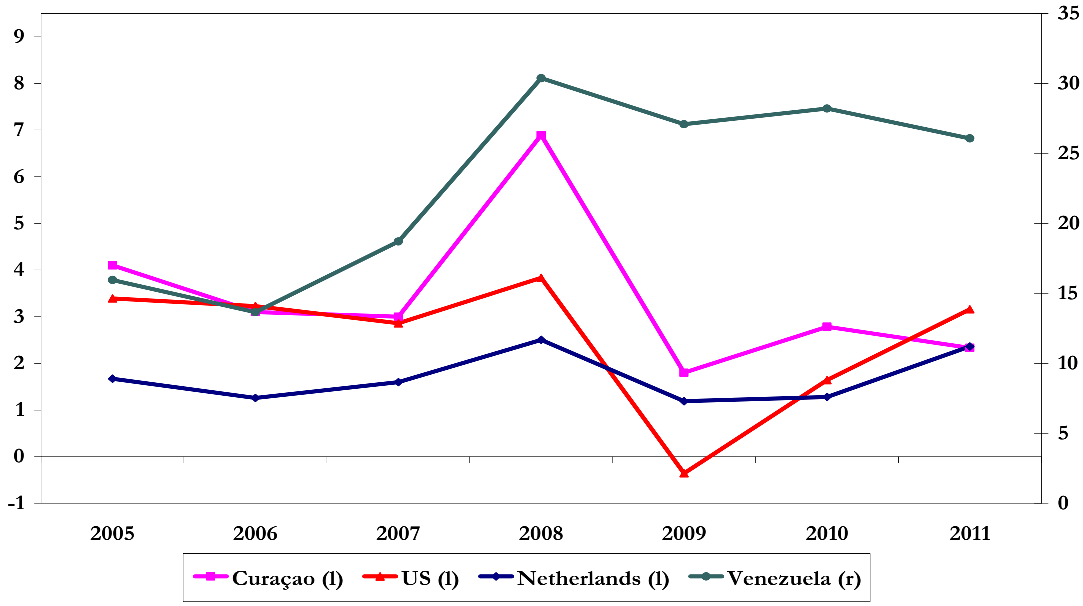
Despite the rising global oil and food prices, the annual consumer prices in Curaçao eased to 2.3% in 2011 dropping from 2.8% in 2010. Throughout 2011, crude oil prices rose further by 31.6%[2] in the world market. The government of Curaçao regulates the prices of domestic oil products, such as petrol, gas oil, kerosene, and cooking gas, with the aim of moderating domestic price movements. As of July 2011, the government started adjusting domestic prices of oil products on a

[2] International Financial Statistics, IMF.

monthly basis in accordance with the global oil price developments with a time lag of 2 months. Besides the oil product prices, domestic utility prices are regulated by the government of Curaçao. In April 2011, electricity prices were reduced by 7.0% and remained unchanged throughout 2011. Hence, the slower inflation did not correspond with the rising trend of inflation of two of our main trading partners, the United States and the Netherlands (see Graph 1).

The stable consumer prices in 2011 mask diverging underlying patterns. Increases in the prices of food and petrol contrasted with lower prices for electricity. The housing component contributed the most to muting the inflationary trends as this expenditure category makes up the largest share (30.8%) of the consumer basket. The deceleration in Housing (0.8%) was the result of a cut in electricity tariffs in the second quarter of 2011. Conversely, price gains in Food (7.7%) and Transport & Communication (2.7%)[3] mitigated the slower pace of growth of the housing component. Food prices continued their ascent, fueled by the discernible surge in the cost of fresh produce (14.6%) and meat & fish products (10.1%). Also, price increases in petrol, diesel, and automobiles led to the rise in the transport component. Compared to 2010, petrol prices were up by 17.0% in 2011. (See Table 11A in the appendix for a detailed overview.)

**Graph 1 Developments in consumer prices (annual percentage change)**




## 3.2 General economic developments in Sint Maarten

### *3.2.1 Developments by sector*

Due to a lack of data, in particular national accounts data and quarterly government statistics for the period 2009 – 2011, only a rough estimate of real GDP growth for Sint Maarten in 2011 could be made. Based on the available indicators of private sector activity, Sint Maarten's economy is estimated to have contracted by 1.5% in 2011. Below, the main developments in the major sectors of the Sint Maarten economy in 2011 are discussed.

[3] Food and Transport contribute, respectively, 12.3% and 22.6% to the consumer price index (CPI).

In 2011, a decline in stay-over tourism led to fewer activities in the sectors hotels & restaurants, wholesale & retail trade, and transport, storage, & communication. The drop in the number of visitors, mainly from the North American market, contributed to the fall in stay-over tourism arrivals (4.2%). This decline was related to, among other things, the closure of the Pelican Club Beach Resort, which accounted for 20% of the country's timeshare capacity. The U.S. market represents about 75% of the timeshare visitors and 50% of the total stay-over tourist arrivals. Moreover, a decline in airlift capacity led to fewer stay-over arrivals in Sint Maarten. As of April 2011, American Eagle discontinued all direct flight connections between San Juan and Philipsburg. Coinciding with the decrease in the number of stay-over travelers, the hotel occupancy rate shrank by 6.3 percentage points to 55.6% in 2011. In contrast, the number of cruise visitors in 2011 grew by 9.5%, albeit at a much slower rate than in 2010 (24.5%). (See Table 10 in the appendix for more details.)

The results of the utility sector were mixed as the production of water expanded while the production of electricity fell during 2011. Meanwhile, both water and electricity consumption was down. The developments in the transport, storage, & communication sector also were mixed. The increase in harbor activities was backed by more vessels being piloted into the harbor, caused by more freighters. Conversely, in the air transportation sector, both the number of passengers transported by the domestic airline and the airport-related activities dropped. The fall in total passenger traffic at the airport was in line with the decline in stay-over tourism.

Adding to the glum performance in the private sector, the performance of the financial services sector also was disappointing, as net income of the domestic commercial banks fell. This decline was due to rising expenses accompanied by a decline in income earned. Compared to 2010, in 2011, the number of business licenses requested was down and more businesses withdrew their license. Moreover, the number of building permits requested shrank by 5.1%, indicating fewer construction investment activities in the near future.

#### *3.2.2 Inflation*

In 2011, Sint Maarten's inflation soared to 4.6% up from 2.3% in 2010, eroding consumers' purchasing power. The upward price trend in 2011 was determined by both external and internal forces. Rising world oil and food prices and an increase in the turnover tax rate were mainly responsible for the elevated 2011 inflation. On February 11, 2011, the turnover tax (TOT) was raised from 3.0% to 5.0%. Most of the CPI components increased at a faster pace, but the categories Food (9.1%) and Beverages & tobacco (9.8%) in particular saw significant price gains. Similar to Curaçao, the cost of fresh produce (13.7%) and meat & fish products (11.2%) increased considerably in 2011. Higher petrol costs led to the increase in the Transport & communication category (4.7%). (See Table 11B in the appendix for a detailed overview.)

### 3.3 Public finances

#### *3.3.1 Public finances Curaçao*

*Cash overview and financing*

Developments in Curaçao's public sector during 2011 must be seen against the setting of the recent constitutional reform,[4] from which Curaçao emerged as an autonomous country within the Kingdom of the Netherlands. In 2011, the government of Curaçao was faced with the ongoing

[4] Curaçao acquired the status of autonomous country within the Kingdom of the Netherlands on October 10, 2010, following the disbanding of the federation of the Netherlands Antilles.

challenge of transforming the old two-tier administration system into an institutional framework befitting the country's new autonomous status. This transformation brought about considerable delays in several administrative and financial reporting processes of the government. The resulting lack of complete, consistent, and reliable data proved a hindrance to estimating the public sector's contribution to Curaçao's GDP in 2011. Another challenge was that all 2011 data had to be compared to data from 2010 when Curaçao was not an autonomous country for most of the year. Still, by using approximations of Curaçao's share in the operations and resources of the former central government, it was possible to gauge the public sector contribution to GDP in 2011.

Over 2011, the government sector contributed negatively to Curaçao's real GDP, as public consumption fell, outweighing the slight gain in public investment. The fall in consumptive outlays was ascribable largely to underspending on goods & services during 2011 since many government departments and services were not functioning at full capacity. The subdued level of activities was due mostly to the ongoing restructuring of the government apparatus. Compared to 2010, government spending on wages & salaries also showed a decline in 2011, contributing to the noted downturn in public consumption.[5] Public investments registered a small rise during 2011, owing mainly to higher spending on budgeted investments. Meanwhile, the development projects financed by USONA[6] continued their due course in 2011, with the largest gains in disbursements on Social Economic Initiative (SEI) and Institutional Strengthening and Execution Power (IVB) projects. The SEI projects are aimed at strengthening Curaçao's economy and the IVB projects at enhancing the quality of public management.

The Curaçao government's primary balance, defined as the fiscal balance exclusive of interest expenses, amounted to 2.2% of GDP in 2011 (see Table 4). In the years before Curaçao became an autonomous country, interest costs used to exert a heavy burden on the public purse. However, since the implementation of the debt relief program, interest costs have gone down drastically and are projected to remain relatively low during the next couple of years.

**Table 4 Selected key variables of the government of Curaçao (in millions NAf.)**

| | **2011** |
|---|---|
| Revenues | 1,556.9 |
| % of GDP | 28.7% |
| Tax revenues | 1,414.6 |
| Nontax revenues | 142.3 |
| | |
| Expenditures | 1,726.2 |
| % of GDP | 31.8% |
| Current expenditures | 1,694.5 |
| Capital expenditures | 31.7 |
| | |
| Budget balance | -169.3 |
| % of GDP | -3.1% |
| | |
| Primary balance | -119.5 |
| % of GDP | -2.2% |

[5] For the purpose of this analysis, the assumption was made that outlays on wages and salaries remained the same in nominal terms during 2011, but declined in real terms when compared to 2010.
[6] The foundation in charge of approving and funding development projects on Curaçao, Sint Maarten, and the other islands that used to form the Netherlands Antilles.

As part of the agreements reached with the Netherlands during the constitutional reform, Curaçao is required to comply with several budgetary rules, among them a balanced budget. Before Curaçao's government budgets can become law, they must be approved by the independent supervisory board, the College Financieel Toezicht (CFT).[7] However, although Curaçao's budget for 2011 showed a small surplus, preliminary data released by Curaçao's government indicate the existence of a cash deficit of NAf.169.3 million. One of the main reasons for this deficit was that several measures that should have been taken during 2011 to curb health care expenditures were not implemented. In addition, both nontax and tax revenues were lower than expected. Nontax revenues remained subdued primarily because of fairly low dividend payouts by state-owned enterprises, while the revenue from the profit tax and sales tax also was less than budgeted. Still, the revenue from these taxes increased by 3.6% compared to 2010, in line with the slight economic expansion registered in 2011. (See Table 12A and Table 12B in the appendix for more details.)

**Table 5 Financing of the cash balance of Curaçao (in millions NAf.)**

| | 2010 | 2011 |
|---|---|---|
| Monetary financing | -474.2 | 90.2 |
| Central bank | -187.8 | 34.3 |
| Commercial banks | -286.5 | 56.0 |
| Nonmonetary financing | -30.6 | 79.0 |
| Government securities with the public | 982.5 | 0.0 |
| Other | -1,013.1 | 79.0 |
| Cash balance | 504.8 | -169.3 |

The net borrowing of Curaçao's government turned positive in 2011, after having been negative in the two preceding years as a result of the debt relief program. To finance its operational deficit, the Curaçao government withdrew funds from its accounts with the banking sector and incurred liabilities with other creditors in 2011. No government securities were issued in 2011 (see Table 5).

*Public sector debt*

The data were not available to determine Curaçao's public debt-to-GDP ratio as of the end of 2011. Not much is known about the public debt of Curaçao at the end of 2011 other than the government had NAf.1,667.4 million in outstanding bonds, which were issued in late 2010, to conclude the debt relief program.[8] During 2011 Curaçao did not issue additional securities to finance its operations, but no information has been released regarding whether any other liabilities or arrears were incurred by the public sector. Therefore, only a partial and indicative debt-to-GDP ratio of 30.7% could be calculated for Curaçao in 2011

### *3.3.2 Public finances Sint Maarten*

*Cash overview and financing*

Public sector developments in Sint Maarten during 2011 must be viewed against the setting of the recent constitutional reform,[9] from which Sint Maarten emerged as an autonomous country within the Kingdom of the Netherlands. Over the course of 2011, Sint Maarten's government focused

7 The CFT was established to temporarily assess the public finances of the five islands of the former Netherlands Antilles and provide counsel.

8 The takeover of all Netherlands Antillean securities by the Netherlands on October 10, 2010, caused the actual amount of debt relief provided to Curaçao to exceed the agreed-upon amount. On October 15, 2010, Curaçao issued NAf.1,667.4 million in new bonds to settle its resulting liability to the Netherlands.

9 Sint Maarten acquired the status of autonomous country within the Kingdom of the Netherlands on October 10, 2010, following the disbanding of the federation of the Netherlands Antilles.

mainly on setting up the institutions that would enable it to function autonomously. A particularly difficult task for Sint Maarten was the drafting of a balanced budget for 2011. As part of the agreements reached with the Netherlands during the constitutional reform, Sint Maarten is required to comply with several budgetary rules, among them a balanced budget. Before any government budget can become law, it must be approved by the independent supervisory board, the College Financieel Toezicht (CFT).[10] Sint Maarten's draft budget for 2011 was rejected twice by the CFT, before finally receiving approval in April 2011 and being signed into law in July 2011. Another challenge facing Sint Maarten's public sector throughout 2011 was the provision of government statistics. Lack of public sector data has been a constraint on Sint Maarten for many years--no specific expenditure information is available, while many other statistics remain limited. Hence, calculating the real GDP growth rate for Sint Maarten in 2011 was not possible; only a very rough estimate could be made based on the available indicators.

The primary balance of Sint Maarten's government, defined as the fiscal balance excluding interest expenditures, was 0.9% of GDP in 2011 (see Table 6). The larger share of the interest costs carried by Sint Maarten during 2011 was related to the bonds the government issued in late 2010 to conclude the debt relief program.[11]

**Table 6 Selected key variables of the government of Sint Maarten (in millions NAf.)**

| | 2011 |
|---|---|
| Revenues | 404.6 |
| % of GDP | 27.2% |
| Tax revenues | 343.9 |
| Nontax revenues | 60.7 |
| | |
| Expenditures | 403.5 |
| % of GDP | 27.1% |
| | |
| Budget balance | 1.1 |
| % of GDP | 0.1% |
| | |
| Primary balance | 13.0 |
| % of GDP | 0.9% |

Source: Estimates by the Central Bank of Curaçao and Sint Maarten.

In 2011, the government of Sint Maarten generated NAf.404.6 million in revenues[12] while incurring NAf.403.5 million in expenditures. These figures indicate that although the government of Sint Maarten struggled at first to create a balanced budget for 2011, by the end of the year total income exceeded total costs by NAf.1.1 million.[13] One reason for this positive outcome was the increase of the turnover tax rate from 3% to 5% on February 11, 2011. As a result of this upward rate adjustment, the proceeds from turnover tax increased significantly in 2011 compared to previous years. Some other tax categories that showed a noteworthy rise during 2011 are wage tax, property transfer tax, and excise on gasoline. By contrast, profit tax proceeds remained subdued, reflecting

[10] The CFT was established to temporarily assess the public finances of the five islands of the former Netherlands Antilles and provide counsel.
[11] The takeover of all Netherlands Antillean securities by the Netherlands on October 10, 2010, caused the actual amount of debt relief provided to Sint Maarten to exceed the agreed-upon amount. On October 21, 2010, Sint Maarten issued NAf.302.1 million in new bonds to settle its resulting liability to the Netherlands.
[12] Excluding funds received from USONA, the foundation that is in charge of approving and funding development projects on Curaçao, Sint Maarten, and the other islands that used to form the Netherlands Antilles.
[13] These figures exclude the buildup of any other liabilities or arrears during 2011, since none have been reported by the government of Sint Maarten.

the slowdown in economic activities on the island. (See Table 13A and Table 13B in the appendix for more details.)

**Table 7 Financing of the cash balance of Sint Maarten (in millions NAf.)**

| | 2011 |
|---|---|
| Monetary financing | -12.6 |
| Central bank | -0.1 |
| Commercial banks | -12.5 |
| Nonmonetary financing | 11.5 |
| Government securities with the public | 26.0 |
| Other | -14.5 |
| Cash balance | 1.1 |

The net borrowing of Sint Maarten's public sector was positive during 2011. Sint Maarten's government used the funds raised through the issuance of government securities in October 2011, as well as its operational cash surplus, to reduce liabilities with other creditors. In addition, the government replenished its accounts with the commercial banks and the central bank, bringing about an overall decline in its monetary financing (see Table 7).

*Public sector debt*

Due to data unavailability, Sint Maarten's public debt-to-GDP ratio as of the end of December 2011 could not be established. The available information regarding the public debt of Sint Maarten indicates that by the end of 2011, the whole public sector had NAf.360.2 million in outstanding liabilities--NAf.328.1 million in government bonds, NAf.25.6 million in other loans of the government, and NAf.6.5 million in outstanding obligations of other public institutions in Sint Maarten. Of the outstanding bonds, NAf.26.0 million was issued in October 2011 as the government of Sint Maarten seized the opportunity created by internationally low interest rates and the standing subscription of the Netherlands[14] to refinance some loans at a more favorable interest rate. Since no further information is available regarding any other liabilities or arrears of the public sector, only a partial debt-to-GDP ratio (24.2%) could be calculated for Sint Maarten in 2011. However, this ratio is indicative only, as it is based on both incomplete debt statistics and a rough estimate of Sint Maarten's GDP growth in 2011.

## 3.4 Developments in the balance of payments

### *3.4.1 Introduction*

The current account of the balance of payments recorded a higher deficit (NAf.1,517.2 million) in 2011 than in 2010 (NAf.1,427.7 million). The increased deficit stemmed largely from lower net current transfers received from abroad, mitigated by an improvement in both the services balance and the trade balance. As the widened current account deficit was not fully covered by external financing and net capital transfers, the international reserves dropped by NAf.506.7 million (see Table 8).

[14] The Dutch State Treasury Agency (DSTA) has a standing subscription on all loans issued by Curaçao or Sint Maarten. All tenders are based on the current yield of public loans with similar terms issued in the Netherlands.

**Table 8  Balance of payments summary (in millions NAf.)**

| | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|
| Current account | -1,513.9 | -608.5 | -1,427.7 | -1,517.2 |
| Capital transfers | 244.8 | 200.6 | 1,200.8 | 116.7 |
| Acquisition of nonproduced nonfinancial assets | -.- | -.- | 0.6 | -.- |
| External financing of the government | 7.4 | 7.6 | 11.1 | 28.7 |
| External financing of the private sector | 1,530.9 | 805.6 | 279.4 | 811.5 |
| - Direct investment *) | 449.0 | 196.4 | 228.6 | 57.2 |
| - Loans and credits *) | 1,208.5 | 797.9 | 1,580.1 | 513.1 |
| - Portfolio investments *) | -126.6 | -188.7 | -1,529.3 | 241.2 |
| | | | | |
| Change in net foreign assets of banking system *) | -371.6 | -539.0 | -162.4 | 506.7 |
| - with central bank | -282.8 | -85.5 | -42.1 | 105.3 |
| - with commercial banks | -88.8 | -453.4 | -120.3 | 401.4 |
| | | | | |
| Statistical discrepancies | 102.2 | 133.9 | 98.2 | 53.6 |

*) a minus sign implies an increase

### *3.4.2 Current account*

In 2011, the net exports of goods and services increased by NAf.349.1 million compared to 2010, as export growth accelerated (NAf.830.7 million), outweighing the increase in imports (NAf.481.6 million). (For a detailed overview, see Table 14 in the appendix.) Below is an analysis of the developments in net exports of goods and services in Curaçao and Sint Maarten.[15]

*Developments in the net exports of goods and services in Curaçao*

In Curaçao, merchandise exports grew by NAf.438.6 million in 2011, due mainly to an expansion in free-zone re-exports. Free-zone exports rose significantly, mostly due to a higher price level of precious metals. Additionally, bunkering activities augmented due mostly to higher international oil prices. Furthermore, a rise in ship repair activities (NAf.113.6 million) contributed to the export growth in 2011. Merchandise imports increased also, but at a slower pace than merchandise exports. The rise in merchandise imports (NAf.407.6 million) was related to the higher international oil prices, higher free-zone imports, and more imports by the wholesale and retail trade sectors. The increase in imports was related to increased private spending and a higher demand from the tourism sector, reflecting an increase in the number of tourists. Overall, the trade balance of Curacao improved by NAf.31.1 million.

The services balance improved significantly by NAf.330.4 million in 2011 compared to 2010, due mainly to a strong improvement in the collected refining fee (NAf.351.8 million), as the refinery became operational again after being out of operation during most of 2010. In addition, foreign exchange earnings from the tourism industry rose in 2011, reflected by higher receipts from stay-over tourism (18.8%) and cruise tourism (6.3%). In contrast, foreign exchange revenues from international financial services declined by NAf.64.2 million, due mostly to fewer activities from banking and trust services provided to abroad. The developments in the trade and services balances resulted in a surge in net exports of goods and services by NAf.361.5 million.

[15] The current account of the monetary union is not equal to the sum of the current accounts of Curaçao and Sint Maarten due to the transactions between the two countries.

*Developments in the net exports of goods and services in Sint Maarten*

In Sint Maarten, net foreign demand expanded by NAf.104.6 million in 2011, as the increase in exports of goods and services (NAf.174.4 million) was offset in part by a rise in imports (NAf.69.8 million). This rise in imports can be ascribed largely to the higher international oil prices combined with slightly increased wholesale imports. Meanwhile, foreign exchange receipts from the tourism industry rose in Sint Maarten, in particular receipts from cruise tourism (NAf.58.5 million), reflecting an increase in the number of cruise tourists.

*Developments in the income balance and the current transfers balance*

The income balance of the monetary union remained fairly stable in 2011 with a marginal improvement of NAf.0.4 million. This improvement reflected a small increase in net interest paid on foreign debt securities, offset by a net increase in the labor income balance. The labor income improved due to, among other things, more transfers from the Dutch government for salary payments to its defense personnel in Curaçao and Sint Maarten.

Finally, net current transfers received from abroad declined by NAf.180.2 million, as no transfers of debt relief funds were made to Curaçao and Sint Maarten in 2011 because the debt relief program ended in 2010. Overall, the current account deficit worsened by NAf.89.5 million to reach NAf.1,517.2 million in 2011.

### *3.4.3 Financing of the current account balance*

As a result of the deficit recorded on the current account of the balance of payments, external financing to the private sector accumulated, further increasing the net debt position. External financing to the private sector rose by NAf.811.5 million, reflecting the worsening of the loans and credits balance, the portfolio investments balance, and the direct investment balance.

The loans and credits balance deteriorated by NAf.513.1 million in 2011, caused largely by increased trade credits received on imports. Moreover, net trade credits extended dropped, as the rise in repayments outweighed the growth in credits extended to foreign customers. In addition, local companies withdrew funds from abroad to finance a portion of their imports. Financial corporations also repatriated funds to finance their operations in Curaçao and Sint Maarten.

The worsening of the portfolio investment balance by NAf.241.2 million in 2011 was the result of a decline in debt securities held by local institutional investors that were not reinvested abroad. This decline was mitigated by increased investments in foreign equity securities and the net redemption of maturing debt securities held by nonresidents. These securities included bonds issued by the government in the past and debt securities issued to finance the construction of the airport in Sint Maarten.

Net direct investments deteriorated by NAf.57.2 million because of an increase in liabilities of resident direct investment companies with their foreign affiliates. Nonresident purchases of real estate in Curaçao and Sint Maarten also contributed to the worsening of the direct investment balance.

In addition, a substantial decline in capital transfers from abroad was registered, reflecting the conclusion of the debt relief program by the Dutch government in 2010. Together with fewer development aid funds received from the Netherlands, net capital transfers dropped by NAf.1,084.1 million in 2011 compared to 2010.

As the capital inflow was not sufficient to cover the deficit on the current account of the balance of payments, net foreign assets (i.e., international reserves) decreased by NAf.506.7 million in 2011, compared to 2010. This decline in reserves was the first in eleven years. (See Table 15 in the appendix for a detailed overview).

## 3.5 Monetary developments

### *3.5.1 Monetary policy and money supply*

During 2011, the Bank tightened its monetary stance in light of balance of payment pressures stemming from the rising deficit on the current account and a declining trend in the level of foreign exchange reserves. The pressures were related in part to the continuing excess liquidity in the banking system, which contributed to a relatively rapid growth in credit extension vis-à-vis nominal GDP growth. The monetary tightening was effectuated by an increase of the reserve requirement percentage, the Bank's main instrument, by 2 percentage points to 9.75% on September 16, 2011. Subsequently, the reserve requirement percentage reached 10.50% by December 2011 as it was raised by 0.25 percentage points monthly.

The Bank's monetary policy is directed at preserving the peg of the Netherlands Antillean guilder to the US dollar. To that end, the intermediate objective is to preserve the official reserves target, i.e., a level of official reserves (excluding gold) of at least three months of forecasted merchandise imports. The Bank's monetary policy instruments are aimed mainly at influencing the amount of base money or, more specifically, the liquidity in the banking system, to control the growth of private credit extension. Limiting the amount of excess liquidity should have a dampening impact on the level of domestic credit extension, domestic spending, imports, and ultimately should result in a positive effect on the level of official reserves.

The Bank's other monetary policy tool, the auctioning of certificates of deposit (CDs), was deployed in a neutral manner in 2011 as the Bank aimed only at the refinancing of maturing CDs at the biweekly auctions. However, shortfalls in subscriptions caused the outstanding amount of CDs to drop by NAf.33.7 million to reach NAf.30.3 million at the end of December 2011.

The Bank kept the official interest rate, the pledging rate, unchanged at 1.00% during 2011 as no major changes occurred in prevailing international market rates.

### *3.5.2 Monetary aggregates*

After shrinking by 3.2% in 2010, money growth picked up in 2011, with broad money (M2) expanding by NAf.91.7 million, or 1.3%. (See Table 16 in the appendix for more details.) The increase in domestic liquidity was concentrated in the first half of 2011, as the money holdings of the private sector increased by NAf.70.8 million compared to end of December 2010. In 2011, the expansion in near money (NAf.74.1 million) was the main factor for the higher M2. The money component (M1), which accounts for 43% of the money supply, rose by NAf.17.6 million, reflecting mainly an increase in total demand deposits. The rise in deposits was driven largely by households and private nonfinancial companies, which increased their outstanding foreign currency balances.

### *3.5.3 Factors affecting the money supply*

The monetary growth during 2011 was attributable entirely to the expansion in net domestic assets by NAf.534.5 million (19.8%). In contrast, net foreign assets dropped by NAf.442.9 million (9.8%). The increase in net domestic assets was backed by more loans extended to the private sector. Moreover, net credit to the government expanded as a result of a drawdown of deposits with the banking system. In contrast, "miscellaneous items" decreased, due largely to additions to the capital and reserves of the monetary sector during 2011.

An analysis of the loans component of credit extended to the private sector reveals the following picture. In Curaçao, private sector loans grew by 8.9% from December 2010 to December 2011, while a decline of 2.4% was registered in Sint Maarten. In Curaçao, all loan components contributed to the growth: mortgages by 16.8%, business loans by 5.9%, and consumer loans by 1.2%. However, the rise in mortgages during 2011 should be interpreted with caution as there were some reclassifications among the loan components. In Sint Maarten, all loan components recorded a decline: consumer loans by 3.1%, business loans by 2.3%, and mortgages by 2.0%.

Both the central bank and the commercial banks showed a drop in net foreign assets in 2011, related to the deficit on the balance of payments. The central bank's net holdings dropped by 0.7% (NAf.20.1 million), while the net holdings of the commercial banks dropped by 26.2% (NAf.422.8 million). (See Table 16 in the appendix for a detailed overview.)

### *3.5.4 Developments in domestic interest rates*

The Bank's official lending rate remained unchanged throughout 2011 after being lowered to 1.00% on December 29, 2008. The rate offered at the auctions of certificates of deposit (CDs) varied in line with international interest rates. The 1-month CD rate reached a minimum of 0.09% around mid-2011 but increased to 0.17% at the end of 2011, the same rate as at the end of 2010.

Despite the increase in excess liquidity in the banking sector and the low international interest rate environment, most commercial bank rates did not decline further in 2011. While the average interest rate on savings deposits remained unchanged at 1.1% throughout 2011, the average rate on 12-month time deposits increased by 0.4 percentage point to 2.1%. Considering commercial bank lending rates, the average mortgage rate, which bottomed in the fourth quarter of 2010, increased by 0.6 percentage point during 2011 to reach 7.3% at the end of December. At the same time, the average interest rate on time loans dropped by 0.5 percentage point to 8.3%.

The offerings by the Dutch State Treasury Agency (DSTA), which participates in the local tender of government securities, are based on the relatively low effective yield of Dutch State loans with similar maturities. As a result, the average effective yield of 5-year government bonds fell further by 1.0 percentage point to 1.4% at the end of 2011. The 1–month treasury bills rate remained unchanged (1.0%) at the end of 2011 compared to the end of 2010 because no new issues were tendered. (See Table 17 in the appendix for a detailed overview.)

## 3.6 Developments in the commercial banking sector

### *3.6.1 Balance sheet and income statement*

Total assets of the domestic commercial banks expanded only marginally--0.1%--during 2011 compared to a 1.8% increase in 2010. The deceleration in the growth rate was due mainly to a decline in interest-bearing cash (11.4%). Loans, on the other hand, increased by 4.3% in 2011, a deceleration compared to the 6.4% growth in 2010. (See Table 18 in the appendix for more details.)

On the liabilities side, total deposits dropped by 1.0% in 2011, after growing by 0.4% in 2010. The decline in total deposits was the result of a decrease in time (12.3%) and savings (4.6%) deposits, outweighing the increase in demand deposits (8.8%). As a result, the composition of total deposits changed as the shares of time and savings deposits dropped, respectively, from 24.8% and 33.6% in 2010 to 21.9% and 32.4% in 2011. The share of the outstanding non-interest-bearing demand deposits in total deposits increased to 45.7% in 2011 from 41.6% in 2010. The capitalization of the domestic banks strengthened further in 2011 as total capital increased by 6.0%. However, total capital grew at a slower pace in 2011 than in 2010.

In 2011, total operational income of the domestic commercial banking sector increased by 5.5%, owing to a rise in both net interest income (4.0%) and other income (8.6%). The increase in net interest income was due to a decline in interest expenses (14.5%) as the amount of outstanding interest-bearing deposits dropped. The declining trend in interest income almost halted.

Operational expenses rose by 3.1% in 2011, a deceleration compared to the 5.1% growth in 2010. The total expenses-to-total assets ratio increased from 4.1% in 2010 to 4.3% in 2011, implying a deterioration in cost efficiency. All categories, with the exception of the net addition to general provisions, contributed to the faster growth in expenses in 2011. The largest increase (8.8%) occurred in salaries and other employee expenses. The growth in operating expenses was outweighed by the growth in operating income, resulting in an increase in net operating income (12.3%). Net income after taxes increased by 15.3% to NAf.244.6 million in 2011. (See Table 19 in the appendix for more details.)

### *3.6.2 Financial soundness indicators*

The banking sector in the monetary union of Curaçao and Sint Maarten performed weakly during 2011. Assets hardly grew while the deposit base declined. Meanwhile, pretax income increased, due to more revenue collected from fees, commissions, and extraordinary items instead of more interest income earned. These developments determined the outcome of the financial soundness indicators.

The Bank analyzes the general performance of the banking sector on a regular basis by the monitoring of financial soundness indicators (FSI). FSI are aggregates of microprudential indicators used to assess the soundness of individual banks. Since these microeconomic indicators consider only the exposure of individual banking institutions, this approach is rather limited. For a more comprehensive analysis, macroeconomic factors also are included by carrying out stress tests. Stress testing helps to anticipate potential vulnerabilities in the financial system. These stress tests together with the FSI enhance the macroprudential approach for a better assessment of the vulnerability of the banking system to shocks and the extent of systemic risk.

The ratio of total capital-to-total assets increased from 10.8% in 2010 to 11.3% in 2011, indicating a larger capital buffer to absorb possible losses from financial risk (see Table 9). The increase in the capital adequacy ratio was due mostly to an increase in qualifying Tier 1 capital. The capital assets ratio exceeded the internationally acknowledged Basel benchmark of 8.0%, meaning that the adequacy of the capital stock of the domestic banks is relatively strong.

A higher increase in nonperforming loans than in provisions caused the ratio of provisions for loan losses-to-nonperforming loans to drop from 53.4% in 2010 to 45.9% in 2011. Moreover, the ratio of nonperforming loans-to-total loans reached 6.8% at the end 2011, up from 5.9% at the end of 2010, underscoring the further deterioration in the quality of the credit portfolio. The deterioration in asset quality resulted from an accelerated growth in nonperforming loans in 2011 (20.1%), while the growth in total loans decelerated (4.5%).

**Table 9 Macroprudential indicators (in %, end of period)**

| | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|
| **Capital adequacy** | | | | |
| Total capital/total assets | 10.0 | 10.2 | 10.8 | 11.3 |
| | | | | |
| **Asset quality** | | | | |
| Nonperforming loans/total loans | 4.4 | 5.7 | 5.9 | 6.8 |
| Provisions for loan losses/nonperforming loans | 63.6 | 50.3 | 53.4 | 45.9 |
| | | | | |
| **Earnings** | | | | |
| Gross earning assets yield | 6.7 | 6.1 | 5.6 | 5.6 |
| Net interest margin | 4.4 | 4.4 | 4.3 | 4.5 |
| Return-on-assets | 2.1 | 1.8 | 1.7 | 1.9 |
| | | | | |
| **Liquidity** | | | | |
| Total loans/total deposits | 61.8 | 61.7 | 65.3 | 68.7 |

The gross earning-assets yield remained unchanged at 5.6% in 2011, as the increases in average earnings assets (0.8%) and the interest earned on these assets (0.5%) balanced each other. The return-on-assets ratio increased from 1.7% in 2010 to 1.9% in 2011, as net income increased more (13.0%) than average total assets (2.2%). Meanwhile, a larger growth in the banks' net interest income (4.9%) combined with a 2.2% increase in average earning assets caused the net interest margin to improve to 4.5% in 2011, up from 4.3% in 2010.

Finally, the ratio of total loans-to-total deposits increased, indicating a drop in liquidity of the domestic banking sector. The increase in the amount of loans extended combined with the drop in the deposit base contributed to the higher ratio in 2011.

## Text box: Financing of the current account deficit

Just like most countries in the Caribbean, the monetary union of Curaçao and Sint Maarten faces structural and significant deficits on its current account of the balance of payments. In the monetary union, the deficit of the current account is caused by large deficits on the trade balance, reflecting much higher imports than exports of goods. In recent years, this deficit has been widening due, among other things to, increased international oil and food prices. The deficit on the trade balance is not offset by surpluses on the services balance, the income balance and the current transfers balance leading to a deficit on the current account. This deficit implies that the goods and services acquired from the rest of the world must be paid for by either liquidating foreign assets or increasing foreign liabilities. In the monetary union, current account deficits are financed mostly by external financing to the private sector, followed by capital transfers (mainly development aid[1]).

An increase of external financing to the private sector reflects a decline in net foreign wealth or an increase in net foreign indebtedness. Therefore, it is important to monitor the development of this form of financing. Furthermore, the current account balance is an important indicator of macroeconomic performance. A large deficit on the current account is considered a problem as it may cause a shift in investor confidence when investors fear loans will not be repaid. In addition, a high level of external financing is considered only sustainable in combination with a high real GDP growth rate. Real GDP growth has a positive impact on foreign investors' willingness to invest or lend. In the past 10 years, Curaçao and Sint Maarten performed moderately with an average real GDP growth rate of about 2%. However, this figure dropped close to zero in 2010 and 2011. When the economy is performing poorly, high current account deficits further augment the monetary union's vulnerability in the long run.

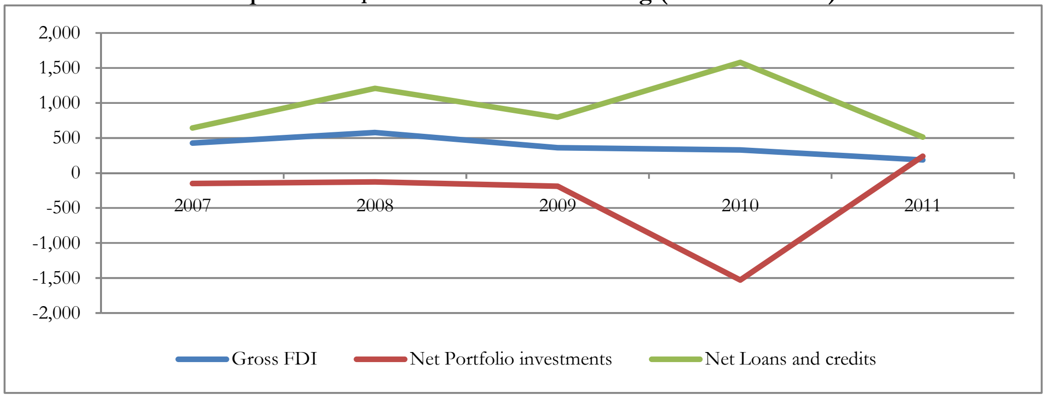
External financing can be classified in three main categories: (1) foreign direct investments, (2) portfolio investments, and (3) other investments, primarily trade credit, currency deposits, and loans. Foreign direct investment (FDI) is a category of lasting cross-border investment, associated with a resident in one country having control or a significant degree of influence in an enterprise that is resident in another country. These types of investments are considered useful and durable, because they are in buildings, machinery and equipment. Moreover, these types of investments will not be quickly reversed if market conditions and sentiments change.

In contrast to foreign direct investment, portfolio investment is of a passive nature. Portfolio investment is defined as cross-border transactions and positions involving debt or equity securities, other than those included in direct investments or reserve assets. These investments are considered indirect investments because there is no direct investment in buildings, machinery, or equipment. Portfolio investments are investments in securities, are intended for financial gain only, and do not create a lasting interest in or effective control over an enterprise.

The third and last possibility for external financing of the private sector is through other investments, a residual category that includes all financial transactions not covered in direct investment, portfolio investment, or reserve assets. These transactions are related to the utilization of assets and incurrence of liabilities, and comprise mostly loans, trade credits, and currency deposits. Loans are created through the lending of funds by a creditor (lender) directly to a debtor (borrower). The amount of a loan, the amount of interest, the repayment date, the qualification of the loan recipient to merit the loan, the credit analysis, and the number of lenders used to achieve the desired loan amount are all variable. Meanwhile, a trade credit is extended when the payment for goods and services is made at a time different from the time when the ownership of the underlying goods or services changes. Trade credit is a critical source of capital for a majority of businesses in business-to-business transactions. For many businesses, trade credit is an essential tool for financing growth. In this context, whether the financing is short or long term is also relevant. Currency deposits are denominated in foreign currency and are mostly transferable deposits exchangeable on demand.

It is interesting to look in more detail at the developments in the various categories of external financing in Curaçao and Sint Maarten during the past five years. The developments are shown in the graph below. In the case of foreign direct investments, we see that the gross FDI inflows are slowing down significantly, from well over NAf.400 million in 2007 and 2008 to NAf.186 million in 2011. This development indicates that confidence and foreign direct investment opportunities in the monetary union have declined significantly. In Curaçao and Sint Maarten, tourism and real estate projects in particular are financed through foreign direct investment.

**Graph: Development in external financing (in million NAf.)**




Net portfolio investments show a completely different picture. Before 2009, funds received from matured securities were mostly reinvested abroad due to the absence of a securities market in Curaçao and Sint Maarten and the limited opportunities for institutional investors to invest locally. So this type of external financing was not relevant for the financing of the current account. However, since the Dutch government took over the debt titles issued by the former Netherlands Antilles,[2] a large part of the funds received from matured securities were not reinvested abroad, but partly used to finance the current account deficit. This shift in net portfolio investments abroad was reinforced by the turbulence in the international financial markets and the lack of investment opportunities abroad with a limited amount of risk. Because in the coming years, more foreign debt securities will mature that will probably not be fully reinvested abroad, the portfolio investments will remain a source of current account financing in the near future. Due to the compilation methodologies, it is very difficult to estimate how much of the current account deficit is financed by these funds.

Finally, the category of other investments shows a more variable picture. This category always shows a positive sign, reflecting a structural higher amount of net loans, trade credit, and currency deposits received from abroad than extended to foreign customers. Given the permanent deficit on the current account balance, this outcome is not surprising.

However, the amount of loans, trade credit, and currency deposits received shows large fluctuations. In the last 5 years, data show that the currency deposits have been a main source of the deficit financing. Besides, the significant surge in other investments in 2010 was the result of delayed payments related to the BRK arrangement[3], reflecting dividend tax payments by Dutch companies to their parent companies in the former Netherlands Antilles, going back to 2006. In 2011, a relatively small amount of trade credits and loans were provided to local companies. This figure implies that local companies are using their foreign currency deposits to cover part of their imports.

Overall, one can conclude that the increasing current account deficit of Curaçao and Sint Maarten, combined with the shift in its financing, is not sustainable in the long run. The foreign finance needed to cover the current account deficit will increase further when international oil and food prices will continue to rise, but also as a result of considerably lower capital transfers as of 2011, because development aid from the Netherlands will be phased out. In 2011, our foreign exchange reserves declined in part because the inflow of capital transfers and external financing to the private sector was not sufficient to cover the current account deficit. A decline in foreign exchange reserves had not occurred in over 11 years. The depletion of reserves can reduce confidence in our economy. Maintaining investor confidence is essential, however, to be able to finance the current account deficit in a sustainable way in the years to come.

[1] The worsening of the current account balance in 2009 and 2010 was masked by the inflow of net current transfers related to the implementation of the debt relief program as part of the dismantling of the Netherlands Antilles. From 2011 onwards, these special net current transfers have ended.

[2] In 2010, substantial capital inflows were registered, reflecting the culmination of the debt relief program on October 10, 2010. On that date, the Dutch government took over all remaining outstanding debt of the former Netherlands Antilles.

[3] According to this arrangement, the withholding tax collected on dividends paid by Dutch companies to their parents in the Netherlands Antilles is transferred entirely to the Netherlands Antillean government.

## APPENDIX

**Table 10 Developments in stay-over tourism per island (% change) [a]**

| | Curaçao | | | | Sint Maarten | | | |
|---|---|---|---|---|---|---|---|---|
| | 2010 | | 2011 | | 2010 | | 2011 | |
| North America, of which: | 32.2 | (2.3) | 25.5 | (2.2) | -1.0 | (-0.4) | -6.5 | (-2.0) |
| -U.S.A. | 34.8 | (2.2) | 27.1 | (2.1) | -1.7 | (-0.5) | -7.3 | (-2.0) |
| Europe, of which: | 9.7 | (2.0) | 2.8 | (0.6) | 2.8 | (0.4) | 0.6 | (0.1) |
| -The Netherlands | 10.4 | (1.9) | 0.5 | (0.1) | 8.4 | (0.2) | 0.7 | (0.0) |
| South & Central America, of which: | -42.6 | (-4.1) | 28.5 | (3.4) | 21.6 | (0.4) | 12.3 | (0.2) |
| -Venezuela | -58.0 | (-3.3) | 38.6 | (2.9) | -10.7 | (0.0) | -0.6 | (0.0) |
| -Brazil | 82.3 | (0.8) | 8.3 | (0.1) | 103.4 | (0.8) | -4.7 | (0.0) |
| -Other | 8.1 | (0.2) | 15.9 | (0.5) | -3.7 | (0.0) | 38.5 | (0.3) |
| Caribbean, of which: | 7.8 | (0.4) | 6.5 | (0.3) | -5.9 | (-0.2) | -2.0 | (-0.1) |
| -Aruba | 12.5 | (0.3) | 8.5 | (0.2) | --- | --- | --- | --- |
| -Dominican Republic | 11.5 | (0.0) | 40.1 | (0.2) | -3.2 | (0.0) | 14.7 | (0.0) |
| -Other | 2.4 | (0.1) | -1.7 | (0.0) | -6.2 | (-0.2) | -4.2 | (-0.1) |
| Total | -6.8 | (-3.0) | 14.2 | (6.8) | 0.7 | (0.4) | -4.2 | (-2.2) |

Source: Curaçao Tourist Board and Sint Maarten Tourist Bureau.
[a] Weighted growth rates between brackets.

**Table 11A  Curaçao consumer prices (annual percentage change)**

| | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|
| Food | 18.4 | 9.9 | 4.6 | 7.7 |
| Beverages & tobacco | 6.3 | 5.5 | 3.5 | 2.5 |
| Clothing & footwear | 2.0 | 2.0 | -1.1 | 0.6 |
| Housing | 5.3 | -1.1 | 4.0 | 0.8 |
| Housekeeping & furnishings | 6.3 | 5.2 | 0.9 | 1.4 |
| Health | 2.5 | 1.9 | 2.2 | 0.9 |
| Transport & communication | 7.8 | -1.9 | 2.5 | 2.7 |
| Recreation & education | 2.5 | 1.8 | -0.1 | -0.1 |
| Other | 2.6 | 3.7 | 2.2 | 1.3 |
| General inflation rate | 6.9 | 1.8 | 2.8 | 2.3 |

Source: Central Bureau of Statistics

**Table 11B  Sint Maarten consumer prices (annual percentage change)**

| | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|
| Food | 13.7 | 9.3 | 3.0 | 9.1 |
| Beverages & tobacco | 7.1 | 6.1 | 2.1 | 9.8 |
| Clothing & footwear | 1.8 | 1.6 | 0.4 | 1.5 |
| Housing | 5.6 | -1.9 | 5.8 | 4.6 |
| Housekeeping & furnishings | 2.3 | 4.5 | 1.1 | 3.6 |
| Health | 0.2 | 1.4 | 0.7 | 0.1 |
| Transport & communication | 2.3 | -1.3 | 1.3 | 4.7 |
| Recreation & education | -0.2 | 0.3 | 0.8 | 1.4 |
| Other | 2.1 | 2.8 | 1.9 | 3.1 |
| General inflation rate | 4.6 | 0.7 | 3.2 | 4.6 |

Source: Department of Statistics, Sint Maarten

**Table 12A Budgetary overview of Curaçao (in millions NAf.)**

| | **2011** |
|---|---|
| Revenues | 1,556.9 |
| Tax revenues, of which: | 1,414.6 |
| Taxes on income and profits | 701.3 |
| Taxes on property | 47.7 |
| Taxes on goods and services | 478.9 |
| Taxes on international trade and transactions | 181.3 |
| Other taxes | 5.3 |
| Nontax and other revenues | 142.3 |
| | |
| Expenditures | 1,726.2 |
| Current expenditures, of which: | 1,694.5 |
| Wages and salaries | 566.7 |
| Goods and services | 400.8 |
| Subsidies | 46.5 |
| Transfers | 583.2 |
| Interest payments | 49.8 |
| Other expenditures | 47.6 |
| Capital expenditures | 31.7 |
| | |
| Budget balance | -169.3 |

**Table 12B Overview of selected tax revenues of Curaçao (in millions NAf.)**

| | **2011** |
|---|---|
| Taxes on income and profits, of which: | 701.3 |
| Profit tax | 198.5 |
| Wage tax | 504.4 |
| Taxes on property, of which: | 47.7 |
| Land tax | 26.1 |
| Property transfer tax | 18.3 |
| Taxes on goods and services, of which: | 478.9 |
| Sales tax | 311.9 |
| Excises, of which: | 101.1 |
| Excise on gasoline | 67.0 |
| Motor vehicle tax | 39.3 |
| Taxes on international trade and transactions, of which: | 181.3 |
| Import duties | 108.4 |

**Table 13A Budgetary overview of Sint Maarten (in millions NAf.)**

| | 2011 |
|---|---|
| Revenues | 404.6 |
| Tax revenues, of which: | 343.9 |
| Taxes on income and profits | 156.6 |
| Taxes on property | 20.5 |
| Taxes on goods and services | 166.8 |
| Nontax and other revenues | 60.7 |
| | |
| Expenditures | 403.5 |
| | |
| Budget balance | 1.1 |

**Table 13B Overview of selected tax revenues of Sint Maarten (in millions NAf.)**

| | 2011 |
|---|---|
| Taxes on income and profits, of which: | 156.6 |
| Profit tax | 34.5 |
| Wage tax | 124.9 |
| Taxes on property, of which: | 20.5 |
| Land tax | 4.1 |
| Property transfer tax | 16.4 |
| Taxes on goods and services, of which: | 166.8 |
| Turnover tax | 112.9 |
| Vehicle tax | 8.5 |
| Excise on gasoline | 9.8 |

**Table 14  Detailed overview of balance of payments (in millions NAf.)**

| | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|
| Trade balance | -3,563.2 | -3,216.5 | -3,359.0 | -3,236.6 |
| -Exports | 1,948.3 | 1,449.9 | 1,451.3 | 1,888.6 |
| -Imports | 5,511.5 | 4,666.4 | 4,810.2 | 5,125.2 |
| | | | | |
| Services balance | 2,118.3 | 1,979.4 | 1,765.6 | 1,994.4 |
| Receipts, of which: | 3,678.3 | 3,643.4 | 3,457.3 | 3,850.7 |
| -Travel | 2,081.2 | 1,939.5 | 2,024.7 | 2,098.7 |
| -Transportation | 290.6 | 311.3 | 324.2 | 317.6 |
| -Other services, of which: | 1,306.5 | 1,392.6 | 1,108.4 | 1,434.4 |
| - Int. fin. & bus. services sector | 302.9 | 313.0 | 256.3 | 191.7 |
| Expenses, of which: | 1,559.7 | 1,664.1 | 1,689.8 | 1,856.4 |
| -Travel | 535.0 | 530.8 | 558.6 | 637.3 |
| -Transportation | 211.9 | 282.9 | 304.0 | 305.8 |
| -Other services, of which: | 812.8 | 850.4 | 827.2 | 913.3 |
| - Int. fin. & bus. services sector | 116.3 | 131.3 | 126.1 | 106.6 |
| | | | | |
| Income balance [a] | -74.1 | -172.9 | -95.2 | -94.8 |
| Current transfers balance [b] | 5.1 | 801.5 | 258.9 | -180.2 |
| - Profit taxes | 156.8 | 153.9 | 79.5 | 44.1 |
| **Current account balance** | **-1,513.9** | **-608.5** | **-1,427.7** | **-1,517.2** |
| | | | | |
| **Capital & financial account balance [c]** | **1,411.7** | **474.5** | **1,329.5** | **1,463.6** |
| | | | | |
| **Net errors & omissions** | **102.2** | **133.9** | **98.2** | **53.6** |

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

**Table 15 Breakdown of net changes in the financial account (in millions NAf.)**

| | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|
| Direct investment | 449.0 | 196.4 | 228.6 | 57.2 |
| - Abroad [a] | -27.0 | -12.9 | -32.8 | 20.7 |
| - In the Netherlands Antilles [b] | 476.0 | 209.3 | 261.4 | 36.5 |
| | | | | |
| Portfolio investment [a] | -126.2 | -188.9 | -1,529.0 | 241.2 |
| | | | | |
| Other investment, of which: | 1,215.7 | 805.4 | 1,591.1 | 541.6 |
| - Assets [a] | 1,218.4 | 842.6 | 1,310.3 | 401.2 |
| - Liabilities [b] | -2.6 | -37.2 | 280.8 | 140.4 |
| | | | | |
| Net lending/borrowing, of which: | 183.8 | -10.6 | 288.6 | 163.1 |
| - Assets [a] | 270.3 | 113.2 | 40.9 | 65.4 |
| - Liabilities [b] | -86.5 | -123.8 | 247.7 | 97.7 |
| | | | | |
| Reserves [c] | -371.6 | -539.1 | -162.2 | 506.9 |
| | | | | |
| Total assets [a] | 693.7 | 101.6 | -413.7 | 1,170.0 |
| Total liabilities [b] | 473.4 | 172.1 | 542.2 | 176.9 |
| | | | | |
| Balance | 1,167.0 | 273.8 | 128.3 | 1,346.9 |

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 16 Monetary survey (in millions NAf.)**

| | 2008 | 2009 | 2010 1) | 2011 |
|---|---|---|---|---|
| **Money supply (M2)** | 6,857.8 | 7,458.2 | 7,216.5 | 7,308.2 |
| | | | | |
| **Money (M1)** | 2,896.4 | 3,266.9 | 3,131.2 | 3,148.8 |
| Coins & notes with the public | 315.1 | 334.1 | 320.6 | 301.3 |
| Total demand deposits, of which : | 2,581.3 | 2,932.8 | 2,810.6 | 2,847.5 |
| - Netherlands Antillean guilders | 1,923.3 | 2,265.0 | 2,218.6 | 2,174.7 |
| - Foreign currency | 658.0 | 667.8 | 592.0 | 672.8 |
| | | | | |
| **Near money** | 3,961.4 | 4,191.3 | 4,085.3 | 4,159.4 |
| Time deposits | 2,241.4 | 2,175.3 | 2,186.6 | 2,266.4 |
| Savings | 1,720.0 | 2,016.0 | 1,898.7 | 1,893.0 |
| | | | | |
| **Factors affecting the money supply** | 6,857.8 | 7,458.2 | 7,216.5 | 7,308.1 |
| | | | | |
| **Net domestic assets** | 4,257.2 | 4,225.9 | 2,696.0 | 3,230.5 |
| General government | 702.1 | 222.1 | -705.2 | -621.6 |
| - Central government | 428.4 | 238.2 | -112.2 | -106.5 |
| - Island governments | 273.7 | -16.1 | -593.0 | -515.1 |
| Private sector | 5,091.4 | 5,634.0 | 5,546.5 | 6,158.7 |
| | | | | |
| **Net foreign assets** | 2,600.6 | 3,232.3 | 4,520.5 | 4,077.6 |
| Central bank | 2,010.7 | 2,188.9 | 2,906.4 | 2,886.4 |
| Commercial banks | 589.9 | 1,043.4 | 1,614.1 | 1,191.3 |
| | | | | |
| **Memorandum items** | -1,536.3 | -1,630.2 | -2,145.4 | -2,306.6 |
| | | | | |
| **Government loans by commercial banks** | 722.2 | 523.9 | 0.2 | 0.1 |
| - Central government | 402.8 | 322.5 | 0.0 | 0.0 |
| - Island governments | 319.4 | 201.4 | 0.2 | 0.1 |
| | | | | |
| **Private sector loans Leeward Islands** | 3,388.4 | 3,649.4 | 3,524.0 | 3,839.3 |
| - Mortgages | 1,269.2 | 1,477.9 | 1,394.1 | 1,628.2 |
| - Consumer loans | 899.7 | 935.4 | 943.9 | 954.9 |
| - Business loans | 1,219.6 | 1,236.0 | 1,186.0 | 1,256.3 |
| | | | | |
| **Private sector loans Windward Islands** | 1,410.2 | 1,567.1 | 1,581.8 | 1,544.0 |
| - Mortgages | 515.6 | 667.1 | 661.7 | 648.2 |
| - Consumer loans | 377.4 | 381.7 | 391.5 | 379.4 |
| - Business loans | 517.2 | 518.4 | 528.6 | 516.4 |

1) Excluding the BES islands (i.e., Bonaire, Sint Eustatius, and Saba)

**Table 17 Developments in domestic interest rates (in %)**

| | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|
| **Central bank** | | | | |
| - Pledging rate | 1.0 | 1.0 | 1.0 | 1.0 |
| - Maximum CD rate (1-month) | 0.57 | 0.16 | 0.17 | 0.17 |
| **Commercial bank borrowing rates** | | | | |
| - Passbook savings | 2.2 | 2.0 | 1.1 | 1.1 |
| - Time deposit (12-month) | 3.8 | 1.8 | 1.7 | 2.1 |
| **Commercial bank lending rates** | | | | |
| - Mortgages | 8.3 | 7.4 | 6.7 | 7.3 |
| - Time loans | 8.2 | 9.6 | 8.8 | 8.3 |
| **Government securities** | | | | |
| - 5-year government bonds (effective yield) | 5.9 | 4.3 | 2.4 | 1.4 |
| - Treasury bills (1-month) | 4.4 | 0.6 | 1.0 | 1.0 |

**Table 18 Aggregate balance sheet for domestic commercial banks (in millions NAf.)**

| | 2008 | 2009 | 2010[1)] | 2011 |
|---|---|---|---|---|
| **Assets** | | | | |
| Non-interest-bearing cash | 1,092.2 | 1,568.1 | 1,441.7 | 1,506.3 |
| Interest-bearing cash | 2,938.6 | 3,257.5 | 2,884.8 | 2,426.9 |
| Investments | 1,508.8 | 1,357.4 | 1,461.9 | 1,540.1 |
| Loans | 7,125.5 | 7,617.7 | 8,106.2 | 8,451.4 |
| Investments in unconsolidated subsidiaries and affiliates | 175.9 | 58.5 | 123.6 | 69.7 |
| Fixed assets | 277.7 | 296.5 | 333.8 | 355.5 |
| Other assets | 279.8 | 235.1 | 295.5 | 307.8 |
| | | | | |
| Total assets | 13,398.5 | 14,390.8 | 14,647.6 | 14,657.8 |
| | | | | |
| **Liabilities** | | | | |
| Demand deposits | 4,571.2 | 5,590.6 | 5,215.6 | 5,673.1 |
| Savings deposits | 3,896.3 | 4,131.5 | 4,211.8 | 4,016.1 |
| Time deposits | 3,003.1 | 2,763.0 | 3,105.8 | 2,724.1 |
| Total deposits | 11,470.7 | 12,485.1 | 12,533.2 | 12,413.3 |
| Borrowings | 130.4 | 49.4 | 99.5 | 31.1 |
| Other liabilities | 462.7 | 396.0 | 427.6 | 531.6 |
| | | | | |
| Total liabilities | 12,063.8 | 12,930.4 | 13,060.3 | 12,976.1 |
| | | | | |
| Minority interest | 8.5 | 8.6 | 9.3 | 10.2 |
| Subordinated debentures | 0.0 | 0.0 | 0.0 | 0.0 |
| General provisions | 201.8 | 223.5 | 266.4 | 282.1 |
| Capital & reserves | 1,124.5 | 1,228.3 | 1,311.5 | 1,389.3 |
| | | | | |
| Total capital | 1,334.7 | 1,460.4 | 1,587.2 | 1,681.7 |
| | | | | |
| Total liabilities and capital | 13,398.5 | 14,390.8 | 14,647.6 | 14,657.8 |

1) Excluding the BES islands (i.e., Bonaire, Sint Eustatius, and Saba)

**Table 19 Aggregate income statement for domestic commercial banks (in millions NAf.)**

| | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|
| Interest income | 766.7 | 738.9 | 713.9 | 712.2 |
| Interest expenses | 252.7 | 215.1 | 164.0 | 140.2 |
| **Net interest income** | 513.9 | 523.8 | 549.9 | 572.0 |
| | | | | |
| Other income | 303.4 | 288.2 | 274.2 | 297.8 |
| **Total operational income** | 817.3 | 811.9 | 824.2 | 869.7 |
| | | | | |
| Salaries & other employee expenses | 296.1 | 297.3 | 308.6 | 335.8 |
| Occupancy expenses | 95.4 | 100.1 | 95.1 | 99.9 |
| Other operating expenses | 126.2 | 126.4 | 132.2 | 138.8 |
| Net addition to general provisions | 34.6 | 52.6 | 69.6 | 49.8 |
| **Total operational expenses** | 552.2 | 576.4 | 605.6 | 624.3 |
| | | | | |
| Net operating income | 265.1 | 235.5 | 218.6 | 245.4 |
| Net extraordinary items | 33.2 | 25.5 | 36.0 | 42.3 |
| Applicable profit taxes | 58.8 | 50.1 | 42.4 | 43.1 |
| **Net income after taxes** | 239.5 | 211.0 | 212.2 | 244.6 |

# 4 DOMESTIC FINANCIAL MARKET DEVELOPMENTS

## 4.1 Introduction

Towards the end of 2008, the Fed funds rate declined from 1% to a range of 0% - 0.25% and remained within that range during 2009-2011. Given the close ties between the United States and domestic financial markets, due to the peg of the Netherlands Antillean guilder to the dollar, the Bank's official lending rate was reduced from 1.75% to 1.00% at the end of 2008 and remained at this historically low level during 2009 - 2011.

In addition to the international developments, local financial market developments were dominated by the impact of the debt relief offered by the Dutch government as part of the constitutional changes. The subscription possibility of the Dutch State Treasury Agency in local government securities puts interest rates under pressure. The Agency subscribes at interest rates prevailing in the Netherlands, which are considerably lower than those common in Curaçao and Sint Maarten. Local investors usually use the US Treasury or US agency interest rates as references for AAA investments. The subscription possibility of the State of the Netherlands through the Dutch State Treasury Agency will be in effect for 5 years after October 10, 2010, the date of the constitutional changes. Only the government of Sint Maarten issued a bond in 2011.

## 4.2 Financial instruments and the money market

Certificates of deposit (CDs) issued by the Bank are among the few tradable nongovernmental instruments available in the local money market. CDs are a monetary tool the Bank uses to control the liquidity in the local money market through bimonthly auctions held according to a set schedule. Commercial banks did not trade in CDs in the secondary market in 2011, preferring to use uncollateralized interbank instruments.

As indicated in Table 20, the average balance of outstanding CDs decreased throughout 2011 to NAf.47.2 million, NAf.18.8 million (28.5%) lower than the average outstanding CD balance in 2010. During 2011, most of the auctions were oversubscribed because of the excess liquidity in the money market.

The average outstanding balance of the non-interest-bearing reserve requirement decreased by NAf.32.2 million (5.6%) to NAf.540.7 million in 2011. The base amount on which the reserve requirement is calculated equals the commercial banks' domestic debt excluding interbank and long-term deposits. The reserve requirement percentage was raised as of September 16, 2011, until the end of the year from 7.50% to 10.50% as a result of a tightening of monetary policy.

Bank liquidity increased in 2011 compared to 2010, reflected by a 26.9% rise in the average outstanding balance of demand deposits with the central bank to NAf.511.3 million. The debt relief and the volatility of the international securities markets are the main causes of the high liquidity of the banking sector.

**Table 20 Average outstanding balances of certificates of deposit, non-interest-bearing reserve requirement, and demand deposits of commercial banks with the central bank (in millions NAf.)**

| | 2009 | 2010 | 2011 | % change 2010-2011 |
|---|---|---|---|---|
| Certificates of deposit | 88.5 | 66.0 | 47.2 | -28.5 |
| Non-interest-bearing reserve requirement | 694.3 | 572.9 | 540.7 | -5.6 |
| Demand deposits | 235.5 | 402.8 | 511.3 | 26.9 |
| Total | 1,018.4 | 1,041.7 | 1,099.2 | 5.5 |

During 2011, neither the government of Curacao nor the government of Sint Maarten issued any treasury bills. Under the debt relief program, all outstanding treasury bills were redeemed.

Financial market information is provided to market participants on a monthly basis to enhance market transparency. The financial market information provides data, including the indicative prices of securities, the local yield curve, the net debt position of the governments, and the maturity schedule. Market transparency is intended to promote activity in the secondary market.

Nevertheless, activities in the secondary market continued at a very slow pace during 2011 even though the Netherlands started to service the government bonds taken over and only one government bond was issued. Investors were holding on to their local government securities because after the constitutional restructuring, the AAA-rated Dutch government would become the debtor of these relatively high-yielding securities.

## 4.3 The market for government securities

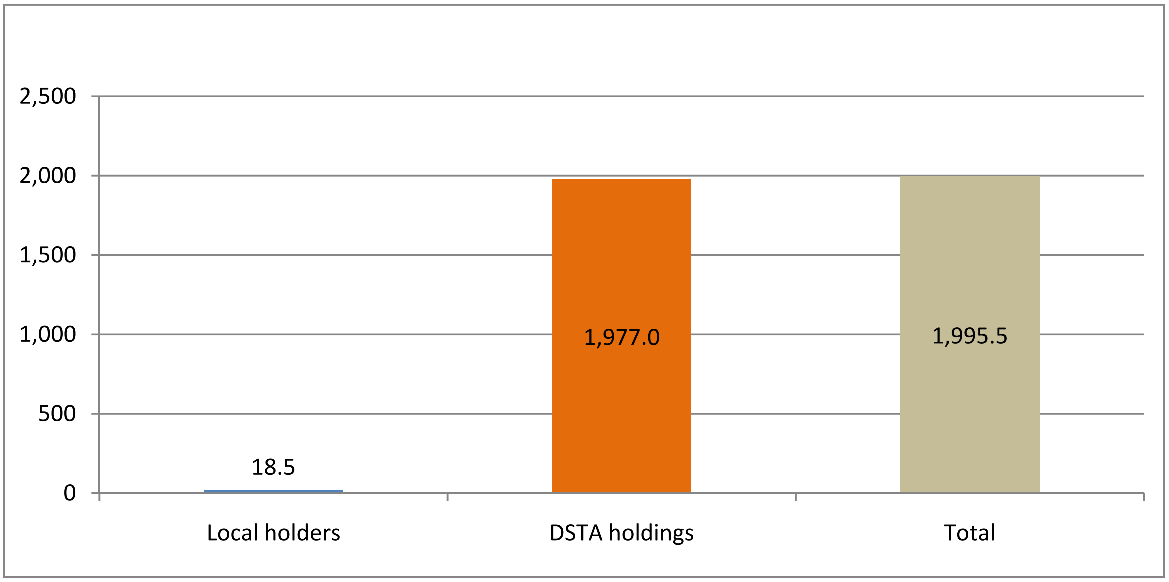
During 2011, the prevailing yield in the local government securities market remained very low, similar to the yield in the Netherlands. A 1-year bond had an average yield of 1.42% and a 3-years bond 1.74%. The average yields for 5-, 10-, 15-, and 20-year bonds were 2.31%, 3.04%, 3.34%, and 3.42%, respectively.

In 2011, only one government bond was issued. On October 12, 2011, the government of Sint Maarten issued a 1.50% 5-year bond totaling NAf.26.0 million with a yield of 1.43%. Because of the low yield, local investors did not subscribe, and the entire issue was allotted to the Dutch State Treasury Agency.

## 4.4 Composition of issued debt securities

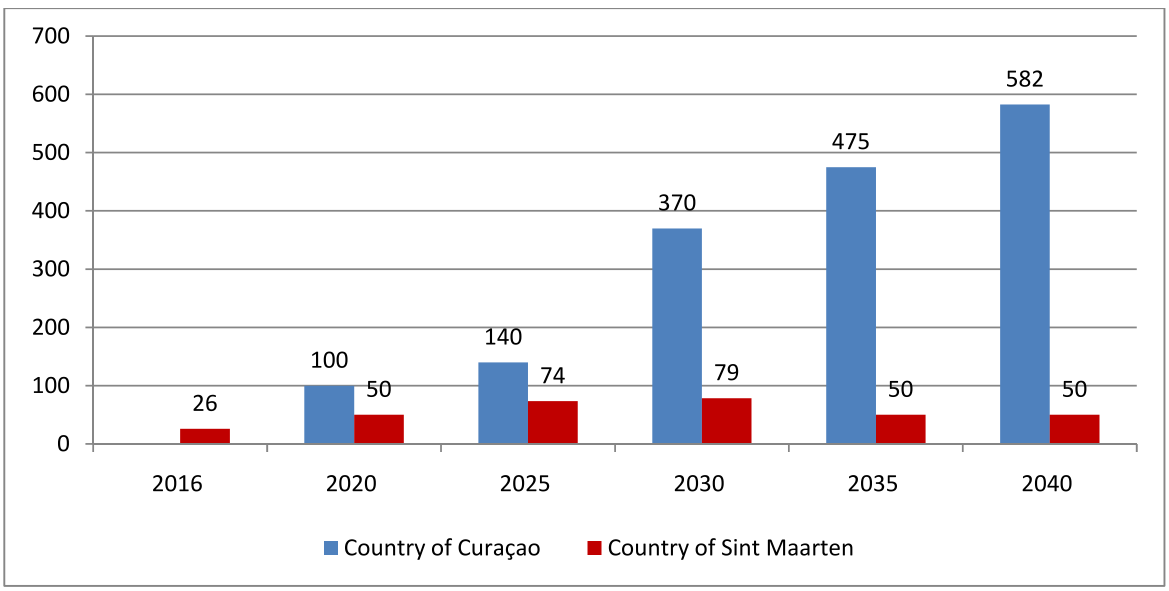
As indicated in Graph 2, the outstanding securities issued by the countries of Curacao and Sint Maarten were almost entirely in the portfolio of the Dutch State Treasury Agency (99%). Local investors considered the coupons and yields too low for their investment appetite. Most institutional investors demand a return of at least 4% on their investments. However, because of the subscription by the Dutch State Treasury Agency, the bonds carried the prevailing yield in the Dutch capital market.

**Graph 2 Government bond holdings as per December 31, 2011 (in millions NAf.)**




Graph 3 provides an overview of the amounts of outstanding bonds of the governments of Curaçao and Sint Maarten that will mature up to 2040.

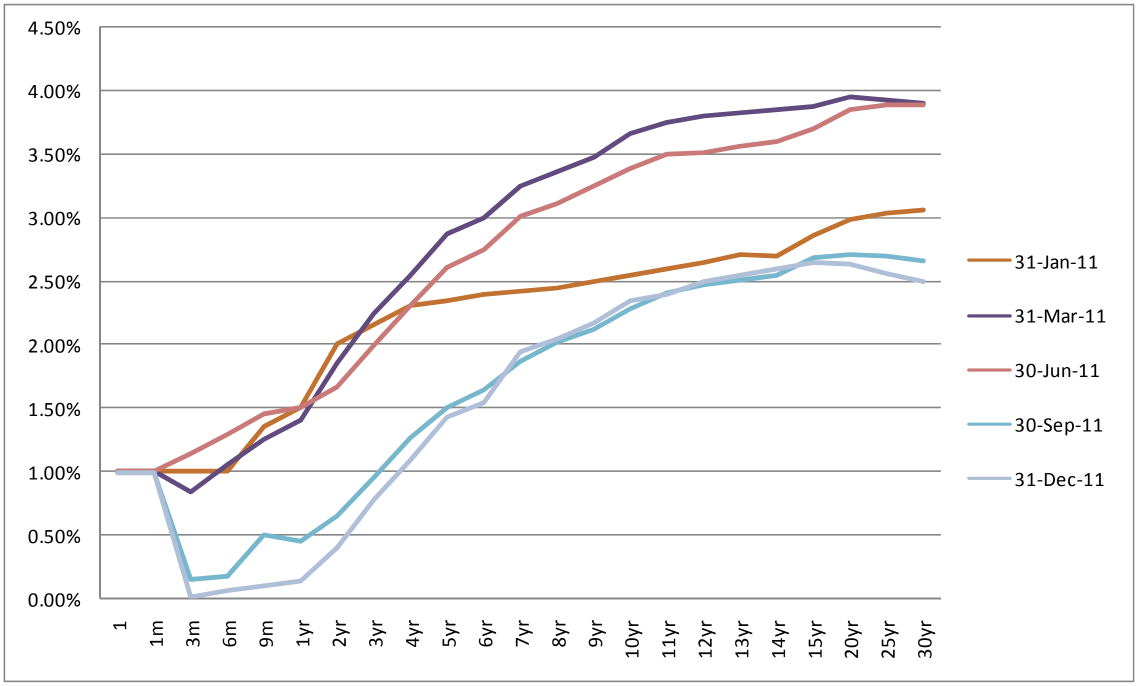
**Graph 3 Maturity schedule for government bonds (in millions NAf.)**




### 4.5 Domestic yield curve developments

The local yield curve experienced an upward shift in the first quarter of 2011 but shifted downward during the subsequent quarters (see Graph 4). The subscription by the Dutch State Treasury Agency on the issues of local government paper at yields prevalent in the Dutch capital market contributed in particular to the low local yield.

**Graph 4  Development in the yield curve for local government securities**



# 5 INSTITUTIONAL INVESTORS

## 5.1 Introduction

Globally, business conditions are getting tougher, which is also the case for the economies of Curacao and Sint Maarten. A more difficult business environment goes hand in hand with increased risk. Therefore, undertaking a proper evaluation of risk exposure and its management is an important aspect of day to day business, since even the best managed businesses can suffer major losses that are beyond their control. A suitable risk management program can prevent or minimize the impact of these losses, lessening the strain on a business. Such a program could include transferring the costs associated with risks, thereby reducing the possibility of affecting business activities. For example, taking on adequate insurance coverage is even more important in economically less favorable periods.

The past couple of years have been rather dramatic, as the turmoil in the financial markets resulted in a global financial crisis in the third quarter of 2008. Although a number of circumstances have been identified that contributed to this financial crisis, it will probably take some time before a complete picture emerges of the causes and impact of the crisis.

As a consequence of the financial crisis, supervision has been tightened, increasing its effectiveness. The aim of tighter supervision is to increase the stability and resilience in the financial markets and to reduce the risk of future financial crises. The Bank is also aware of the need to tighten its supervisory regime regarding the insurance companies, pension funds, and insurance intermediaries under its supervision. To that aim, cooperation has been intensified with the other supervisory authorities within the Kingdom of the Netherlands, i.e., De Nederlandsche Bank (DNB), the Autoriteit Financiële Markten (AFM), and the Centrale Bank van Aruba (CBA).

As another consequence of the global financial crisis, new core principles for insurance have been adopted by the International Association of Insurance Supervisors (IAIS). The IAIS's insurance core principles, standards, guidance and assessment methodology (ICP) form the globally accepted framework for evaluating national insurance regimes. The new ICP is based on developments that occurred in insurance markets and supervision since its last revision in 2003. The Basel, Switzerland-based IAIS adopted the revised principles in October 2011. Together with some 140 other countries, Curacao and Sint Maarten are also a member of the IAIS through the Bank.

The 2011 Atlantic hurricane season qualified as one of the most active seasons in recorded history, as an above-average number of 19 tropical storms were formed. However, the 7 actual hurricanes that developed, which included 4 major ones, were a near normal number.

On March 11, 2011, a massive earthquake hit Japan and caused a devastating tsunami. This disaster proved to be the most costly ever from a human, insurance, and economic perspective, killing nearly 16,000 people and causing an estimated US$35 billion insured loss and US$210 billion economic loss. While the suffering from the earthquake and tsunami was limited mainly to Japan, the economic aftershocks will be felt worldwide. Many companies, especially in the United States, suffered serious economic consequences. Damage to Japanese manufacturing facilities, roads, railroads, and ports resulted in unfulfilled orders for products and component parts, forcing companies to find alternative suppliers and pay higher prices. In addition, some companies temporarily lost access to markets in Japan. Meanwhile in 2011, New Zealand was struck by two separate heavy earthquakes in the greater Christchurch region that produced a combined insured loss of US$15 billion.

With approximately US$ 108 billion in insured catastrophe losses, 2011 ranks as one of the most expensive years for the insurance industry, second only to 2005 (US$ 123 billion). Moderate hurricane losses in 2011 kept costs lower than in 2005, the year when hurricanes Katrina, Wilma, and Rita alone caused claims of over US$ 100 billion. The total disaster-related economic losses (both insured and uninsured) in 2011 reached an estimated US$ 350 billion.

In 2011, the European Commission introduced guidelines for insurance companies preventing insurers from charging different premium rates for men and women. The guidelines followed a court order by the European Court of Justice forbidding discrimination based on gender in calculating the premium rate. Applying different premiums had been a common practice, especially in the life and motor vehicle damage segments, since long-term data has shown a considerably shorter life span, higher probability of death at a certain age, and an increased frequency of accidents for men. The Bank monitors these developments and is considering whether the same principle should be applied in the insurance market of Curacao and Sint Maarten.

Solvency II is the new regime for all insurers and reinsurers in the European Union, scheduled to come into effect in January 2013. The aim of Solvency II is to implement solvency requirements that are expected to better reflect the risks that insurance companies face. The new regime is designed so that insurers understand the inherent business risks in the industry and the allocation of sufficient capital to cover these risks. Compliance with the Solvency II requirements should improve the safety and soundness of the 5,000 insurers and reinsurers in the European Economic Area.

However, a Solvency II quantitative study conducted between August and November 2010--the so-called QIS5--showed that the system is too complex, particularly for small- to medium sized insurers. Additional studies will be conducted that introduce simplifications to the standard formula for these insurers when determining their solvency. The Bank is also performing the necessary studies on how the Solvency II requirements will be implemented in the local insurance market.

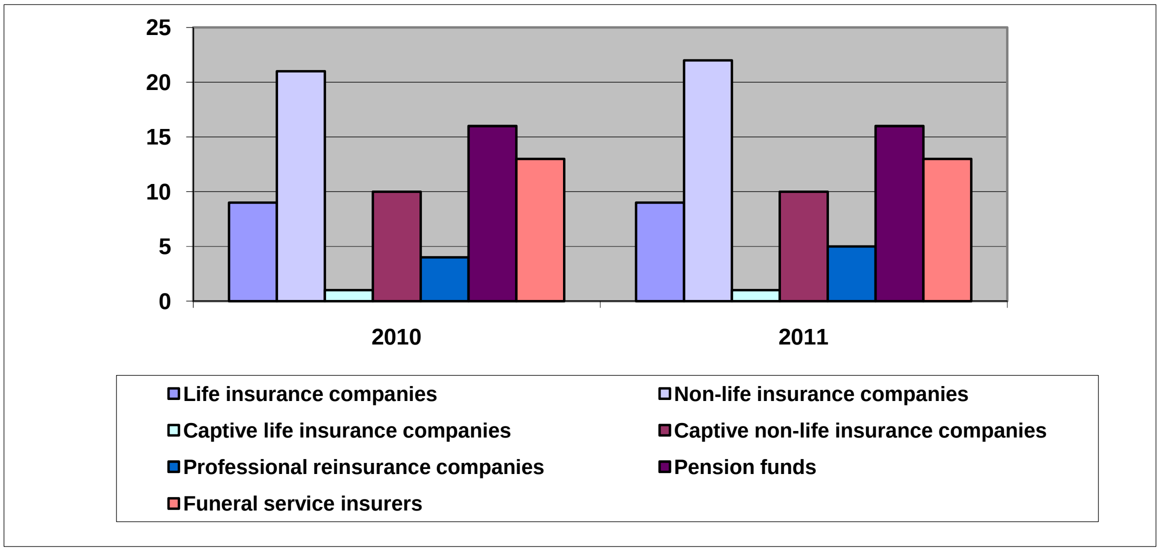
Pension funds are large institutional investors and, hence, subject to investment risks. The pension sector also experienced difficult times the last couple of years. As a consequence of the financial crisis, some pension funds lost a substantial amount of their reserves. As the stock markets recuperated afterwards, these losses were mostly eliminated. However, pension funds also are confronted with low interest rates, forcing them to have more cash funds in place. To maintain the coverage level at or above the legal requirements, several pension funds were forced to adapt their pension arrangements, e.g., increase the pension age.

### 5.2 The institutional investors' sector

The number of institutional investors operating in Curaçao and Sint Maarten in 2011 was 59 (2010: 59): 9 life insurance companies (2010: 9), 22 non-life insurance companies (2010: 21), 13 funeral service insurers (2010: 13), and 15 pension funds (2010: 16).

The number of insurance companies servicing the international market was 16 at the end of 2011 (2010: 16): one was involved in the life insurance business, 10 in the non-life business, and 5 were professional reinsurers (see Graph 5).

**Graph 5  Composition of the institutional investors' sector (number of companies)**




Graph 5 does not include insurance companies and pension funds in the process of liquidation. However, these institutions remain subject to Bank supervision until they are completely liquidated.

At the end of 2011, the number of insurance intermediaries registered with the Bank was 62, and 3 applications were in process.

## 5.3 Life insurance industry

### *5.3.1 Balance sheet*

According to Table 21, the total assets of the local life insurance sector increased by NAf.147.4 million (7.1%) in 2010, reaching NAf.2.2 billion. The equity position of the local life insurance companies, consisting of capital, surplus, and subordinated instruments increased by NAf.23.4 million (9.9%) in 2010. This increase was driven mainly by the sector's net profit of NAf.38.3 million in 2010 (see Table 22).

In 2010, the solvency requirement of the local life insurance sector on a consolidated basis was NAf.56.9 million, while the equity available to cover the solvency requirement amounted to NAf.259.3 million. Based on these figures, the sector had a solvency surplus of NAf.202.4 million in 2010, an improvement compared to the solvency surplus of NAf.163.8 million in 2009.

The total assets of the international life insurance companies (i.e., captive insurance companies and professional reinsurers) increased by NAf.8.9 million (9.7%) in 2010. The solvency requirement of the international life insurance sector on a consolidated basis amounted to NAf.2.4 million in 2010. The equity available to cover the solvency requirement was NAf.18.0 million, resulting in a solvency surplus of NAf.15.6 million.

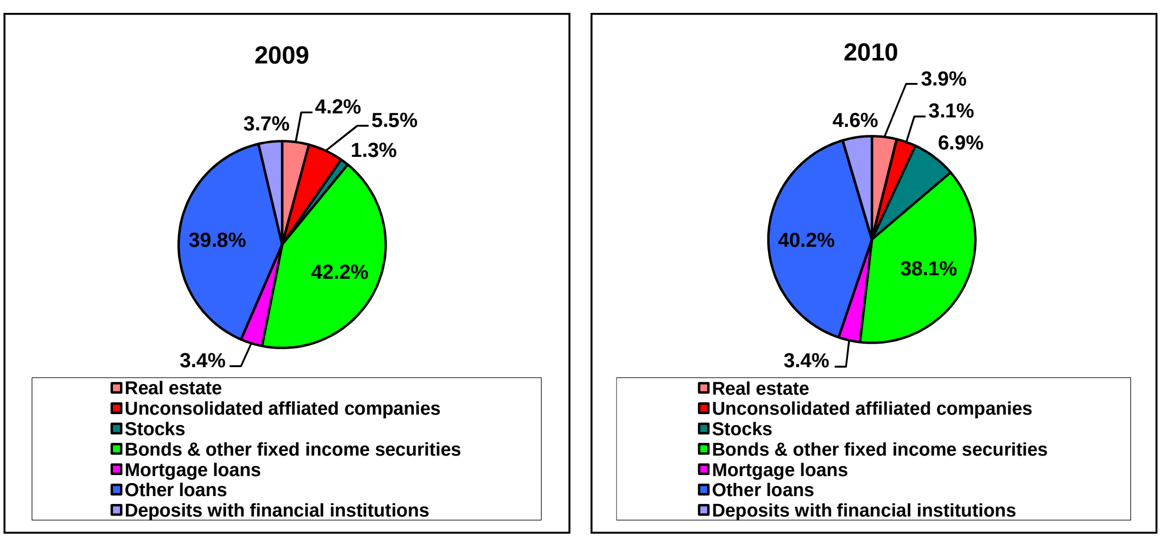
**Table 21 Consolidated balance sheet of the life insurance sector (in millions NAf.)**

| | 2008 | | 2009 | | 2010 | |
|---|---|---|---|---|---|---|
| | Local | Int'l | Local | Int'l | Local | Int'l |
| ASSETS | | | | | | |
| Intangibles | 1.2 | - | 1.2 | - | 1.2 | - |
| Total investments | 1,882.9 | 72.1 | 1,653.1 | 82.4 | 1,774.3 | 95.1 |
| Current assets | 252.1 | 5.8 | 183.8 | 9.4 | 190.7 | 5.6 |
| Other assets | 48.9 | - | 44.2 | - | 50.1 | - |
| From separate accounts statement | 188.0 | - | 199.1 | - | 212.5 | - |
| Total admissible assets | 2,373.1 | 77.9 | 2,081.4 | 91.8 | 2,228.8 | 100.7 |
| EQUITY, PROVISIONS, AND LIABILITIES | | | | | | |
| Capital | 78.9 | 1.0 | 80.9 | 1.0 | 80.9 | 1.0 |
| Surplus | 121.6 | 9.0 | 155.7 | 8.7 | 179.1 | 17.0 |
| Subordinated instruments | 0.3 | - | 0.4 | - | 0.4 | - |
| Technical provisions | 1,894.4 | 72.4 | 1,574.3 | 80.1 | 1,684.1 | 82.1 |
| Current liabilities | 73.0 | 3.8 | 55.0 | 3.6 | 51.3 | 2.6 |
| Other liabilities | 6.0 | -8.3 | 6.1 | -1.6 | 9.7 | -2.0 |
| Contingent liabilities | 10.9 | - | 9.9 | - | 10.8 | - |
| From separate accounts statement | 188.0 | - | 199.1 | - | 212.5 | - |
| Total equity, provisions, and liabilities | 2,373.1 | 77.9 | 2,081.4 | 91.8 | 2,228.8 | 100.7 |

### *5.3.2 Investments*

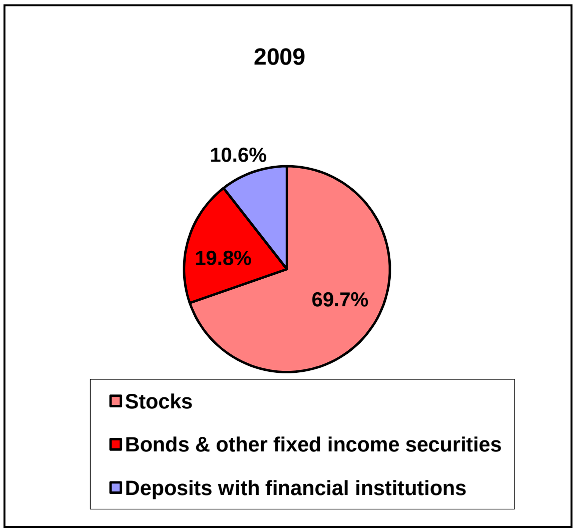
Total investments of the local life insurance sector increased by NAf.121.2 million (7.3%) in 2010. The composition of the consolidated 2009 and 2010 investment portfolios of the local life insurance companies is presented in Graph 6. This graph indicates that the proportion of bonds & other fixed income securities, investments in real estate, and unconsolidated affiliated companies decreased by 4.1, 0.3, and 2.4 percentage points, respectively, from 2009 to 2010, while the proportion of investments in stocks, other loans, and deposits with financial institutions increased by 5.6, 0.3, and 0.9 percentage points, respectively. The investments in subsidiaries are reported under unconsolidated affiliated companies.

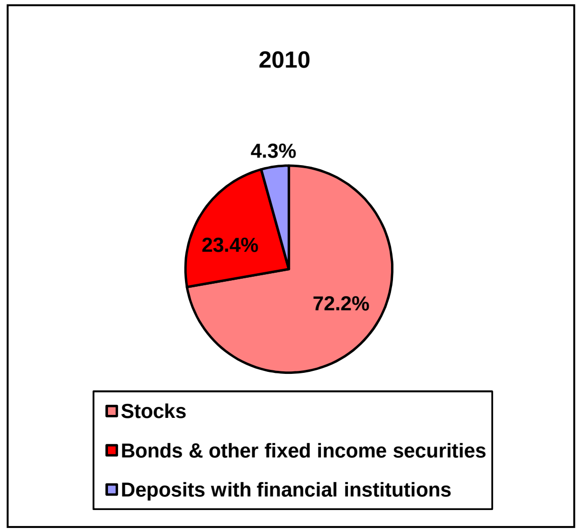
**Graph 6 Composition of the investment portfolio of the local life insurance sector**



The composition of the consolidated 2009 and 2010 investment portfolios of the international life insurance companies is presented in Graph 9. This investment portfolio is not as diversified as that of the local life insurance companies as it consists only of stocks, bonds, and deposits with financial institutions. Graph 7 indicates that the international life insurance companies have investments mainly in stocks, the share of which increased from 69.7% in 2009 to 72.2% in 2010.

**Graph 7 Composition of the investment portfolio of the international life insurance sector**




### *5.3.3 Profit and loss statement*

The operating results of the life insurance industry are presented in Table 22. Total net premium income of the local life insurance companies increased by NAf.15.2 million (8.6%), and this sector reported a total operational income of NAf.309.7 million in 2010. Total operational expenditures increased by NAf.9.1 million (3.4%) in 2010 to a total of NAf.273.6 million. The sector ended 2010 with a net profit of NAf.38.3 million, an increase of NAf.9.5 million (33.0%) compared to 2009.

The year 2010 also was a relatively good year for the international life insurance industry, reporting a positive net result of NAf.9.4 million. This positive result was due mainly to the net unrealized gains reported in 2010.

**Table 22 Consolidated profit and loss statement of the life insurance sector (in millions NAf.)**

| | 2008 | | 2009 | | 2010 | |
|---|---|---|---|---|---|---|
| | **Local** | **Int'l** | **Local** | **Int'l** | **Local** | **Int'l** |
| INCOME | | | | | | |
| Total net premium income | 256.9 | 9.8 | 176.2 | 8.2 | 191.4 | 10.4 |
| Net investment income and realized capital gains and losses | 124.0 | 1.5 | 118.5 | 1.6 | 112.5 | -0.3 |
| Net other operational income | 14.9 | 0.3 | 0.2 | 0.1 | 5.8 | 0.1 |
| Total operational income | 395.8 | 11.6 | 294.9 | 9.9 | 309.7 | 10.2 |
| EXPENSES | | | | | | |
| Net benefits incurred | 103.1 | 3.8 | 99.9 | 4.9 | 103.4 | 4.3 |
| Changes in net technical provisions | 178.8 | 4.8 | 101.2 | 4.5 | 97.5 | 5.8 |
| Net operational expenditures | 66.7 | 0.7 | 53.3 | 0.8 | 58.1 | 0.8 |
| Net other operational expenditures | 1.6 | 0.2 | 0.9 | 0.1 | 1.1 | 0.1 |
| Other changes affecting net results | -0.4 | 0.1 | - | -0.1 | 0.8 | -0.1 |
| Profit sharing to policyholders | 26.6 | 2.8 | 9.2 | 0.8 | 12.7 | -3.8 |
| Total operational expenditures | 376.4 | 12.4 | 264.5 | 11.0 | 273.6 | 7.1 |
| Extraordinary results | 1.6 | - | -0.8 | - | 2.3 | - |
| Net operational result before corporate taxes and before net results from separate accounts | 21.0 | -0.8 | 29.6 | -1.1 | 38.4 | 3.1 |
| Corporate taxes | 3.6 | 0.2 | 8.0 | 0.1 | 10.6 | 0.2 |
| Net operational result after corporate taxes and before net results from separate accounts | 17.4 | -1.0 | 21.6 | -1.2 | 27.8 | 2.9 |
| Net result from separate accounts | 4.2 | - | -2.1 | - | 4.5 | - |
| Net operational result | 21.6 | -1.0 | 19.5 | -1.2 | 32.3 | 2.9 |
| Net unrealized gains or losses | -6.3 | -17.8 | 9.4 | 10.3 | 6.0 | 6.5 |
| Net profit or loss | 15.3 | -18.8 | 28.8 | 9.1 | 38.3 | 9.4 |

Graph 8 presents an overview of the consolidated net profit and loss of the local life insurance companies during the period 2001–2010 and confirms that 2010 was a record year for the sector's profitability.

**Graph 8 Net results after corporate taxes of the local life insurance sector (in millions NAf.)**

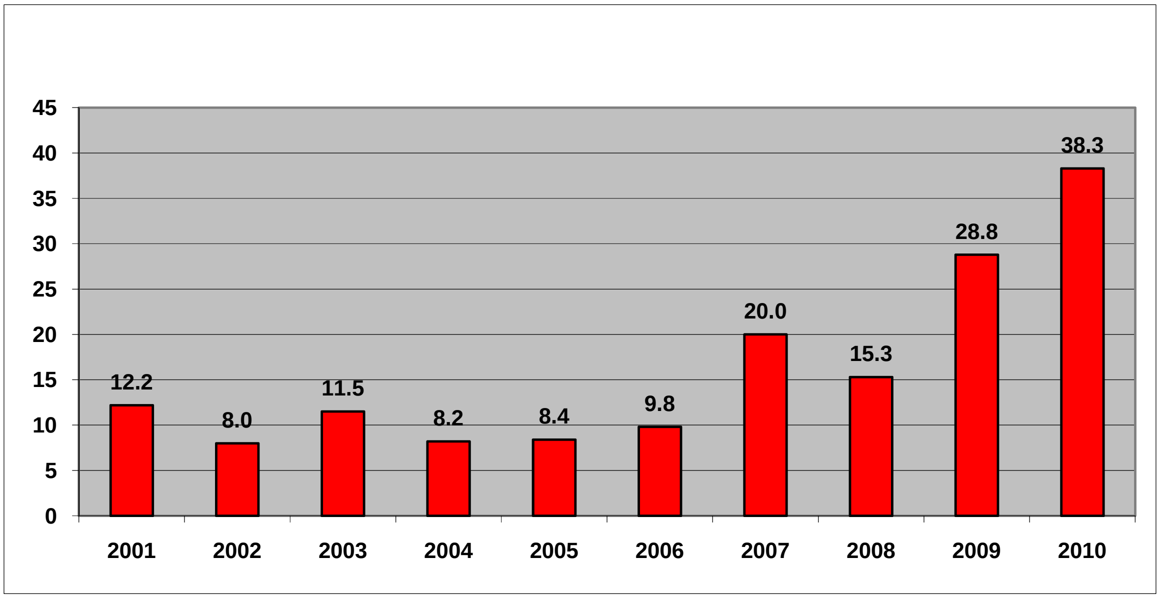



Table 23 shows the distribution of the operational result by line of business of the local life insurance companies in 2010. This table indicates that the individual life insurance business was the biggest contributor to the consolidated net operational result of NAf.32.3 million.

**Table 23 Consolidated operational result by line of business of the local life insurance companies (in millions NAf.)**

| | Life insurance | | Accident & sickness | Total |
|---|---|---|---|---|
| | Individual | Group | | |
| INCOME | | | | |
| Total net premium income | 117.8 | 67.2 | 6.4 | 191.4 |
| Net investment income and realized capital gains or losses | 45.8 | 66.7 | - | 112.5 |
| Net other operational income | 2.5 | 3.3 | - | 5.8 |
| Total operational income | 166.1 | 137.2 | 6.4 | 309.7 |
| EXPENSES | | | | |
| Net benefits incurred | 61.2 | 38.9 | 3.3 | 103.4 |
| Changes in technical provisions | 42.1 | 55.6 | -0.2 | 97.5 |
| Net operational expenditures | 38.9 | 17.3 | 1.9 | 58.1 |
| Net other operational expenditures | 0.6 | 0.5 | - | 1.1 |
| Other changes affecting net results | 0.8 | - | - | 0.8 |
| Profit sharing to policyholders | 2.3 | 10.4 | - | 12.7 |
| Total operational expenditures | 145.9 | 122.7 | 5.0 | 273.6 |
| Extraordinary results | 1.1 | 1.2 | - | 2.3 |
| Net operational results before corporate taxes and net results from separate accounts | 21.3 | 15.7 | 1.4 | 38.4 |
| Corporate taxes incurred | 5.8 | 4.5 | 0.3 | 10.6 |
| Net operational results after corporate taxes and before net results from separate accounts | 15.5 | 11.2 | 1.1 | 27.8 |
| Net result from separate accounts | 1.8 | 2.7 | - | 4.5 |
| Net operational results | 17.3 | 13.9 | 1.1 | 32.3 |

## 5.4 The non-life insurance industry

### *5.4.1 Balance sheet*

Table 24 reveals that in 2010 the aggregated balance sheet total of the non-life insurance companies operating in the domestic market increased by NAf.57.1 million (13.1%) compared to 2009. This increase was due mainly to increases in the current and other assets reported by this sector. Technical provisions and current liabilities recorded the largest increases on the liabilities side of the balance sheet.

The solvency requirement of the local non-life insurance sector on a consolidated basis was NAf.47.8 million in 2010, while the equity available to cover the solvency requirement was

NAf.172.2 million. Based on these figures, the sector had a solvency surplus of NAf.124.4 million in 2010.

The non-life insurance companies servicing the international market (captive insurance companies and professional reinsurers) reported total assets of NAf.3,465.1 million in 2010, a decrease of NAf.528.5 million (13.2%) compared to 2009. Equity, consisting of capital and surplus, decreased by NAf.621.3 million in 2010 compared to 2009. This decrease was due mainly to a dividend payment by one of the captive insurance companies.

The international non-life insurance sector had a solvency surplus of NAf.1.8 billion in 2010, a decrease of NAf.0.7 billion compared to the solvency surplus in 2009.

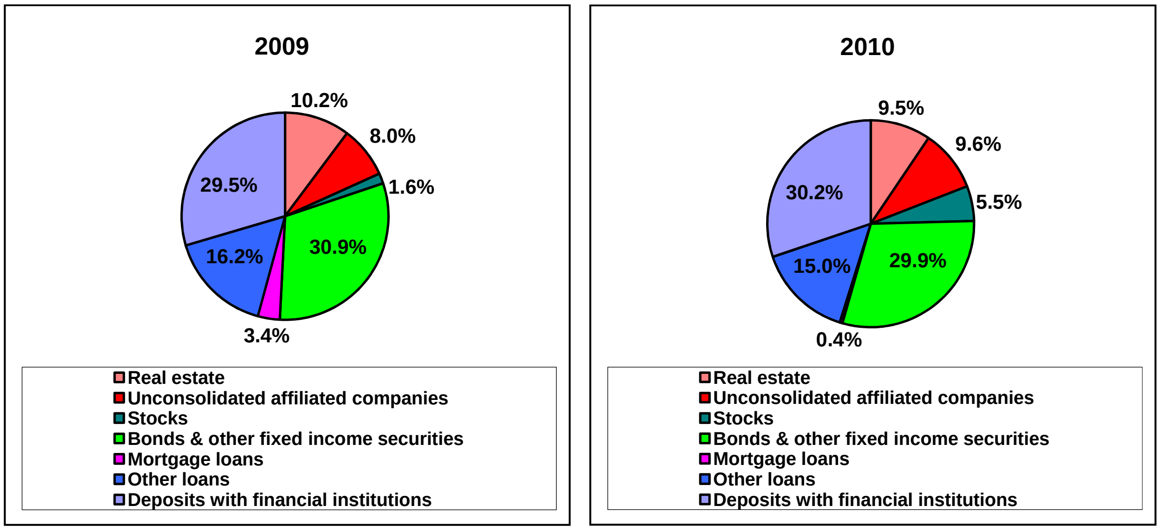
**Table 24 Consolidated balance sheet of the non-life insurance industry (in millions NAf.)**

| | 2008 | | 2009 | | 2010 | |
|---|---|---|---|---|---|---|
| | **Local** | **Int'l** | **Local** | **Int'l** | **Local** | **Int'l** |
| ASSETS | | | | | | |
| Intangibles | 0.9 | - | 0.9 | - | 0.2 | - |
| Total investments | 361.9 | 3,417.5 | 293.2 | 3,535.6 | 295.2 | 2,957.2 |
| Current assets | 143.8 | 305.2 | 130.0 | 458.0 | 155.3 | 507.9 |
| Other assets | 7.4 | 7.2 | 8.8 | - | 39.4 | - |
| Total admissible assets | 514.0 | 3,729.9 | 433.0 | 3,993.6 | 490.1 | 3,465.1 |
| EQUITY, PROVISIONS, AND LIABILITIES | | | | | | |
| Capital | 104.0 | 392.7 | 98.3 | 392.8 | 99.1 | 434.0 |
| Surplus | 62.8 | 1,841.3 | 68.8 | 2,120.0 | 71.8 | 1,457.5 |
| Subordinated instruments | 1.5 | - | 1.4 | - | 1.5 | - |
| Technical provisions | 218.8 | 1,447.1 | 174.4 | 1,424.5 | 193.5 | 1,524.8 |
| Other provisions & liabilities | 3.7 | 1.8 | 19.3 | 8.4 | 17.1 | 1.5 |
| Current liabilities | 123.1 | 47.0 | 70.7 | 47.8 | 107.0 | 47.3 |
| Contingent liabilities | 0.1 | - | 0.1 | - | 0.1 | - |
| Total equity, provisions, and liabilities | 514.0 | 3,729.9 | 433.0 | 3,993.6 | 490.1 | 3,465.1 |

### *5.4.2 Investments*

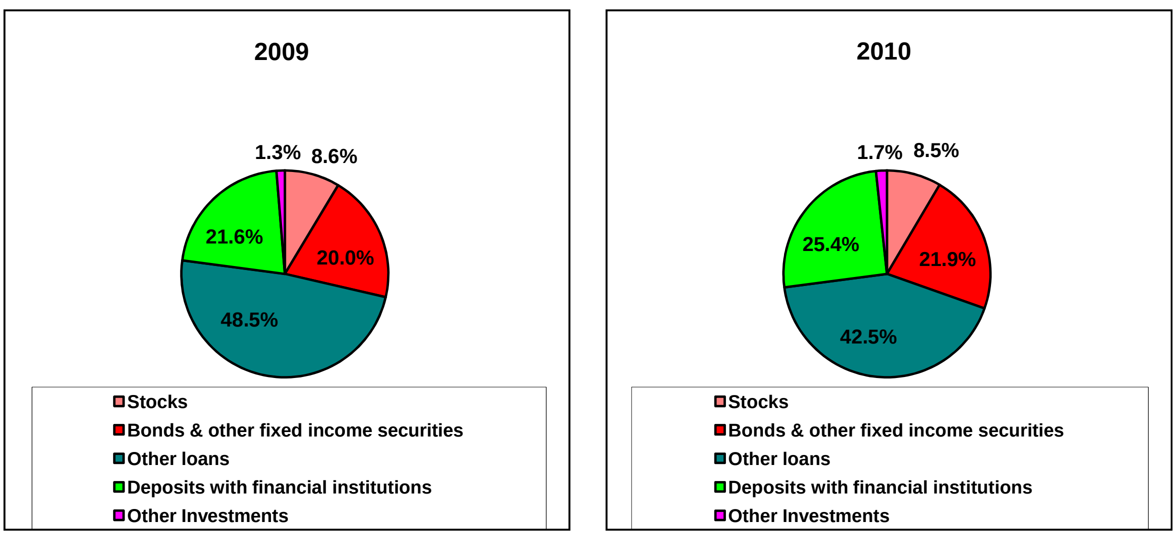
The composition of the investment portfolio of the local non-life insurance companies is presented in Graph 9. This graph indicates that the proportion of the investments in real estate, bonds & other fixed income securities, mortgage loans, and other loans decreased by 0.7, 1.0, 3.0, 1.2 percentage points, respectively, in 2010 compared to 2009 while the proportion of investments in unconsolidated affiliated companies, stocks, and deposits with financial institutions increased.

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




The composition of the investment portfolio of the international non-life insurance companies is illustrated in Graph 10. This graph indicates that the proportion of investments in bonds & other fixed income securities, deposits with financial institutions, and other investments increased at the expense of other loans, which decreased by 6.0 percentage points.

**Graph 10 Composition of the investment portfolio of the international non-life insurance companies**




### *5.4.3 Profit and loss statement*

Table 25 presents the operational results for the non-life insurance industry. The net earned premium of the local non-life insurance industry increased marginally by NAf.1.6 million in 2010. On the other hand, operational expenditures increased by NAf.25.6 million (10.5%) primarily because of the claims resulting from the flooding in Curacao and Bonaire, which was due to the heavy rainfall brought by tropical storm Tomas in November 2010. Despite the reported negative underwriting result of NAf.13.9 million, the sector ended with a net profit of NAf.18.1 million, attributable mainly to the extraordinary results of NAf.17.6 million in 2010.

The international non-life insurance companies reported a net profit of NAf.328.7 million in 2010, a decrease of NAf.199.8 million compared to 2009. This decrease resulted mainly from the declines in net earned premium, net investment income, and net unrealized gains of NAf.105.0 million, NAf.59.6 million, and NAf.33.8 million, respectively.

**Table 25 Consolidated profit and loss statement of the non-life insurance industry (in millions NAf.)**

| | 2008 | | 2009 | | 2010 | |
|---|---|---|---|---|---|---|
| | **Local** | **Int'l** | **Local** | **Int'l** | **Local** | **Int'l** |
| INCOME | | | | | | |
| Total net earned premium | 279.6 | 544.1 | 258.1 | 609.4 | 259.7 | 504.4 |
| Net other underwriting income | 1.9 | 3.7 | 1.9 | 5.1 | -3.2 | 8.2 |
| Total operational income | 281.5 | 547.8 | 260.0 | 614.5 | 256.5 | 512.6 |
| EXPENSES | | | | | | |
| Net claims incurred | 153.3 | 370.1 | 124.8 | 275.9 | 143.2 | 286.5 |
| Claim adjustment expenses | 7.6 | 0.8 | 5.6 | 2.5 | 6.9 | 1.2 |
| Changes in various provisions | 1.8 | 1.8 | 1.7 | -10.3 | 1.8 | 3.6 |
| Underwriting expenses incurred | 128.1 | 29.6 | 111.6 | 31.8 | 116.3 | 27.4 |
| Net other operational expend. | 1.2 | - | 1.1 | 7.1 | 2.2 | 7.8 |
| Total operational expenditures | 292.0 | 402.3 | 244.8 | 307.0 | 270.4 | 326.5 |
| Underwriting result | -10.5 | 145.5 | 15.2 | 307.5 | -13.9 | 186.1 |
| Net investment income | 22.8 | 129.2 | 15.4 | 135.1 | 15.2 | 75.5 |
| Other results | -2.1 | -54.2 | -3.9 | 4.5 | 0.9 | 19.2 |
| Extraordinary results | - | - | - | 0.3 | 17.6 | 2.6 |
| Net result before corporate taxes | 10.2 | 220.5 | 26.7 | 447.4 | 19.8 | 283.4 |
| Corporate taxes incurred | 4.1 | -1.4 | 4.4 | 10.6 | 1.7 | 12.6 |
| Net unrealized gains or losses | 1.2 | -49.0 | -0.3 | 91.7 | - | 57.9 |
| Net profit or loss | 7.3 | 172.9 | 22.0 | 528.5 | 18.1 | 328.7 |

Graph 11 presents an overview of the consolidated net results of the local non-life insurance companies from 2001 to 2010. As can be seen, the sector's high net results from 2005 continued through 2010, with the exception of a weak 2008 because of an active hurricane season.

**Graph 11 Net results after corporate taxes of the local non-life insurance sector (in millions NAf.)**

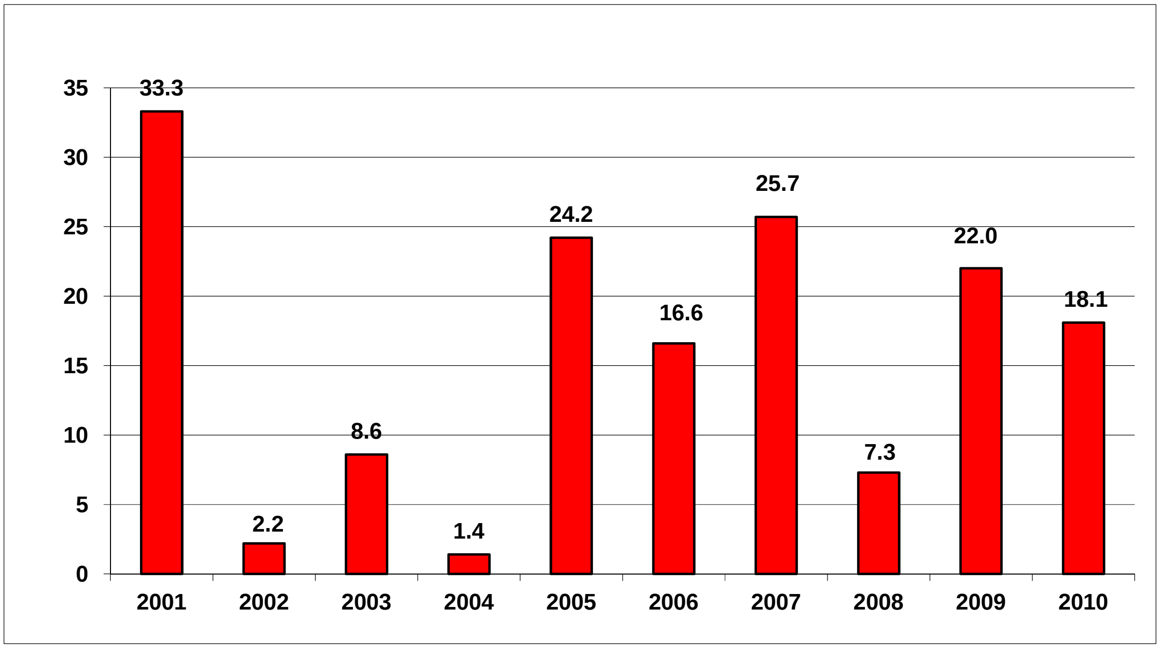



Table 26 shows the distribution of the operational results of the locally operating non-life insurance companies by indemnity group for the year 2010. As can be seen, the motor vehicle and property businesses reported a negative underwriting result. The extraordinary result of NAf.17.6 million in 2010 was almost entirely responsible for the year's net operational result of NAf.18.1 million.

**Table 26 Consolidated operational result by indemnity groups of the local non-life insurance industry (in millions NAf.)**

| | Accident & sickness | Motor vehicle | Marine, transit & aviation | Property | Others | Total |
|---|---|---|---|---|---|---|
| INCOME | | | | | | |
| Net earned premium | 85.6 | 93.5 | 4.9 | 71.0 | 4.7 | 259.7 |
| Net other underwriting income | -0.9 | -2.1 | -0.2 | -0.7 | 0.9 | -3.2 |
| Total operational income | 84.7 | 91.4 | 4.7 | 70.1 | 5.6 | 256.5 |
| EXPENSES | | | | | | |
| Net claims incurred | 56.3 | 52.1 | 0.9 | 32.5 | 1.4 | 143.2 |
| Claim adjustment expenses | 1.6 | 2.3 | 0.1 | 2.7 | 0.2 | 6.9 |
| Changes in various provisions | 1.8 | - | - | - | - | 1.8 |
| Underwriting expenses incurred | 27.7 | 42.8 | 2.4 | 40.5 | 2.9 | 116.3 |
| Net other operational expend. | 0.3 | 0.6 | - | 1.3 | - | 2.2 |
| Total operational expenditures | 87.7 | 97.8 | 3.4 | 77.0 | 4.5 | 270.4 |
| Underwriting result | -3.0 | -6.4 | 1.3 | -6.9 | 1.1 | -13.9 |
| Net investment income | 6.2 | 3.9 | 0.1 | 4.4 | 0.6 | 15.2 |
| Other results | 0.6 | 1.1 | - | 0.2 | -1.0 | 0.9 |
| Extraordinary results | 0.7 | - | - | - | 16.9 | 17.6 |
| Net result before corporate taxes | 4.5 | -1.4 | 1.4 | -2.3 | 17.6 | 19.8 |
| Corporate taxes incurred | 1.8 | 0.5 | 0.2 | -1.3 | 0.5 | 1.7 |
| Net operational results after taxes | 2.7 | -1.9 | 1.2 | -1.0 | 17.1 | 18.1 |

## 5.5 The pension industry

### *5.5.1 Balance sheet*

The 2010 consolidated financial figures of the pension industry show a coverage ratio of 88% (investments-to-provisions for pension obligations), which is below the required minimum of 100%. This ratio may differ from fund to fund and depends also on the specific circumstances of each fund, including the average age of the participants and the financial strength of the sponsor. The coverage ratio in 2010 decreased when compared to 2009 (91%), despite an increase of 24% in the consolidated stocks portfolio. The total investments increased by 1.8% to NAf.5.6 billion, while the provisions for pension obligations increased by 5.4% to NAf.6.3 billion. The Bank is closely monitoring the pension funds with a coverage ratio below the 100% threshold.

The pension industry reported total assets of NAf.6.8 billion in 2010, an increase of 6.1% compared to 2009 (see Table 27). The current assets and current liabilities represented 17.9% and 0.2%, respectively, of the balance sheet total.

**Table 27 Consolidated balance sheet of the pension industry (in millions NAf.)**

| | 2008 | 2009 | 2010 |
|---|---|---|---|
| ASSETS | | | |
| Total investments | 5,174.4 | 5,471.4 | 5,568.1 |
| Current assets | 661.3 | 920.7 | 1,221.2 |
| Other assets | 37.3 | 17.3 | 14.1 |
| | | | |
| Total assets | 5,873.0 | 6,409.4 | 6.803.4 |
| | | | |
| EQUITY, PROVISIONS, AND LIABILITIES | | | |
| Equity | 61.8 | 223.6 | 276.3 |
| Provisions for pension obligations | 5,694.5 | 6,010.7 | 6,337.6 |
| Current liabilities | 116.7 | 175.1 | 189.5 |
| | | | |
| Total equity, provisions, and liabilities | 5,873.0 | 6,409.4 | 6,803.4 |

### *5.5.2 Profit and loss statement*

The pension industry reported a net investment income and capital gains & losses of NAf.429.9 million in 2010, which is equal to 6.8% of the provisions for pension obligations (see Table 28). The objective of most pension funds is to obtain an investment return of at least 4% of the provisions for pension obligations to be able to meet their future financial obligations.

The net result for the year 2010 represented 1.1% of the provisions for pension obligations and 1.0% of total assets, which is under the rate of 4% generally used by most of the local pension funds to discount their (future) obligations. The net result for the year 2010 decreased compared to 2009, due mainly to a decrease in the items "contributions" and "net investment income and capital gains and losses."

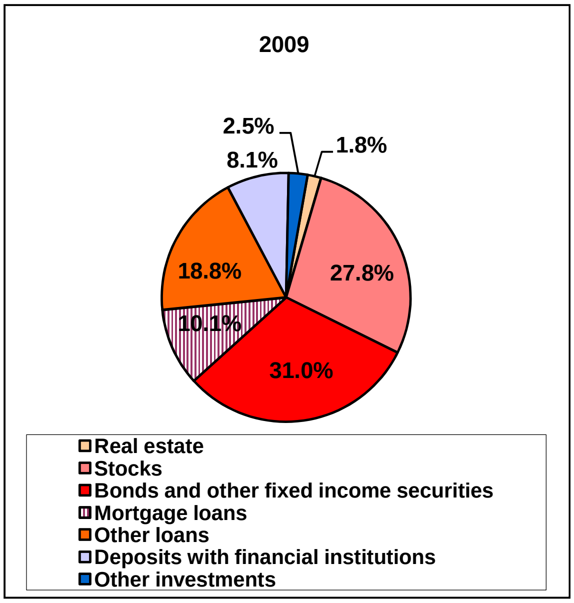
**Table 28 Consolidated profit and loss statement of the pension industry (in millions NAf.)**

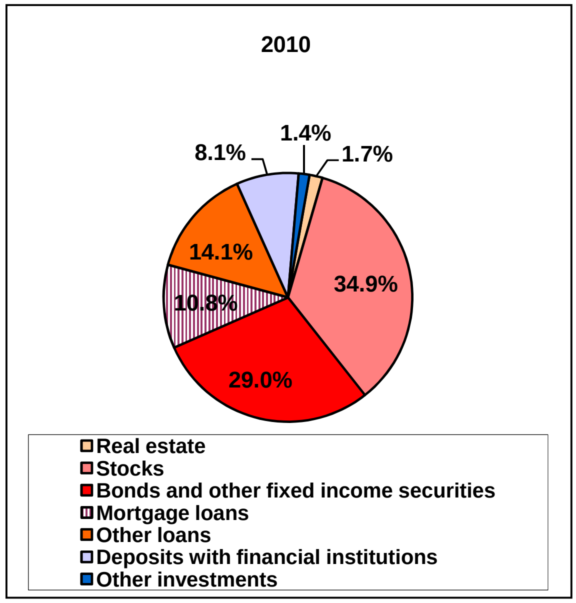
| | 2008 | 2009 | 2010 |
|---|---|---|---|
| INCOME | | | |
| Contributions | 192.8 | 224.2 | 193.7 |
| Net investment income and capital gains and losses | -256.3 | 523.3 | 429.9 |
| Other income | 22.7 | 30.5 | 19.5 |
| | | | |
| Total income | -40.8 | 778.0 | 643.1 |
| | | | |
| EXPENSES | | | |
| Pension benefits incurred | 214.1 | 227.4 | 206.6 |
| Change in net technical provisions | 298.4 | 308.3 | 338.7 |
| Operational expenses incurred | 23.1 | 27.9 | 25.5 |
| Other expenses incurred | 84.3 | 9.5 | 4.3 |
| | | | |
| Total expenses | 619.9 | 573.1 | 575.1 |
| | | | |
| Extraordinary results | - | - | 2.1 |
| | | | |
| Net profit or loss | -660.7 | 204.9 | 70.1 |

### *5.5.3 Investments*

The composition of the investment portfolio of the pension funds is presented in Graph 12. The graph indicates that the proportion of investments in stocks and mortgage loans increased by 7.1 and 0.7 percentage points, respectively, in 2010 compared to 2009, mainly at the expense of the investments in bonds and other fixed income securities, and other loans.

**Graph 12 Composition of the investment portfolio of the pension industry**



# 6 SUPERVISORY POLICIES AND ACTIVITIES OF THE BANK

## 6.1 Supervision of trust service providers

The Bank has been entrusted with the supervision of the trust sector since the beginning of 2004. In 2011, the number of trust service providers with a license increased slightly from 92 to 94. The number of trust service providers with a dispensation recorded a large net increase of 56, reaching 121 dispensations. As a result, the Bank had a total of 215 approved trust service providers under its supervision at the end of 2011 (2010: 157).

In 2011, the bank maintained its high qualitative and quantitative risk-based selection criteria to perform supervision. The Bank visited 30 entities within the sector: 18 onsite investigations and 12 management meetings. Of those 30 visits, 21 were at trust service providers. In addition, the department held over 60 meetings with entities at the Bank itself, more than 20 of them with trust service providers.

## 6.2 Supervision of investment institutions and administrators

Investment institutions and administrators have been subject to supervision by the Bank since the beginning of 2003. The number of supervised investment institutions and administrators increased from 34 in 2010 to 35 in 2011. The Bank conducted 8 visits at investment institutions and administrators during 2011, 3 of them onsite investigations and 5 management meetings.

## 6.3 Supervision of securities exchange

The supervision of the securities exchange started in March 2010 when the exchange received its license. The exchange has reached more than 10 listings, but no trading has occurred. During 2011, 3 formal meetings were held with the securities exchange.

## 6.4 Supervision of banks and credit institutions

In 2011, the draft legislation to harmonize and to update prevailing supervision laws and the draft legislation on the supervision of money transfer companies continued in the legislative process.

The possibility of imposing fines and penalties on banks for noncompliance with laws, regulations, and requirements was included in the draft Harmonization and Actualization of Supervision Ordinances of Curaçao and Sint Maarten. This addition comes on top of the already existing possibility for the imposition of fines for the late submission of prudential reports and the violation of the AML/CFT legislation and provisions & guidelines.

The draft harmonization and actualization legislation addresses some of the comments made by the IMF in its OFC Assessment of the Supervision and Regulation of the Financial Sector. This law, when executed, will enable the Bank to more effectively execute its supervisory tasks.

The Bank is concluding a new Chart of Accounts reporting system (NCOA) for credit institutions based on comments received from the banking sector and from internal reviews. Plans are for the NCOA to replace the existing COA reporting system in 2013. In principle, the NCOA will be based on IFRS and the Basel II framework, while reporting will be on a gross basis. The NCOA will apply to both locally operating and internationally operating banks.

A proposal for the introduction of a Dutch Caribbean Deposit Insurance System for the local banking sector of Curaçao, Sint Maarten, and the BES islands (Bonaire, Sint Eustatius, and Saba) was presented to the respective bankers associations. Extensive deliberations within the working group resulted in a Memorandum of Understanding on the Implementation of a Dutch Caribbean Deposit Insurance System, which was signed in 2011 by the Centrale Bank van Curaçao en Sint Maarten as the supervisory authority for Curaçao and Sint Maarten, the Dutch central bank as the supervisory authority for the BES islands, and the respective bankers associations of the locally active banks in Curaçao, Sint Maarten, and the BES islands. The Deposit Insurance System is intended to become effective on January 1, 2013.

A proposal for the introduction of a Deposit Insurance System for the credit unions of Curaçao and Sint Maarten was presented to the association of credit unions for comments. The association informed the Bank that it applauds the initiative but requested more time to comment on the contents of the draft Deposit Insurance System since it wishes to consult the Caribbean Confederation of Credit Unions (CCCU) for advice.

The banking supervision department continued to refine its risk-based supervision approach, which will allow the examiners to focus on the higher risk areas. Furthermore, the department continued to monitor closely the way the international banks coped with the global financial crisis.

In 2011, 21 onsite examinations were conducted at institutions operating with either a license or dispensation from the Bank. Three full-scope examinations were performed: one at a local general bank, one at a foreign bank branch, and one at a savings bank. One limited review was conducted at a foreign bank branch. Furthermore, eight targeted examinations were conducted: six at nonconsolidated international banks and two at branches of local general banks. The banking supervision department also conducted two quick-scan examinations at institutions that recently had obtained a license from the Bank. Five special assignments (mostly related to liquidity issues) were conducted at local general banks and a branch of a foreign bank. Finally, one follow-up review at a foreign bank branch was conducted.

On June 1, 2011, and June 23, 2011, the Bank issued a license to South American International Bank Curacao N.V. and Sky Bank N.V. Both institutions were registered as international banks. Furthermore, the Bank revoked the license of three international banks--First Curacao Banking Corporation N.V., ING Middenbank N.V., and ING Bank N.V., and the credit union Kooperativa di Servisio Multiple den Komersio i Industria.

### 6.5 Supervision of institutional investors and insurance intermediaries

An important objective of the Bank's supervision of the financial sector is to promote the stability of the financial system and the reputation of Curacao's financial sector. The Bank deems it imperative that its supervisory regime is conducive to the application of the risk-based approach to achieve this objective. The Bank intends to fully apply the risk-based supervision approach beginning in 2013.

Training and further customizing of the software that will support the risk-based supervision process continued in 2011. This project will be finalized in 2012.

The draft valuation guidelines for the insurance industry were finalized in 2011. During the last two months of 2011, the Bank presented these guidelines to the industry and other stakeholders. The presentations took place both in Curacao and Sint Maarten. The insurance industry and other stakeholders were granted several weeks to provide the Bank with their comments, if any, on the draft valuation guidelines. The Bank will analyze these comments and, subsequently, finalize the guidelines. It is expected that these new valuation guidelines will be used to complete the 2012 financial figures. Currently, insurance companies and pension funds are legally required to report on an annual basis. The Bank is evaluating the possibility of increasing the frequency of reporting in the future.

In 2011, 18 onsite examinations were conducted at supervised institutions, 7 of them at general insurance companies, 2 at life insurance companies, 1 at a funeral insurer, and 8 at insurance intermediaries.

During these examinations, the Bank continued to assess the supervised institutions' compliance with the Anti-Money Laundering and Combating Terrorist Financing (AML/CTF) regulations and guidelines and also with the National Ordinance Identification when Rendering Financial Services (LIF). The Bank will on a continuous basis devote attention to this important aspect of compliance during its onsite examinations.

To have a closer relationship with the institutions it supervises, the Bank initiated the process of conducting annual supervisory meetings with the Board of Directors of these institutions. These meetings continued in 2011.

In anticipation of the harmonized legislation, the Bank will develop new guidelines, among other things, in the area of market conduct. To have a level playing field between the countries within the Dutch Kingdom, guidelines will be developed that are in line with the supervision of market conduct exercised by the Autoriteit Financiële Markten (AFM) in Bonaire, Sint Eustatius, and Saba (BES-islands).

The Bank has close working relationships with foreign supervisors such as De Nederlandsche Bank (DNB), the Centrale Bank van Aruba (CBA), the Autoriteit Financiële Markten (AFM), and the National Association of Insurance Commissioners (NAIC). In 2011, the Bank signed a Memorandum of Understanding (MoU) with the NAIC. One of the benefits of this MoU is that Bank staff will be able to attend special NAIC training for regulators.

The Bank is also a member of international standard-setting bodies such as the International Association of Insurance Supervisors (IAIS), the Offshore Group of Insurance Supervisors (OGIS), the Financial Action Task Force (FATF), and the Organization for Economic Co-operation and Development (OECD). These organizations play an important role in developing supervisory standards with which their members have to comply in order to enhance their supervisory regimes. Additionally, the Bank again was elected Secretary of the OGIS in 2011.

### 6.6 Integrity aspects of financial sector supervision

The number of (co-)policymakers and holders of qualifying interests recorded in the Integrity Financial Sector Register increased further from 3,000 in 2010 to about 3,100 subjects in 2011. During 2011, 445 integrity tests were conducted with a positive result (327 were conducted in 2010): 150 for the banking and credit institutions sector, 229 for the trust and investment sector, and 66 for the institutional investors sector. Of the 445 integrity tests, 217 persons were registered and tested for the first time: 72 for the banking and credit institutions sector, 112 for the trust and investment sector, and 33 for the institutional investors sector. The remaining 228 tests were periodic tests conducted during 2011, which fall within the regular 3-year cycle of integrity testing.

In 2011, 14 cases with integrity doubts were officially disclosed and dealt with by the Integrity Commission of the Bank: 6 resulted in a negative test result because of serious doubts. In accordance with the Policy Rule on Integrity Testing and in the opinion of the Bank, these persons formed an impediment to discharging the position of (co)policymaker holding a qualifying interest, or obtaining a dispensation in pursuit of the Supervision Act. After close consideration, three of the remaining eight cases were settled with a positive test result, two of which included a written reprimand from the Bank for withholding antecedent information. Two cases resulted in an official Warning Notice on the Bank's website, while the three other cases remained pending further investigation.

As part of its integrity testing, the Bank received 13 information requests in 2011, all of them from the supervisory authorities in the Netherlands regarding their supervised institutions on BES islands. Furthermore, the Bank registered 44 reported incidents of eroding integrity: 10 cases were reported internally and 34 externally. The externally reported incidents were pursuant mainly to the Policy Rule for Sound Business Operations in the Event of Incidents and Integrity-sensitive Positions.

The Working Group HIT (Harmonization Integrity Supervision) presented its first report to the Technical Committee (TC) of Kingdom Supervisors at the end of 2011. The report contained specific recommendations to the central banks of Aruba, Curacao and Sint Maarten, and the BES islands on how to harmonize integrity supervision in the Caribbean part of the Kingdom of the Netherlands. These findings oversee the different regulations in the fields of sound business operations, integrity testing, and customer due diligence obligations. This first report was approved by the Technical Committee, pending a second report by the Working Group concerning the reporting obligation, sanction regulation, enforcement tools, confidentiality versus information sharing, and rules relating to wire transfers. With respect to mutual co-operation and information sharing, the Bank has received the draft "Bilateral Memorandum of Understanding (MOU) between AFM and CBCS regarding the supervision in Bonaire, Sint Eustatius, Saba (BES), Curaçao, and Sint Maarten", to be signed in the beginning of 2012.

### 6.7 IT aspects of financial sector supervision

During 2011, the Bank performed regular IT examinations at 2 trust companies, 3 insurance companies, 1 pension fund, 1 credit institution, and 1 international bank. The IT examinations were focused mainly in the areas of business continuity and information systems management. A special IT examination also was performed at one commercial bank in Curaçao and at all seven commercial banks in Sint Maarten to determine if they had all the necessary operational procedures and infrastructure in place to become members of the Bank's Payment Clearing System.

Furthermore, the Bank continued to monitor the commercial banks' compliance with the "Provisions and Guidelines for Safe and Sound Electronic Banking" issued in December 2007. By the end of 2011, all the commercial banks in Curaçao providing Internet banking services were compliant with the most important aspect of the policy, i.e., the use of two-factor authentication to access the Internet banking services. A few banks decided to use tokens while others decided to use a matrix card.

A few or all banks still need to comply with some aspects of the policy, the most important ones being:

- credit institutions should protect customers at least against unauthorized access to or use of their records or information that could result in substantial damage or inconvenience to any customer;

- credit institutions should pay special attention to the provision of easy-to-understand and prominent advice to their customers on e-banking security precautions (regretfully not much was done in 2011 to warn customers against cyber threats);
- credit institutions are required to use multi-factor authentication for internet banking:
    - when the user logs in to the system;
    - when the user wants to make a transaction.

  A few banks still don't use multifactor authentication when the user makes a transaction (only when logging in to the system).

In its continuing effort to promote and ensure a safe and sound functioning of the financial system, the Bank issued in April 2011 the "Provisions and Guidelines for Information Security Management" (ISM) and the Simplified version of the Supervised Institutions IT Questionnaire ("SSIIQ"). The ISM provides principles for setting up a comprehensive ISM program and the implementation of an Information Security Management Framework. Its objective is to safeguard the interest of the supervised institutions' key stakeholders, reputation, brand, and business. The SSIIQ is the simplified version of the SIIQ (Supervised Institutions IT Questionnaire) introduced in 2010. The objective of the SSIIQ is to evaluate the adequacy of IT- related controls in place at small-scale supervised institutions and determine the IT governance maturity level of these institutions. Both documents were introduced during a seminar in June 2011 on Information Security Management.

### 6.8 International financial sector policy developments

Curaçao, as a member of the Financial Action Task Force (FATF) and the Caribbean Financial Action Task Force continued its efforts to implement the 40 revised anti-money laundering Recommendations of 2003 and the 9 Special Recommendations on terrorist financing. During 2011, both the National Committee on Money Laundering and Terrorist Financing (CIWG) and the Bank continued to implement the international standards set by the FATF. The Bank carries the presidency and the secretariat of the CIWG.

In 2011, the National Decree designating services and supervision under the National Ordinance on the Identification of Clients when Rendering Services (N.G. 2011, no. 32) and the National Decree designating services and supervision under the National Ordinance on the Reporting of Unusual Transactions (N.G. 2011, no. 31) were implemented. These decrees make Curaçao more compliant with the 49 FATF AML/CFT Recommendations.

The Bank also placed FATF warnings on its website identifying countries that are not compliant with the international standards.

Finally, staff members of the Bank were actively involved in FATF and CFATF activities in 2011. Considerable efforts were put into the preparations for the Mutual Evaluation of Curaçao and the CFATF onsite examination that took place between August 22 and September 2, 2011, underscoring the Bank's commitment to keep up with the latest AML/CFT developments.

# 7 FOREIGN EXCHANGE REGULATIONS AND THE LICENSE FEE

## 7.1 Introduction

The foreign exchange regulations in Curaçao and Sint Maarten are based on the Foreign Exchange Regulation of Curaçao and Sint Maarten (2010). As of October 10, 2010, these two autonomous countries within the Kingdom of the Netherlands form a monetary union with a common currency and central bank.

According to the foreign exchange regulation, current transactions are free in principle, while capital transactions require a license. Although capital transactions are bound by a license, the Bank has issued several foreign exchange notifications that have 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 regulation are to:

1. promote international financial activities in Curaçao and Sint Maarten; for this reason, the ordinance contains special provisions for companies engaged in international financial and business transactions;

2. gather the necessary information and data essential for compiling the balance of payments;

3. 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. 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 governments of Curaçao and Sint Maarten. The Bank is charged with executing the foreign exchange regulations and managing the available foreign exchange reserves for account and risk of both governments. Therefore, the Bank is empowered to grant licenses and exemptions by virtue of the Foreign Exchange Regulation of Curaçao and Sint Maarten (2010).

## 7.2 Foreign exchange licenses

The number of foreign exchange licenses issued by the Bank in 2011 dropped by 55 (5%) to 1,122 (see Table 29). This drop can be attributed primarily to fewer foreign exchange exemptions granted to international financial and business companies (112). Nevertheless, the total capital related to the granted licenses increased slightly by NAf.18.3 million (2%) to NAf.982.2 million. The number and value of licenses granted for transfers by individuals to their own accounts abroad and portfolio investments abroad by institutional investors continued to increase in line with the gradually increasing appetite to invest abroad. The value of licenses for borrowing abroad declined significantly (65%), but the decline was mitigated by the increase in the value of licenses granted for intercompany financing (79%).

**Table 29 Overview of foreign exchange licenses issued (in numbers and millions NAf.)**

| Description | 2010 Number | 2010 Amount | 2011 Number | 2011 Amount |
|---|---|---|---|---|
| Participation in local company by nonresident | 19 | 20.7 | 10 | 20.7 |
| Transfer to own account abroad | 15 | 13.2 | 38 | 69.3 |
| Portfolio investment abroad | 49 | 314.2 | 55 | 395.8 |
| Participation abroad | 3 | 1.5 | 1 | 0.2 |
| Borrowing abroad | 63 | 420.0 | 47 | 148.0 |
| Lending abroad | 56 | 29.8 | 56 | 58.3 |
| Intercompany financing | 42 | 149.7 | 67 | 268.6 |
| Request for foreign bank account | 101 | - | 82 | - |
| Request for local nonresident account | 11 | - | 12 | - |
| Granting guarantee abroad | 5 | - | 3 | - |
| Exemption int. fin. & bus. serv. companies | 801 | - | 689 | - |
| Other | 12 | 14.8 | 62 | 21.3 |
| Total | 1,177 | 963.9 | 1,122 | 982.2 |

### 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 through 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 government. The Bank assesses and collects the license fee in Curaçao and Sint Maarten, the proceeds of which are remitted to the government of each country.

**Table 30 License fees collected from 2009 through 2011 (in thousands NAf.)**

| | 2009 Curacao | 2009 St. Maarten | 2010 Curacao | 2010 St. Maarten | 2011 Curacao | 2011 St. Maarten |
|---|---|---|---|---|---|---|
| January | 4,384.6 | 2,325.3 | 3,667.9 | 2,064.6 | 4,408.6 | 2,056.2 |
| February | 3,570.2 | 2,085.1 | 3,791.1 | 1,851.9 | 3,544.3 | 2,013.6 |
| March | 4,312.7 | 2,323.0 | 4,206.8 | 2,256.5 | 4,987.8 | 2,288.6 |
| April | 4,272.5 | 1,767.4 | 3,875.1 | 1,849.4 | 3,506.9 | 1,873.7 |
| May | 3,488.0 | 1,981.7 | 5,025.4 | 1,969.1 | 4,802.9 | 1,916.5 |
| June | 4,176.8 | 1,899.4 | 4,250.8 | 1,775.8 | 4,381.5 | 1,958.8 |
| July | 4,096.1 | 1,746.7 | 4,044.1 | 1,936.1 | 4,258.7 | 1,556.4 |
| August | 3,585.9 | 1,510.4 | 5,391.3 | 1,608.6 | 4,266.7 | 1,741.1 |
| September | 4,241.5 | 1,709.1 | 4,507.7 | 1,848.7 | 4,392.0 | 1,682.7 |
| October | 3,947.4 | 1,797.0 | 4,204.8 | 1,654.7 | 4,172.9 | 1,641.3 |
| November | 4,572.9 | 1,693.3 | 4,093.8 | 1,856.5 | 6,434.4 | 1,732.3 |
| December | 6,130.1 | 2,244.8 | 4,731.3 | 2,380.7 | 4,770.8 | 3,081.3 |
| Total | 50,778.7 | 23,083.2 | 51,790.1 | 23,052.6 | 53,927.5 | 23,542.5 |

Table 30 provides an overview of the license fees collected by Curacao and St. Maarten from 2009 through 2011. Both countries collected more license fees in 2011 than in 2010. In Curaçao, the amount collected increased by NAf.2,137.4 thousand (4.1%) to NAf.53,927.5 thousand. In Sint Maarten, NAf.489.9 thousand (2.1%) more was collected in license fees, reaching NAf.23,542.5 thousand.