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Bank van de Nederlandse Antillen

REPORT OF THE PRESIDENT

The decline in the Netherlands Antillean economy continued in the second quarter of 1998, as reflected by a 1.0% decline in the annualized real Gross Domestic Product. The economic contraction was due to weak domestic demand caused by low private investment and consumption resulting from the uncertainties surrounding a program to address the financial economic situation. In contrast, the export sector recorded moderate growth. The economic downturn was accompanied by a further decline in the annualized inflation rate, attributable to the low inflation rates of our main trading partners, the decline in oil prices, and the dampening effects of the government's revenue-enhancing measures.

The overall moderate growth of exports resulted from mixed developments in our main export sectors. The largest growth was recorded in merchandise exports, owing primarily to the continued good performance of free zone re-export activities. In addition, free zone visits increased after a long period of decline. Activities in the tourist sector continued to increase, dominated entirely by St. Maarten. In Curacao, stay-over and cruise tourism recorded increases, but foreign exchange income recorded a decline. In Bonaire, all tourism indicators showed a deterioration. The relatively high prices, the lack of hotels affiliated with large international chains, and insufficient air connections compared to other destinations are considered the main reasons for the weak development in tourism in Curacao and Bonaire. For this reason, the Bank welcomes the efforts of the authorities to increase air connections to the islands.

Activities in the transportation sector decreased, although the developments by industry were mixed. The national carrier recorded an increase in the number of passengers transported, while freight shipments dropped. Both the airports of Curacao and St. Maarten performed well, reflected by a marked growth in passenger movements. Harbor activities in Curacao increased substantially, although this resulted partly from the weak performance in 1997 related to the collapse of the rice and sugar trade from "Overseas Countries and Territories" with the European Union. Activities in the ship repair sector, as measured by the number of man-hours sold, expanded substantially. This expansion, however, was not yet reflected in foreign exchange income earned, which showed a decline. Oil transshipment and storage activities declined, due to developments in Bonaire. In addition, bunker sales showed a deterioration. The oil refinery in Curacao recorded a decline in production and operational costs, due partly to maintenance activities. Finally, the international financial and business services sector recorded a slight deterioration in both income received from services rendered and profit tax transferred to the government.

The sluggish economic development was accompanied by a slight deterioration in the balance of payments, attributable to both the current and the capital account. The deficit on the current account widened as a result of a lower surplus on the services balance. This low surplus was due to a stagnation in foreign exchange receipts and an increase in foreign exchange expenses, particularly related to travelling abroad. The deterioration in the services balance was mitigated by the improvement in the merchandise and income balances. The improvement of the merchandise balance was the result primarily of the increase in free zone re-exports and a decline in non-oil imports, in line with the sluggish domestic demand. The increase in the current account deficit was accompanied by a smaller surplus on the

capital account of the balance of payments, accounted for by both the private and the official capital accounts. These developments resulted in a decline in our foreign exchange reserves. With respect to our weak balance of payments and, hence, foreign exchange reserves position, the Bank wants to underline again the importance of revitalizing of our export sector. This, however, could be attained only through regaining investors' confidence with the implementation of a comprehensive structural adjustment program.

The deficit of the General Government on a cash basis deteriorated significantly. This deterioration was attributable to an increase in current expenditures, dominated by the elimination of arrears to the civil servants pension fund by the Central Government. Total revenues increased, owing entirely to tax revenues. The latter increase, however, was mainly the result of the transfer of the wage tax by the Central Government to the Island Government of Curacao for the periodic debt settlement. Corrected for this transitory factor, tax revenues increased very little, in line with the sluggish economic development. Despite developments in the second quarter of 1998, recent estimates show that the actual cash deficit for 1998 will be much lower than originally projected because of increasing financing constraints for the governments. These financing constraints are forcing the government to continue phasing expenditures into the future and increasing its arrears, actions with repercussions for the quality of government services and public investments. To prevent a further worsening of the government's financial position, fiscal consolidation efforts should be accelerated. These efforts should focus on the restructuring of the public finances. Only then could a complementary economic policy result in a resumption of investments and a recovery of the economy.

The monetary aggregates showed a relatively large growth in the second quarter of 1998, compared to previous quarters. This growth was attributable entirely to the domestic sector, and particularly the government sector. The latter growth can be explained by the government's financing part of its cash deficit monetarily through the withdrawal of deposits at the banking system. The private sector also exerted an expansionary impact due to an increase in loans. However, the outstanding loans to the private sector remained within the limit of the monetary cash reserve arrangement.

The Bank's monetary policy for the second half of 1998 will be conducted against the backdrop of a weak foreign exchange reserves position and the uncertainties surrounding the government's recovery plan. Credit to the private sector is allowed to grow marginally by 0.25% over the June 1998 limit of the monetary cash reserve arrangement. In addition, the reserve requirement was increased from 4% to 6% in September 1998, when the Bank introduced its new, more market-oriented monetary policy. In October, a further increase to 6 1/2% was effectuated to adequately reduce the overliquidity in the banking system and, hence, its potential to extend credit. On the other hand, the Bank took a first step toward the gradual abolition of the monetary cash reserve arrangement through a reduction of the cash reserve percentage scheme and, hence, the penalty on excess credit beginning in October 1998.

The current financial-economic crisis calls for urgent actions by our policymakers in the fields of public finance and the revitalization of our economy. This need for action has become more pressing in light of the slowdown in the world economy. The government,

therefore, should speed up its efforts to implement a viable and comprehensive structural adjustment program. The challenge is to take major, credible actions on fiscal policy to move the budget to a clearly sustainable position. The prospects for renewed growth will only be assured if authorities persevere with market-oriented reform and resist the temptation to try to stimulate the economy through direct intervention. The current administration's shifting of policy priorities toward job creation should be consistent with fiscal consolidation. Durable jobs can only be created by economic expansion. For this to take place, we have to bolster investors confidence by creating an environment conducive to more investment. By proceeding along the path of fiscal consolidation, the government will free-up the scarce financial resources now diverted toward financing the unsustainable high fiscal deficits, to finance the much-needed investments of the private sector. This consolidation should lead to sustainable economic growth, and hence, more jobs. The Bank welcomes the recently announced tax initiatives of the current government. For this measure to be effective in encouraging investments, however, necessary complementary issues ought to be addressed.

First, if these measures are not accompanied by compensating measures to deal with the ballooning fiscal deficits, further pressure will result on the rate of interest, thereby choking off private sector investments. Second, the structural rigidities in our economy that hamper private sector initiatives - like bureaucratic red tape, labor market rigidities, market protection, and telecommunication infrastructure - must be addressed. Otherwise, these structural rigidities will render the tax measures ineffective.

In light of this situation, the Bank wants to reiterate that only a comprehensive Structural Adjustment Program will provide us with the necessary conditions to ensure a revival of economic activities, thereby laying the foundation for a sustainable economic expansion and hence, job creation.

E.D. Tromp
President

DEVELOPMENTS IN THE REAL SECTOR

General economic developments

Real GDP weakened further in the second quarter of 1998, contracting by 1.0%. The combination of poor domestic and foreign demand has been a drag on economic growth. The present global market crisis, led by the Asian countries, may have reduced the foreign demand for our service sector. The decline in domestic demand meant fewer production activities. This poor production performance stemmed from fewer private investments, which hampered progress in the labor market. The low second-quarter growth was accompanied by mild inflation. The annual inflation rate dipped to 1.6%, down from 4.0% in the second quarter of 1997. This slower inflation may be generated from the bottoming-out effects of the sales tax, the lower foreign (U.S.A.) inflation rate, and lower world oil prices.

National production and spending

The performance of the Antillean economy continued to be gloomy in the second quarter of 1998. Despite the current adverse economic conditions, however, the financial sector performed relatively well. Real gross domestic product tightened in the second quarter of 1998, by 1.0%, after a 2.0% decrease in the corresponding quarter of 1997. Several factors contributed to the decline: real consumer spending and business investments continued to be slow. Another setback for GDP growth was the reduction of 30.3% in government investment. Contrary to government investment, government consumption expanded by 23.3% during this period, ascribable to government debt payments to the pension fund (APNA). Consequently, this growth in government consumption did not improve disposable income and, ultimately, had no impact on consumer spending. In addition to the negative growth, the government's failure to fulfill its mounting debt obligations points to a persisting weak economy. The rising budget shortfalls caused a paucity of confidence; as a result, investment conditions are liable to deteriorate further. The ongoing poor producer confidence reduced overall investment activity, causing the unemployment rate to remain high. Uncertainty in labor market developments also has a negative impact on consumer confidence. The lack of certitude and purchasing power resulted in lower overall spending on housing and other consumer goods. Little improvement is unlikely in the short term, and swift action is necessary. Clearly, economic reform must be enacted soon.

Inflation

Annual inflation in the Netherlands Antilles has been subsiding since the third quarter of 1997. From April to June of 1998, the annual inflation rate eased to 1.6%, down from 4.0% in the second quarter of 1997. During this period, US inflation dipped to 1.7% from 2.3% in the corresponding quarter of 1997. On an annual basis, St. Maarten has the highest inflation in the Netherlands Antilles. However, the country's price inflation fell at an annual rate of 1.9% in the second quarter of 1998, slowing from 3.7% in the second quarter of 1997. Curaçao's and Bonaire's inflation in the second quarter of 1998 were, 1.7% and 1.1%, down from 4.1% and 2.7%, respectively, in the same quarter of 1997.

Price analysis on a quarterly basis indicated that St. Maarten experienced a -0.1% inflation in the second quarter of 1998, compared to the first quarter's 0.2% surge (table 1). The highest price increase came from the category "beverages and tobacco"(4.6%), which was led by the price hike of beverages. "Food" (-0.1%), "housing" (-0.2%), and "transport and communication" (-0.9%) contributed to the deceleration in consumer prices.

Table 1
Inflation rates for Curaçao, Bonaire, and St. Maarten during the second quarter of 1998 (% changes)

	Curaçao	Bonaire	St. Maarten
Food	0.7%	0.1%	-0.1%
Beverages & tobacco	0.9%	1.4%	4.6%
Clothing & footwear	-0.6%	0.0%	0.0%
Housing	0.4%	0.4%	-0.2%
Housekeeping & furnishings	0.2%	0.1%	0.1%
Health	0.0%	0.1%	0.4%
Transport & communication	0.1%	0.0%	-0.9%
Recreation & education	0.3%	0.5%	0.0%
Other	0.2%	0.1%	0.0%
General inflation rate	0.3%	0.2%	-0.1%

During the April-June period of 1998, Curaçao's inflation edged up slightly by 0.3%, compared to the first quarter of 1998. In the third quarter of 1998, the largest price rise occurred in the sector "beverages and tobacco"(0.9%), resulting from a price rise in beverages. Moreover, the increase of 0.7% in "food" was caused by higher-priced fresh produce. In contrast, the inflation rate in the item "clothing and footwear" declined by 0.6%, a result of cheaper prices of clothing.

In Bonaire, the inflation rate in the second quarter of 1998 remained similar to the preceding quarter (0.2%). Fuelled by increases in the prices of beverages, inflation in the items "beverages and tobacco" rose by 1.4% in the second quarter of 1998. The lowest rate of inflation, nevertheless, came from the categories "clothing & footwear" (0.0%) and "transport & communication" (0.0%).

Labor market

Developments in the labor market in Curaçao continued to deteriorate in the first half of 1998, as the number of actual personnel being dismissed increased by 324 persons.

In the first half of the past two years, laid-off workers were concentrated in the construction sector. However, in the first half of 1998 employees were dismissed in nearly all sectors, but mainly in the industrial and transportation sectors. Weak domestic demand and the reduction of imports from C.T.O1 to Europe resulted in staff layoffs in the industrial sector. Additionally, the implementation of the Business plan by "Air ALM," as part of the restructuring process, caused the dismissal of workers in the transportation sector (table 2).

Table 2
Laid-off personnel in Curaçao by sector

1st half of:	1996	1997	1998
Sectors:			
Industry	45	17	80
Construction	161	157	55
Trade, hotel, & restaurant	57	33	63
Transportation & communication	7	7	82
Financial & business services	2	53	12
Other services	2	6	32
Total	274	273	324

Developments by sector

Mining

Bonaire's salt industry improved marginally by 0.3% in the second quarter of 1998, following an increase of 39.9% in the corresponding quarter of 1997. Aside from salt production expansion, salt exports swelled by 18.5%, compared to a fall of 32.0% in 1997's second quarter.

Industry

Developments in the oil sector in the second quarter of 1998 were slow with respect to oil refining. Production of the oil refinery "ISLA" fell by 4.4% in the second quarter of 1998, compared to an expansion of 27.2% in the same quarter of 1997.

Additionally, operational costs declined by 10.3%, caused mostly by a reduction in the refinery's own use of fuel. Due to increased maintenance of the plants, contract payments increased by 72.2%, contrasting with the 63.6% decrease in the second quarter of 1997.

The ship repair sector in Curaçao recorded an improvement, as the number of man-hours sold and the quantity of ships repaired soared by 54.6% and 50.0%, respectively, in the period April-June 1998. In contrast to the buoyant ship repair industry, foreign exchange earnings dropped by 17.6% during this same time.

Utilities

The Antillean electricity production rose by 11.0% in the second quarter of 1998, from a 0.3 % gain in the same period of 1997. An analysis by islands shows that electricity production grew by 15.0 percentage points to 11.4% in Curaçao, and by 14.3 percentage points to 16.4% in Bonaire. In the Leeward Islands, the warm and humid weather in the first 6 months of the year may have led to an increasing demand for energy. In the Windward Islands, however, electricity production declined by 7.1 percentage points to 7.8%.

Water production in the Netherlands Antilles jumped by 11.3% in 1998's second quarter, up from a 2.3% rise in the second quarter of 1997. The growth came largely from Curaçao (15.5%), and secondly from Bonaire (4.0%). In contrast, the Windward Islands' water production dropped by 6.3% in the second quarter of 1998, compared to a 2.5% increase in the months April to June 1997.

Construction

The construction industry in Curaçao showed mixed developments during the second quarter of 1998. The number of total projects completed dwindled by 55.4%, but the value of construction permits soared by 97.5% in the quarter ending June 1998. The rise in the value of construction permits was related mainly to the large number of licenses granted for non-residential projects in the months April and June 1998. Consequently, the construction sector might pick up in the near future. In contrast, through the second quarter of 1998, the value of construction projects in Bonaire, decreased by 21.6%, compared to the same quarter a year ago.

Trade

According to the Bank's Business Cycle Survey, the turnover in retail trade continued its downward trend in the second quarter of 1998. The free zone trade, on the other hand, continued to expand.

For the second quarter of 1998, the free zone activities improved, as re-exports increased by 20.5%, following a 45.9% jump in the same quarter of 1997. The growth in free zone re-exports was accompanied by a gain of 35.1% in the number of free zone visits. Except for Brazil, the growth was registered in all the main markets, such as Guyana (44.4%), Haiti (82.8%), Jamaica (19.8%), the Dominican Republic (87.1%), Trinidad (48.7%), and Venezuela (36.7%). Jamaica continued with the largest market share (22.2%) in the free zone in Curaçao.

Tourism

Tourism is one of the principal activities and foreign exchange earners in the Antillean economy. Foreign exchange earnings in the Netherlands Antilles were up by 6.3% in the second quarter of 1998, compared to a swell of 10.6% in the second quarter of 1997. In 1998's second quarter, the tourist sector in the Netherlands Antilles recorded a rise in stay-over tourism, and a contraction in cruise tourism. The number of stay-over tourists grew by

8.7% in the second quarter of 1998, up from a surge of 6.4% in the same quarter of 1997. Cruise tourism dipped by 3.4%, in contrast to an increase of 24.9% in 1997. An analysis by islands shows that all islands except Bonaire reported positive growth in stay-over tourism. Furthermore, Curaçao was the only island that posted a gain in the cruise tourist sector.

Tourist activities in St. Maarten recorded mixed developments in the quarter ending June 1998. The increase in stay-over tourism was reflected by a 13.1% rise in the number of stay-over guests. By contrast, the number of cruise visitors declined by 6.2%. The growth in stay-over tourism was related to, respectively, the 12.6% and 4.0% upturn in the main markets, the USA and France (table 3). In contrast, the number of Dutch passengers tumbled by 8.4% during the period April-June of 1998, but this drop was outbalanced by the increase in the number of French visitors, which enhanced the European market. The South American market improved by 48.0%, a consequence of more tourist arrivals from Venezuela and Brazil.

Bonaire's tourism developments were poor in the second quarter of 1998. Both the number of stay-over and cruise travelers shrank by 1.3% and 3.9%, respectively, in the April-June quarter of 1998. The weak performance in stay-over tourism was attributable to the decline in the North American (-2.4%) and European (-10.6%) markets. The US and Dutch arrivals, Bonaire's largest tourism market, showed a drop of 1.5% and 18.1%, respectively. Stay-over guests from the South American market, however, grew by 49.1%, primarily due to the increase in the number of Venezuelan visitors.

Table 3
Developments in stay-over tourism by island
(% change)

	Curaçao		St. Maarten		Bonaire	
	1997- II	1998- II	1997- II	1998- II	1997- II	1998- II
North America, of which:	2.3%	11.7%	25.2%	14.0%	-3.8%	-2.4%
-U.S.A.	2.5%	10.7%	24.3%	12.6%	-1.6%	-1.5%
-Canada	-2.6%	35.3%	38.5%	32.9%	-	-
					48.1%	38.4%
Europe,	-0.9%	-9.5%	0.8%	9.2%	-0.6%	-
						10.6%
of which:						
-The Netherlands	-3.9%		-39.3%	-8.4%	0.5%	-
		10.0%				18.1%
-France	-	-	-3.6%	4.0%	-	3.0%
					35.9%	
-Germany	7.0%	-	-	-	-1.5%	2.0%
		11.5%				
-Other Europe	26.9%	-3.2%	0.1%	55.2%	0.0%	18.4%

South & Central America,	-3.1%	20.9%	4.4%	48.0%	-49.1%	
						37.7%
of which:						
-Venezuela	-7.7%	44.7%	17.9%	109.2%	-66.6%	
						39.9%
-Brazil	-4.8%	-	2.4%	181.7%	-	-
		55.4%			36.8%	15.0%
-Other S&C America						
Caribbean,	0.1%	2.6%	-6.1%	7.4%	-	-
						24.8%10.8%
of which:						
-Aruba	4.6%	-1.3%	-	-	-	-
						24.4%15.7%
-Santo Domingo	-	-0.6%	-	9.1%	-46.3%	
	12.2%		11.2%			29.3%
-Other Caribbean						
Rest of World	12.8%	-	7.4%	-2.9%	-60.0%	
		10.0%				66.1%
Total	0.4%	2.5%	12.4%	13.1%	-9.0%	-1.3%

Curaçao's tourist sector posted advances of, respectively, 2.5% and 18.4% in stay-over and cruise tourism. Over the years, the island's stay-over tourism has reported a decelerating trend, caused partly by the lack of moderately priced and quality hotel rooms, compared to the other Caribbean destinations. Hence, charter operators have not been able to include Curaçao as part of their vacation destinations. Most important, there is a paucity of big hotel chains with an international marketing network that can promote the island. The number of stay-over travelers from the European market contracted by 9.5% in the second quarter, following a decrease of 0.9% a year earlier. Dutch visitors, the largest European market visiting Curaçao, plummeted by 10.0%. However, the North American market grew by 11.7%, as US passenger arrivals increased by 10.7%. The number of tourists from the Caribbean and South America were up by 2.6% and 20.9%, respectively. The moderate stay-over tourist industry also was reflected by the decline in the amount of visitor nights, as the hotel occupancy rates weakened by 33.3%, compared to a fall of 0.9% in the second quarter of 1997.

Transportation

The air transportation sector experienced mixed performance in the second quarter of 1998. The number of passengers transferred by the national airline "Air ALM" advanced by 28.1%,

while freight shipments transported decreased by 11.9%. The rise in the number of passengers was the result of more passengers traveling abroad during the summer holidays.

In addition to the modest gain in Curaçao's tourist sector, airport activities, as measured by total passenger traffic also improved. Airport activities grew by 12.3% in the second quarter of 1997, as total traffic of passenger arrivals and departures expanded. Over the months April-June 1998, St. Maartens air transportation continued to increase, as commercial landings and total passenger traffic swelled by 0.4% and 11.8%, respectively. This development clearly reflects the growing tourism industry in St. Maarten.

In the second quarter of 1998, oil transshipment and oil storage movements in Curaçao rose by 19.9% and 2.4%, respectively. While in Bonaire, oil transshipment activities were down by 40.0%, in contrast to a rise of 39.1% in the corresponding quarter of 1997. As well as the deterioration in oil transshipments, the amount of oil stored slipped by 38.3%, compared to the 40.0% growth in the second quarter of 1997.

PUBLIC FINANCE

General developments in the public sector

Developments in the public sector in the second quarter of 1998 can be related to a changing of the guard at the central government level. As result of the January 1998 elections for Parliament in the Netherlands Antilles, negotiations for forming a new government that began in the first quarter of 1998 extended through the second quarter of 1998. The new cabinet took office on June 1, 1998.

The General Government's deficit on a cash basis deteriorated considerably in the second quarter of 1998 when compared with the second quarter of 1997. The growth in expenditures (12.6%) outpaced the growth in revenues (4.8%), causing the deficit to rise by 61.9% (NAf.28.9 million).

table 4
Operations of the General Government (in millions NAf.)

	<i>Change</i>				
	1998-II		1997-NAf.		%
	II				
REVENUES	311.2	2296.9	14.3	4.8%	
Tax revenues	277.5	265.9	11.6	4.4%	
Nontax revenues	31.9	29.2	2.7	9.4%	
Capital revenues	0.0	0.4	-0.4	-	
				100.0%	
Grants	1.8	1.4	0.4	28.6%	
EXPENDITURES	386.8	343.6	43.2	12.6%	
Current expenditures	375.9	323.8	52.1	16.1%	

Capital expenditures	10.9	19.8	-8.9	-44.9%
BALANCE	-75.6	-46.7	-28.9	61.9%
% of GDP	-1.7%	-	1.1%	

The General Government experienced difficulties in financing the deficit during the second quarter of 1998. Investors in the domestic financial market were reluctant to finance the budget deficits completely. As a consequence, the government is financing its deficit at increased costs through higher interest rates.

The Central Government was able to raise NAf.41.4 million through the issue of debt instruments in the second quarter of 1998. The market, on the other hand, was not willing to refinance all of the maturing securities of the island government of Curaçao, which actually had a net redemption of NAf.11.7 million during the second quarter. A 9.25% 7-year coupon bond issue of the island territory of Curaçao closed at an effective yield of 9.85% at the end of the second quarter of 1998 .

Comparing developments in the second quarter of 1998 with those in the second quarter of 1997, one can conclude that:

- The budget deficit on a cash basis deteriorated substantially;
- Revenues developed satisfactorily; tax revenues increased by 4.4% (NAf.11.6 million), while non tax revenues increased by 9.4% (NAf. 2.7 million);
- Total expenditures increased by 12.6% (NAf.43.2 million), due mainly to a substantial growth of NAf.52.1 million (16.1%) in current expenditure outlays because of settlement of arrears to the civil servant pension fund APNA (NAf.45.9 million);
- Capital outlays were down by NAf.8.9 million;
- Interest rates during the second quarter of 1998, for 4- to 7-year bond issues, were on average 29 basis points higher than bonds issued in the same period in 1997. Because of the lower rates in the international financial markets, the spread between local instruments and US treasury paper for 4- to 7-year bonds has widened by an average of 120 basis points;
- The period in which the settlement of the revenue-sharing agreement and the debt settlement arrangement between the island government of Curaçao and the Central Government takes place influences to a large extent the results of the operations of both government levels. In the second quarter of 1998, settlement took place for the last two quarters of 1997; and
- The need for corrective measures to contain expenditures is pressing.

Operations of the Central Government

The deficit of the Central Government deteriorated by NAf.60.7 million in the second quarter of 1998 when compared to the second quarter of 1997. This deterioration was the

result of NAf.45.6 million (31.2%) higher expenditure outlays, while total revenues fell by NAf.15.1 million (10.7%). The only tax category that generated revenues above trend during the second quarter of 1998 was the sales tax. All other tax categories dropped during the second quarter of 1998 when compared to the second quarter of 1997. Revenues from the sales tax increased by 4.8% in the second quarter of 1998. This increase is the result of a 2.5% (NAf.0.6 million) increase in the income from the sales tax generated on Curaçao and Bonaire, mainly because of an increase in the revenues collected in the services sector. The income from the turnover tax, effective in St. Maarten, Saba, and St. Eustatius, grew by 10.6% (NAf.1.0 million) in the second quarter of 1998 when compared to the second quarter of 1997. The increase in the proceeds from the turnover tax can be explained by better registry of enterprises eligible for this tax, increased efficiency, and changes in the law commencing January 1, 1998.

Table 5
Breakdown of the revenues from the sales tax in the Netherlands Antilles, in millions of NAf.

	1998-II	1997-II	Change	
			NAf.	%
Sales tax				
Curaçao and Bonaire (ABB)	24.5	23.9	0.6	2.5%
Turnover tax St. Maarten, Saba, and St. Eustatius (BBO)	10.4	9.4	1.0	10.6%
Total sales tax revenues	34.9	33.3	2.4	4.8%

Import duties were NAf. 2.8 million (8.8%) lower in the second quarter of 1998 than in the corresponding quarter of 1997.

Non tax revenues dropped by 41.8% (NAf.11.9 million) in the second quarter of 1998, the result of a drop of NAf.3.3 million (29.7%) in entrepreneurial and property income, and NAf.8.6 million less in receipts in the category "other non tax revenues". The only income received as entrepreneurial and property income was NAf.7.8 million in license fees collected by the Central Bank.

In the second quarter of 1998, the Central Government did not receive any contribution in the form of dividends from the government-owned entities. This development in other non tax revenues is in contrast to the second quarter of 1997 when a one-time contribution of NAf.8.6 million was received from Antelecom N.V. due to an already existent agreement. This contribution explains to a large extent, the drop in other non tax revenues in the second quarter of 1998.

For fees, charges and sales the Central Government received the same amount in the second quarter of 1998 as it did in the same quarter of 1997.

Table 6
Operations of the Central Government (in
millions NAF.)

	Change			
	1998- II	1997- II	NAf.	%
REVENUES	125.7	140.8	-15.1	-10.7%
	107.3	110.9	-3.6	-3.2%
Tax revenues,				
of which:				
-excises	35.4	36.7	-1.3	-3.5%
-import duties	29.1	31.9	-2.8	-8.8%
-foreign exchange tax	0.0	0.1	-0.1	-
				100.0%
-property transfer tax	2.6	4.2	-1.6	-38.1%
-sales tax	34.9	33.3	1.6	4.8%
Nontax revenues,				
of which:				
-entrepreneurial and				
property income	7.8	11.1	-3.3	-29.7%
-fees, charges, and sales	8.8	8.8	0.0	0%
-other nontax revenues	0.0	8.6	-8.6	-
				100.0%
	0.0	0.0	0.0	
Capital revenues				
	1.8	1.4	0.4	28.6%
Grants				
EXPENDITURES	191.6	146.0	45.6	31.2%
	186.0	130.8	55.2	42.2%
Current expenditures,				
of which:				
-wages and salaries	113.6	75.5	38.1	50.5%
wages	63.4	62.0	1.4	2.3%
social security	2.5	2.6	-0.1	-3.8%
pension	47.7	10.9	36.8	337.6%
-goods and services	23.2	27.7	-4.5	-16.2%
-interest payments	1.2	9.1	-7.9	-86.8%

-subsidies	1.8	5.2	-3.4	
-transfers	46.2	13.3	32.9	247.4%
other government levels	39.5	5.9	33.6	569.5%
households	1.5	1.6	-0.1	-6.3%
nonprofit institutions abroad	5.2	5.8	-0.6	-10.3%
	5.6	15.2	-9.6	-63.2%

Capital expenditures,

of which:

-investments	5.6	12.1	-6.5	-53.7%
-capital transfers	0.0	3.1	-3.1	

BALANCE -65.9 -5.2 -60.7

On the expenditures side, higher expenditure outlays were caused by an increase in wage payments in the amount of NAf.38.1 million (50.5%) and NAf. 32.9 million more in transfers. As can be seen in table 6, the substantial increase in wages and salaries was caused by a settlement of the short-term debt (inclusive payment arrears) to the civil servant pension fund to the extent of NAf.36.8 million.

In the second quarter of 1998, NAf.33.6 million more was transferred to other levels of government than in the same quarter of 1997. The largest share of these additional transfers can be explained by the settlement of the debt-settlement arrangement and revenue-sharing agreement between the Central Government and the government of the island territory of Curaçao. These transfers are summarized in table 7.

Table 7
Transfers from the Central Government to, among others, other government levels (in millions NAf)

Island territory of Curaçao of which:	
Debt comparison third and fourth quarters of 1997	20.0
Revenue-sharing agreement first quarter 1998	4.8
Solidarity Fund (contribution 1998)	3.0
Budget Support Island territory of Saba	0.6
SOFNA Development Fund (contribution 1998)	2.0
Social safety net (contribution 1998)	2.0
Criminality Trust Fund	0.8

The settlements of these debt, payment arrears, and revenue-sharing arrangements contributed to an increase of NAf.55.2 million in the current expenditures in the second

quarter of 1998 when compared to the same quarter of 1997. These developments were mitigated slightly by lower subsidies in the amount of NAf.3.4 million.

The drop by NAf.7.9 million in interest payments must be interpreted with caution and must be seen against the background of the debt settlement between the Island Government and the Central Government. The Central Government and the Island Government of Curaçao maintain a current account relationship with each other for the settlement of debts. During the second quarter of 1998 the aforementioned governments settled debts dating back to the third and fourth quarters of 1997.

As an outcome of this debt settlement exercise, among other things, NAf. 10.6 million of interest expenses related to the development aid loan repayments were settled by the island government of Curaçao to the Central Government. The Central Government deducted this interest payment from its total interest expense. However, since the debt settlement was not settled at the usual end of quarter, the comparative interest expense figures become distorted. Taking this into account, one must conclude that the interest expenses during the second quarter of 1998 actually increased by NAf. 2.5 million when compared with the second quarter of 1997.

In the second quarter of 1998, capital expenditures dropped by NAf.9.6 million (247.4%), the result of NAf.6.5 million less investments and NAf.3.1 million less capital transfers.

Table 8
Changes in outstanding balances of the
Central Government (in millions NAf.)

	1998-II 1997-II	
FISCAL BALANCE	-65.9	-5.2
MONETARY FINANCING,	23.3	5.4
of which:		
Central Bank	26.3	1.6
Commercial banks	-3.8	3.7
Coins & notes	0.8	0.1
NON-MONETARY	42.6	-0.2
FINANCING,		
of which:		
Government securities with the	41.4	6.9
public		
Other	1.2	-7.1

The Central government ended up with a negative fiscal balance on a cash basis of NAf.65.9 million at the end of the second quarter of 1998. This deficit was financed both monetarily and non monetarily as can be seen in table 8. The deficit was financed by drawing down the deposits at the Central Bank in the amount of NAf.29.4 million. In addition, the Central Government borrowed NAf.41.4 million from the general public in the second quarter of 1998.

Operations of the Island Government of Curaçao

The deficit of the Island Government of Curaçao developed satisfactorily during the second quarter of 1998. The deficit improved by NAf.31.8 million in the second quarter of 1998 when compared to the second quarter of 1997. Although expenditures increased by NAf.27.8 million (14.0%), it was mainly the windfall in revenues that contributed to the improvement in the balance in the second quarter of 1998.

Total revenues increased significantly by NAf.59.6 million (38.0%) when comparing the second quarters of 1997 and 1998. The improvement in total revenues was due to an increase of 9.8% (NAf.15.2 million) in tax revenues, an increase of NAf.14.4 million in non tax revenues, and a substantial contribution of grants received in the amount of NAf.30.4 million.

No noticeable change occurred in the profit and income tax area when comparing the second quarters of 1997 and 1998. Wage taxes increased by 25.0% (NAf. 18.5 million), while land tax paid dropped by NAf.2.2 million from the second quarter of 1997 to the second quarter of 1998. Of the NAf.18.5 million increase in wage taxes, NAf.8.9 is attributable to settlement in connection with debt-comparison with the Central Government.

The growth in non tax revenues was caused by a NAf.4.3 million increase in entrepreneurial and property income, NAf.3.1 million in fees, charges, and sales, and NAf.7.0 million in other non tax revenues. The increase in entrepreneurial and property income was a NAf.5.0 million dividend received from Curoil N.V. to the Island Government of Curaçao in the second quarter of 1998.

Table 9
Operations of the Island Government of
Curaçao (in millions NAf.)

	Change			
	1998- II	1997- II	NAf.	%
REVENUES	216.6	157.0	59.6	38.0%
	170.2	155.0	15.2	9.8%
Tax revenues,				
of which:				
-profit tax	59.2	59.3	-0.1	-0.2%
-income tax	10.2	10.1	0.1	1.0%
-wage tax	92.6	74.1	18.5	25.0%

-land tax	0.6	2.8	-2.2	-78.6%
-motor vehicle tax	2.2	3.3	-1.1	-33.3%
	15.3	0.9	14.4	1600.0%

Non tax revenues,

of which:

-entrepreneurial and property income	5.8	1.5	4.3	286.7%
-fees, charges, and sales	6.8	3.7	3.1	83.8%
-other non tax revenues	2.7	-4.3	7.0	-162.8%
	0.0	0.4	-0.4	

Capital revenues

	31.1	0.7	30.4	4342.9%
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Grants

EXPENDITURES	226.3	198.5	27.8	14.0%
	221.0	193.9	27.1	14.0%

Current expenditures,

of which:

-wages and salaries	90.6	78.9	11.7	14.8%
wages	77	73.9	3.1	4.2%
pension premiums	13.6	5.0	8.6	172.0%
-goods and services	60.9	52.1	8.8	16.9%
-interest payments	26.6	20.0	6.6	33.0%
-subsidies to public companies	20.9	22.4	-1.5	-6.7%
-transfers	22.0	20.5	1.5	7.3%
to other government levels	3.9	3.7	0.2	5.4%
to households	11.3	9.5	1.8	18.9%
to non-profit institutions abroad	6.8	7.3	-0.5	-6.8%
	5.3	4.6	0.7	15.2%

Capital expenditures,

of which:

-investments	5.2	3.4	1.8	52.9%
-net lending	0.0	1.2	-1.2	-100.0%
-amortization	0.1	0.0	0.1	

BALANCE	-9.7	-41.5	31.8	
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In the second quarter of 1998 the Central Government transferred NAf.31.1 million to the island territory of Curaçao. This transfer is related to the revenue-sharing agreement and the debt-settlement arrangement for both the third and the fourth quarters of 1997. Because of this transfer, grants were above normal levels in the second quarter of 1998 when compared to the second quarter of 1997.

On the expenditures side, current expenditures and capital expenditures increased by NAf.27.1 million and NAf.0.7 million, respectively. In the current expenditures category, wages increased by NAf.3.1 million and pension premium contributions by NAf.8.6 million when comparing the second quarter of 1998 with the same quarter of 1997. This increase in current expenditures was aggravated further by higher expenditures of NAf.8.8 million (16.9%) on goods and services, higher interest payments of NAf.6.6 million (19.8%), and an increase of NAf.1.5 million (4.4%) in transfers in the second quarter of 1998. Subsidies to public companies, on the other hand, dropped by NAf.1.5 million in the second quarter of 1998.

Capital expenditures increased by 15.2% (NAf.0.7 million) in the second quarter of 1998 mostly because of a NAf.1.8 million increase in investments, offsetting a reduction in net lending by NAf.1.2 million in the second quarter as compared to the second quarter of 1997.

Table 10
Changes in outstanding balances of the
Island Government of Curaçao (in millions
NAf.)

	1998-II	1997-II
FISCAL BALANCE	-9.7	-41.5
MONETARY FINANCING,	7.4	13.5
of which:		
Central Bank	8.5	-6.4
Commercial banks	-1.1	19.9
NON-MONETARY	2.3	28.0
FINANCING,		
of which:		
Government securities with the	-11.7	17.7
public		
Other	14.0	10.3

The financing of the fiscal balance of the Island Government of Curaçao in the second quarter of 1998 was covered both monetarily and non monetarily. Among other things the island government of Curaçao ran down its deposits at the Central Bank in the amount of NAf.8.5 million.

Total outstanding public debt and guarantees

The total outstanding debt of the Netherlands Antilles increased by NAf.27.7 million (0.9%) during the second quarter of 1998 when compared to the first quarter of 1998. Domestic debt increased by NAf.16.4 million (0.7%), while foreign debt increased by NAf.11.3 million (2.0%). Total debt, as a percentage of GDP, reached 68.5% of GDP at the end of the second quarter of 1998.

Table 11
Total outstanding consolidated public debt and guarantees¹⁾ (in millions NAf.)

			Change	
	1998-II	1998-I	NAf.	%
Domestic consolidated debt	2417.8	2401.4	16.4	0.7%
of which:				
-Central Government	1019.2	1021.0	-1.8	-0.2%
-Curaçao	1331.1	1333.9	-2.8	-0.2%
-Bonaire	71.7	69.8	1.9	2.7%
-St. Maarten	14.4	10.7	3.7	34.6%
-St. Eustatius	2.1	2.0	0.1	5.0%
-Saba	1.5	1.3	0.2	15.4%
Foreign debt	564.6	553.3	11.3	2.0%
Total debt (consolidated)	2982.4	2954.7	27.7	0.9%
(% of GDP)	68.5%	68.1%		
Guarantees	346.5	347.1	-0.6	-0.2%
Total debt and guarantees	3328.9	3301.8	27.1	0.8%
(% of GDP)	76.5%	76.1%		

¹⁾ Estimate, consolidated for Central Government debt to Island Government of St. Maarten and Curaçao

The Central Government reduced its debt to other government levels and to the civil servant pension fund (APNA) by NAf.15.8 million and NAf.29.6 million, respectively. Government securities with the public issued by the Central Government increased by NAf.41.4 million during the second quarter of 1998.

The domestic debt of the Island Government of Curaçao dropped by NAf.2.8 million (0.2%) at the end of the second quarter of 1998 when compared to the end of the first quarter of 1998. The major factors that contributed to this development were the drop of NAf.12.9 million in the debt incurred through securities with the public and a drop of NAf.3.5 million in arrears to other creditors. This development was offset partly by an increase of NAf.11.7

million in the debt to the social security bank (SVB) and an increase of NAf.4.0 million in the debt to the pension fund (APNA).

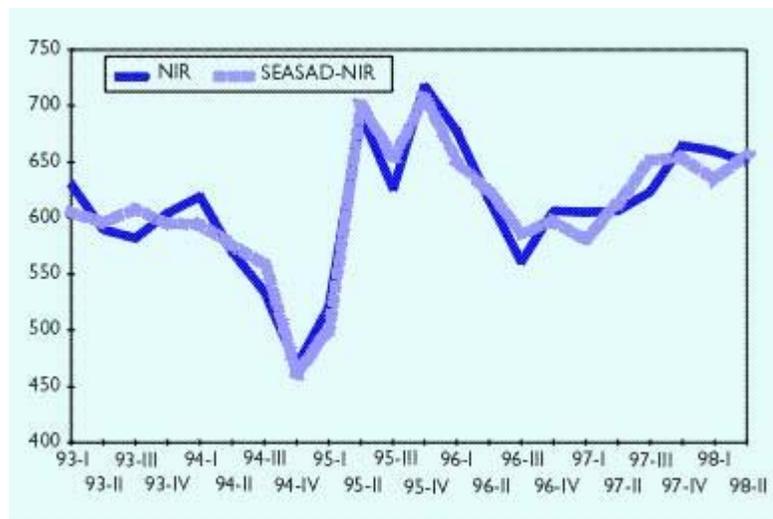
DEVELOPMENTS IN THE EXTERNAL SECTOR

Introduction

Net international reserves declined by NAf.9.4 million to NAf.649.9 million in the second quarter of 1998. The decline was the result of a drop of NAf.34.0 million in the foreign exchange reserves held at the commercial banks, offsetting an increase of NAf.24.6 million in the official exchange reserves held at the central bank (graph 1).

Graph 1

Development in net international reserves (in millions NAf.)



Both the current account deficit and the capital account surplus deteriorated in the second quarter of 1998 compared to the second quarter of 1997, explaining the decline in the net international reserves, as can be seen in table 12

Table 12
Balance of payments summary¹⁾ (in millions NAf.)

	1997- II	1998- II	diff.
Current account	-36.8	-43.0	-6.3
Capital account	47.8	29.0	-
		18.8	
Statistical discrepancies	-9.8	4.7	14.5
Balance of Payments	1.2	-9.3	-
		10.6	

Change in reserves ²⁾	-1.2	9.3	10.6
-with commercial banks	-13.5	34.0	47.5
-with Central bank	12.3	-24.6	-
			36.9

Memorandum Items

Official reserves (excluding gold)

-in millions NAF.	310.7	370.2	59.5
-in months of merchandise imports	1.6	1.8	0.2

¹⁾ *Cash basis*

²⁾ *-Sign denotes an increase in reserves (excluding gold)*

The current account

The current account of the balance of payments recorded a deficit of NAF.43.1 million in the second quarter of 1998, a worsening of NAF.6.3 million compared to the same period in 1997. As illustrated in table 13, this development in the current account was due primarily to a drop of NAF.34.7 million in net earnings from the services sector, mitigating the improvement in the trade balance.

Table 13
A breakdown of the current account ¹⁾ (in millions NAF.)

	1997- II	1998- II	diff.
Merchandise balance	-454.3	-437.8	16.5
-Exports	106.9	128.8	21.8
-Imports	561.2	566.6	5.3
Services balance	421.4	386.7	-34.7
Receipts, of which:	684.3	683.5	-0.8
-Transportation	151.1	136.5	-14.6
-Travel	270.4	287.4	17.0
-Int. financial & business services sector	150.0	147.1	-2.9
-Taxes	28.7	26.8	-1.9
-Operational income	121.3	120.3	-1.0
Expenditures, of which:	262.9	296.8	33.9
-Travel	102.5	138.1	35.6
-Int. financial & business services sector	46.9	59.5	12.6
Income balance ²⁾	23.5	34.7	11.2
Unrequited transfers ³⁾	-27.4	-26.7	0.7

Current account balance -36.8 -43.1 -6.3

¹⁾ Cash basis

²⁾ Income : investment and labor income.

³⁾ Unrequited transfers: private remittances (excl. labor income and life insurance).

The trade balance

The trade balance improved by NAf. 16.5 million in the second quarter of 1998, compared to the same period in 1997. This improvement was primarily the result of a NAf.21.8 million rise in exports, while imports increased by just NAf.5.3 million. A breakdown of the merchandise balance by island (table 14) reveals that exports increased particularly in Curaçao, while imports increased considerably on the Windward Islands.

Table 14
Merchandise balance per island¹⁾ (in millions NAf.)

	inflows			outflows		
	1997-II	1998-II	1998-diff.	1997-II	1998-II	1998-diff.
Curaçao						
Merchandise	96.9	115.2	18.3	418.7	401.4	-17.7
-Non-oil products	96.9	115.2	18.3	365.1	369.7	4.6
Free zone re-exports	69.9	74.8	4.9	74.4	88.2	13.8
Adj. Non-oil prod.	27.0	40.4	13.4	290.7	281.5	-9.2
-Oil products	0.0	0.0	0.0	53.6	31.3	-22.3
Bonaire						
Merchandise	1.4	1.1	-0.3	8.0	8.3	0.3
-Non-oil products	1.4	1.1	-0.3	8.0	8.3	0.3
-Oil products	0.0	0.0	0.0	0.0	0.0	0.0
Windward Islands						
Merchandise	8.6	12.5	3.8	134.5	157.3	22.7
-Non-oil	7.6	10.0	2.4	135.5	124.9	-10.6

products						10.6
-Oil products	1.1	2.5	1.4	-1.0	32.4	33.4

Netherlands

Antilles

Merchandise	106.9	128.8	21.8	561.2	566.6	5.3
-Non-oil products	105.9	126.3	20.4	508.6	502.9	-5.7
-Oil products	1.1	2.5	1.4	52.6	63.7	11.1

1) Cash basis

From table 14 it can be deduced that the improvement in the merchandise balance was primarily concentrated in Curaçao. Curaçao's merchandise balance improved by NAf.36.0 million as a result of higher exports and lower imports. The growth in exports was almost entirely related to the re-exporting activities of the free zone companies. Non-oil-related imports increased by just NAf.4.6 million in the second quarter of 1998. However, if adjusted for imports for free zone-related activities, non-oil-related imports actually declined by NAf.9.2 million. This decline was concentrated primarily in the real estate sector, which declined by approximately NAf.7.5 million.

The trade balance on Bonaire remained almost constant, whereas the Windward Islands recorded a NAf.18.9 million worsening in their trade balance, due mainly to higher oil imports. Non-oil imports decreased by NAf.10.6 million in the second quarter of 1998, attributable mainly to lower imports by the retail sector in the second quarter of 1998.

The services balance

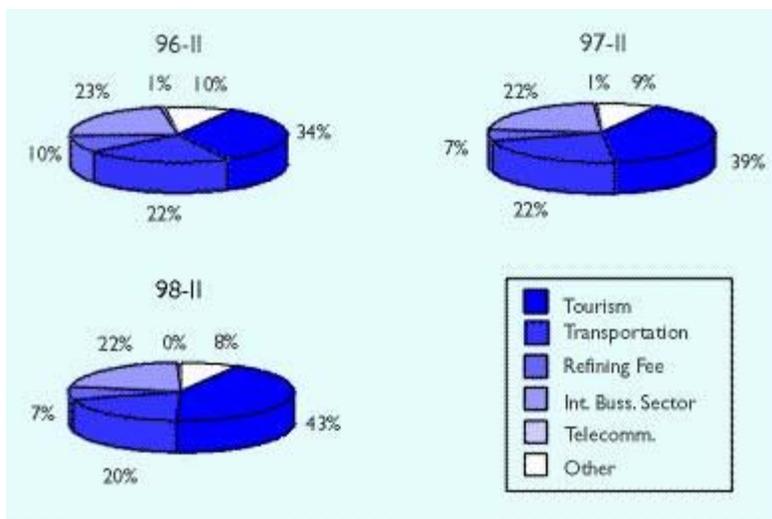
The surplus on the services balance recorded a huge drop of NAf.34.7 million in the second quarter of 1998. This deterioration was largely the result of stagnation in foreign exchange receipts, while foreign exchange expenses grew by almost 13% compared to the second quarter of 1997.

Foreign exchange earnings dropped by just 0.8 million, particularly as a result of the NAf.14.6 million drop in the transportation sector and the NAf.2.9 million decline in the international financial & business services sector. The combined drop in both sectors nullified the NAf.17.0 million improvement in tourism earnings. Contrary to this development, foreign exchange expenses grew by NAf.33.9 million, primarily related to expenditures by residents abroad.

As shown in graph 2, the composition of earnings from the services sector has changed. In particular, the share of tourist earnings increased from 34% in 1996 to its current 43%. The international financial & business sector is still the second main foreign exchange contributor in our services sector, despite the negative developments in this sector.

Graph 2

Composition of services sector earnings (in percentage)



Tourism

The tourism sector recorded a good overall performance. As can be seen in table 15, foreign exchange receipts from the tourism sector in the Netherlands Antilles increased by NAf.17.0 million (5.9%) in the second quarter of 1998, mainly as a consequence of a rise in tourist receipts on the Windward Islands.

Foreign exchange generated by the tourism industry on the Windward Islands jumped by 12.8 % in the second quarter of 1998. Concomitant with this development, the number of stay-over visitors surged by 13.1%.

Table 15
Second quarter foreign exchange revenues from tourism by island¹⁾ (in millions NAf.)

	1994- II	1995- II	1996- II	1997- II	1998- II
Bonaire	13.0	16.1	19.2	19.2	17.4
Curaçao	75.4	69.5	74.2	98.5	94.9
Windward Islands	176.2	170.5	151.0	152.7	175.1
Netherlands Antilles	264.6	256.1	244.4	270.4	287.4
Percentage growth	2.6%	-3.2%	-4.6%	10.6%	6.3%

¹⁾ Cash basis

The strong development in tourism activities on the Windward Islands was offset slightly by developments on the Leeward Islands. Foreign exchange earnings on Bonaire declined by just NAf.1.8 million. This performance was reflected in stay-over tourism, which declined by 31.2%. Curaçao recorded a small drop in foreign exchange earnings following a strong first

quarter performance; foreign exchange revenues decreased by N Af3.6 million in the second quarter of 1998. Contrary to this development, both the numbers of stay-over tourists and cruise tourists increased compared to the second quarter of 1997. Particularly, cruise tourism recorded a good performance (18%) during the second quarter of 1998.

Expenditures by residents abroad recorded a huge increase of N Af.35.6 million compared to the same period in 1997. Despite the apparent reduced spending capacity, residents have increased their travelling abroad.

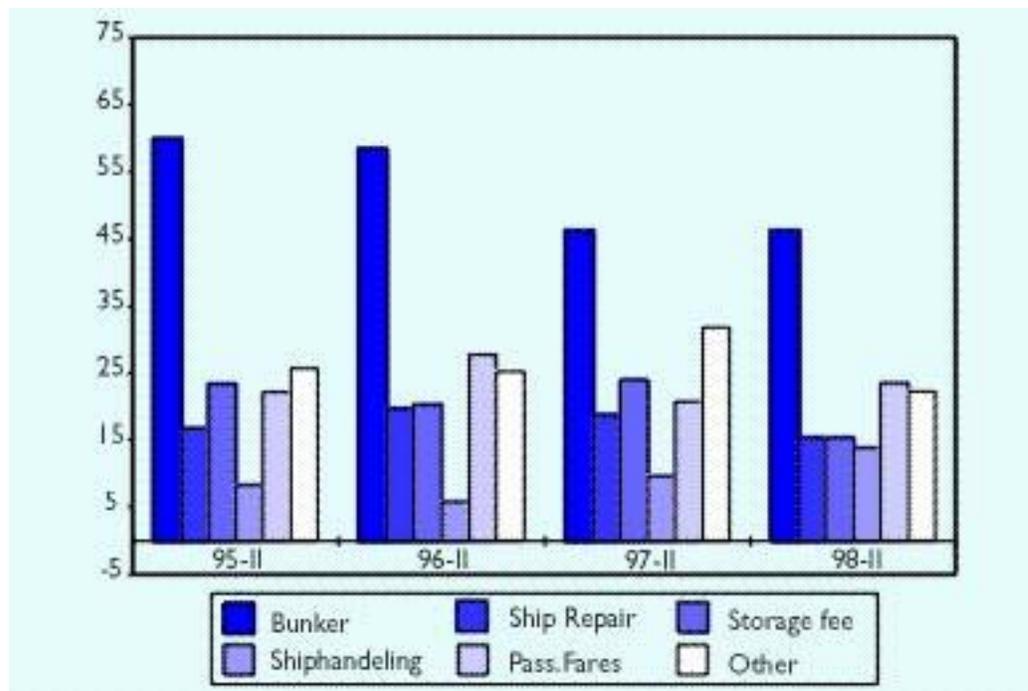
Transportation

The transportation sector recorded an absolute disappointing performance in the second quarter of 1998 (graph 3). Foreign exchange earnings from transportation activities decreased by N Af.14.6 million in the second quarter of 1998 compared to the same period in 1997. This drop in foreign exchange receipts can be ascribed primarily to less buoyant performance in bunker and storage activities.

Overall payments for transportation services received increased by N Af.4.3 million in the second quarter of 1998, particularly for the passenger fares paid to foreign carriers, which partly explains the huge rise in tourist expenses by residents abroad.

Graph 3

Developments in foreign exchange generation in the transportation sector by branch of industry (in millions N Af.)



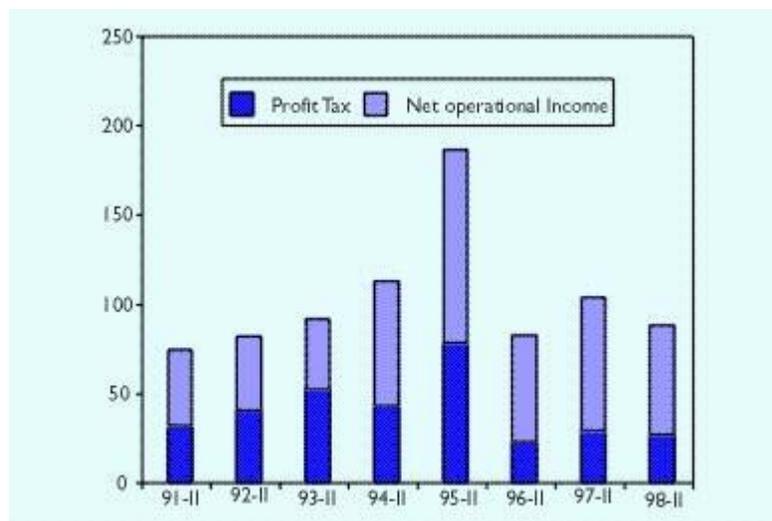
The international financial and business services sector

Foreign exchange earnings from the international financial and business services sector recorded a net drop of just NAf.2.9 million in the second quarter of 1998, compared to the second quarter of 1997. The deterioration in foreign earnings occurred in both the operational income and profit taxes.

Contrary to this development, foreign exchange expenses for services received rose by NAf.12.6 million, as compared to the same period in 1997.

Graph 4

Development in the international financial and business services sector (in millions NAf.)



The income balance

The income account of the balance of payments recorded a higher surplus than in the second quarter of 1997. The surplus recorded amounted to NAf. 34.7 million, an increase of NAf.11.2 million compared to the same period in 1997. This increase can be ascribed entirely to investment income, since the labor income balance deteriorated by NAf.4.4 million. As table 16 reveals, the increase in investment income was the result of overall higher receipts.

Table 16

Breakdown of the income account⁽¹⁾ (in millions NAf.)

	1997-II	1998-II	diff.
Investment income	23.4	39.0	15.6
-Direct investment income	-5.7	-7.3	-1.6
Received	0.0	0.5	0.5

Paid	5.7	7.9	2.2
-Other investment income	29.1	46.4	17.3
Received	35.5	52.4	16.9
Paid	6.4	6.0	-0.4
Labor income	0.1	-4.3	-4.4
Received	2.6	1.3	-1.3
Paid	2.5	5.6	3.1
Total income balance	23.5	34.7	11.2

¹⁾ *Cash Basis*

The investment income balance increased by NAf.15.6 million during the second quarter of 1998. This development was primarily the result of higher interest receipts by local banks and insurance companies from abroad (NAf. 15.2 million), offsetting an increase in profit transfers by resident companies to abroad by NAf.2.2 million in the second quarter of 1998.

The capital account

The capital account of the balance of payments recorded a surplus of NAf.29.0 million in the second quarter of 1998, a worsening of NAf.18.8 million compared to the second quarter of 1997. This deterioration can be attributed to both the private capital balance and the official capital balance.

The decline in the private capital balance of NAf.9.4 million (table 17) in the second quarter of 1998 was, among other things, the result of drops of NAf.6.9 million and NAf.2.9 million in net investment abroad and net foreign borrowing activities, respectively, as compared to the same period in 1997. The drop in net investment abroad in the second quarter of 1998 was a combination of a drop in net direct investment and a drop in net portfolio investment. The latter decline was due mainly to the NAf.40 million increase in re-investments abroad by particularly institutional investors and individuals, despite the high interest rates offered on government paper. The drop in net foreign borrowing was a combination of substantially fewer funds borrowed and fewer repayments made by resident companies.

Table 17
Major components of the capital account¹⁾
(Net flows in millions NAf.)

	1997-II	1998-II	diff.
Private capital,	14.3	4.9	-9.4
of which:			
-direct investment (Real	8.9	5.9	-3.0
estate)			
-portfolio investment	15.3	11.4	-3.9
(Securities)			
-loans (net)	-1.8	-4.7	-2.9

-comm. banks borrowings	0.3	0.0	-0.3
-other private cap.	-8.4	-7.7	0.7
Official capital,	33.5	24.1	-9.4
of which:			
-loans & grants	34.5	24.5	-10.0
-other Government cap.	-1.0	-0.4	0.6
 CAPITAL BALANCE	 47.8	 29.0	 -18.8

¹⁾ *Cashbasis*

MONETARY DEVELOPMENTS

Introduction

Monetary developments during the second quarter of 1998 must be seen against a background of growing uncertainties in the Antillean economy after the elections of January 1998. These uncertainties were caused, to a great extent, by the delay in the formulation of a policy to reduce the budget deficit. Under these circumstances, the Bank had to determine the permissible growth for credit to the private sector on a quarter-to-quarter basis to prevent excessive domestically induced monetary expansion, which directly leads to a depletion of our foreign exchange reserves.

For the second quarter of 1998, a permissible growth rate for credit to the private sector was set at 2% over the amount outstanding in September 1997. In addition, net credit to the government sector was limited to the amount outstanding in October 1996, implying zero growth.

Net domestic credit to the General Government increased, however, during the second quarter of 1998. This increase was mainly a result of a marked drop in the deposits of both the Central Government and the Island Governments. The demand for liquid assets by the private sector, measured as net credit to the private sector, showed a substantial increase in the second quarter of 1998. The outstanding amount of private sector loans of the combined banks remained just below the permissible amount. Overall, net domestic assets showed a considerable increase, the largest since the first quarter of 1996.

The foreign component of the total demand for liquid assets, net foreign assets, showed a slight decrease in the second quarter of 1998. This decrease was the result of an increase in foreign liabilities of the banking system, which outweighed the increase in foreign assets.

In light of these developments, the Bank decided to tighten its monetary policy further. For the period July 1, 1998, till December 31, 1998, net domestic credit of the banking system to the government will remain fixed at the amount outstanding on October 31, 1996. The permissible domestic credit growth rate for private sector loans for the second half of 1998, however, is set at 0.25% over the maximum allowed amount as of June 30, 1998.

Effective August 17, 1998, the Bank introduced new elements in its monetary policy, to make this policy more market-oriented. The most important change concerns the reserve requirement policy of the Bank, which is a monetary instrument aimed at mopping up excessive liquidity in the banking system and, hence, limiting the credit potential of commercial banks. The reserve requirement entails the placing of a non-interest-bearing deposit (reserve requirement) by the banks on a blocked account at the Bank, for a certain period of time. New in the measure is the possibility for commercial banks to buy or hold certificates of deposits (CDs) issued by the Bank to comply with up to 25% of their reserve requirement on the first day of the reserve requirement period. In between the first day of subsequent reserve periods, the CDs will be tradable among the local commercial banks, providing them more flexibility in their liquidity management. Effective September 16, 1998, the Bank raised the reserve requirement by 2% to 6% implying that under this new arrangement up to 1.5% of this 6%-reserve requirement can be met by buying or holding CDs on the first day of a requirement period.

Another important new element in the Bank's monetary policy is the deactivation of the B-9 policy, which among other things, entailed a maximum allowed foreign exchange working balance for commercial banks, effective August 17, 1998. Under the new policy, the net foreign asset position of the banks is no longer bound to a maximum. Negative foreign assets positions, however, will not be allowed and will be penalized by the Bank.

Money supply

During the second quarter of 1998, the money supply (M2) expanded by 1.9% (NAf.49.1 million), compared to a 0.9% (NAf.23.4 million) contraction in the second quarter of 1997. As shown in table 18, the expansion in the second quarter of 1998 can be attributed entirely to an increase in the near-money component.

Table 18
Quarterly changes in the components of the money supply (in millions NAf. and in percentages)

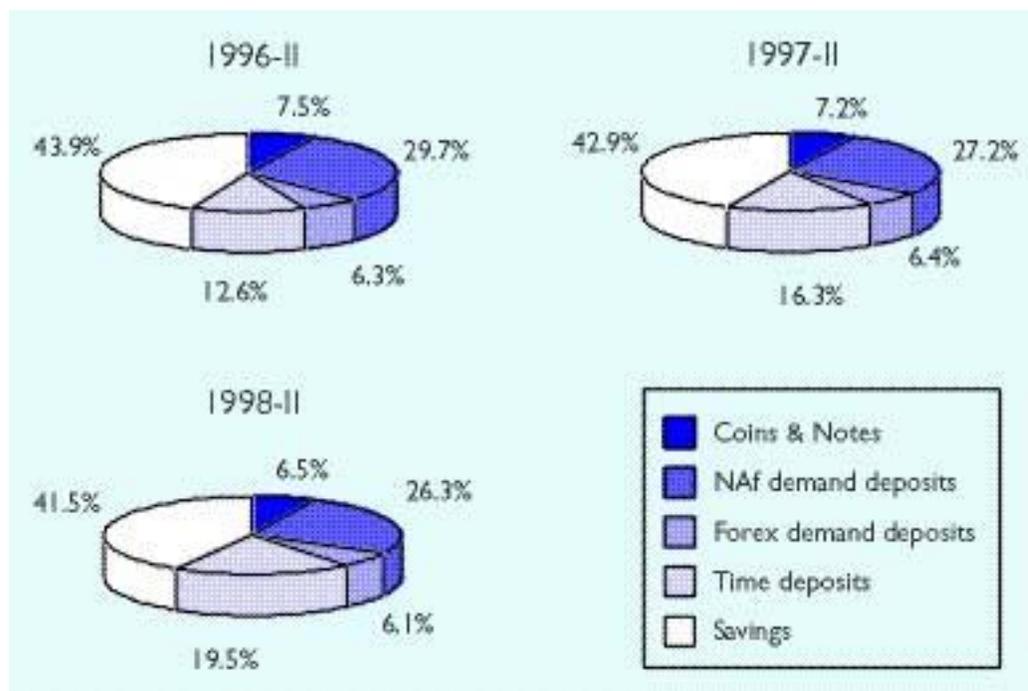
	1998-II		1997-II		1996-II	
Coins and notes with the public	-0.5	-0.3%	0.9	0.5%	-1.9	-1.0%
Demand deposits held by the public, of which:	-	-1.9%	-	-7.9%	-	-1.3%
-Neth. Ant. guilders	16.9		73.7		12.1	
-Foreign currency	-1.5	-0.2%	-	-7.2%	1.6	0.2%
			53.9			
	-	-8.7%	-	-10.8%	-	-7.8%
	15.4		19.8		13.7	

Money (M1)	- 1.7%	- 6.5%	- 1.2%
	17.4	72.8	14.0
Time deposits	68.3 15.1%	60.9 17.2%	--10.0%
			36.0
Savings	-1.8 -0.2%	- 1.0%	-3.5 -0.3%
		11.5	
Near money	66.5 4.3%	49.4 3.4%	- -2.6%
			39.5
Money supply	49.1 1.9%	- 0.9%	- -2.0%
		23.4	53.5

The money component of the money supply contracted by 1.7% (NAf.17.4 million) in the second quarter of 1998, compared to a 6.5% (NAf.72.8 million) contraction in the second quarter of 1997. The decrease in money during the second quarter of 1998 was the result of an decrease in all components of M1. The foreign currency and NAf.-denominated deposits declined by 8.7% (NAf.15.4 million) and 0.2% (NAf.1.5 million), respectively. Coins and notes with the public declined by 0.3% (NAf.0.5 million). The decrease in coins and notes with the public on an annual base, continued for the tenth consecutive quarter. This development reflects the increased efficiency in the payments system, with economic agents shifting from cash payments to banking transfers (e.g., checks, standing orders, and transfers) or electronic means of payments at the point of sale, like debit cards. The overall decline in M1, being the transaction balances of the public, is in line with the weak performance of our economy.

The near-money component of the money supply expanded by 4.3% (NAf.66.5 million) in the second quarter of 1998 compared to a 3.4% (NAf.49.4 million) expansion in the same quarter of 1997. This slight acceleration was mainly the result of a slowdown in the decline in savings deposits from a 1.0% (NAf.11.5 million) contraction to a 0.2% (NAf.1.8 million) contraction. Time deposits, which are held by non individuals, grew by 15.1% during the second quarter of 1998 compared to the same period in 1997. The marked growth of these time deposits must be seen against a background of a marginal increase of 0.1% in the average interest rate on time deposits, and also may be a reflection of the reticent attitude of entrepreneurs towards other investments due to uncertainties related to, among other things, the public finances.

Graph 5
Developments in the composition of the money supply



With respect to the composition of the money supply, graph 5 reveals that at the end of the second quarter of 1998, the share of time deposits increased by 3.2 percentage points to 19.5%. This increase was at the expense of all other subcategories, of which the decline in saving deposits (2.4 percentage points) was most pronounced. The drop in the share of savings deposits in the composition of the money supply is the combined result of the slowdown in economic activities, the rise of the cost of living, and the continuing efforts of the Tax Office to speed up the collection of tax arrears.

Factors affecting the demand for liquid assets

The demand for liquid assets expanded by 1.9% (NAf.49.1 million) in the second quarter of 1998. This increase can be attributed to developments in the domestic sector, since the external component contracted. (see table 19).

Table 19
Quarterly changes in the demand for liquid assets by sector (in millions NAf. and in percentages)

	1998-II	1997-II	1996-II
Government	44.9 38.3%	3.2 1.9%	1.6 0.7%
sector,			
of which:			
-Central	27.0 45.1%	3.2 3.5%	16.5 23.9%
Government			
-Island	17.9 31.3%	- 0.0%	-14.9 -9.9%
governments			
Private sector	19.4 0.8%	- -0.7%	74.7 3.4%

			16.0			
Miscellaneous	-7.8	2.1%	-	2.9%	-20.9	4.9%
			11.3			
Net domestic assets	56.7	2.8%	-	-1.2%	55.4	2.8%
			24.1			
Net foreign assets,	-7.6	-1.3%	0.7	0.1%	-	-17.0%
of which:					108.9	
-Gold	-	0.0%	-	0.0%	-	0.0%
-Official reserves	24.5	7.1%	-	-3.8%	-6.2	-1.6%
			12.2			
-Net foreign assets of commercial banks	-	-	-12.9	95.6%	-	-
	32.1	68.4%			102.7	150.4%
Total liquid assets	49.1	1.9%	-	-0.9%	-53.5	-2.0%
			23.4			

The demand for liquid assets by the domestic sector expanded by 2.8% (NAf.56.7 million) in the second quarter of 1998, compared to a 1.2% (NAf. 24.1 million) contraction in the same quarter of 1997. The expansion in the second quarter of 1998 can be ascribed to increases in the demand for liquid assets by both the public and the private sectors. These increases were mitigated partly by miscellaneous factors.

The demand for liquid assets by the government sector, measured as net domestic credit to the government, increased by 38.3% (NAf.44.9 million) during the second quarter of 1998, compared to a 1.9% (NAf.3.2 million) increase in the second quarter of 1997.

The demand for liquid assets by the Central Government increased by 45.1% (NAf.27.0 million) during the second quarter of 1998. This increase can be explained almost entirely as the net result of the drop in its deposits at the Central Bank by NAf.32.3 million, on the one hand, and the rise in its deposits at the commercial banks by NAf.3.3 million, on the other. Furthermore, claims on the Central Government (government paper) held by the domestic banking sector, declined by NAf.0.5 million.

The Island Governments' demand for liquid assets also increased by 31.3.% (NAf.17.9 million) in the second quarter of 1998, compared to zero growth in the second quarter of 1997. The increase in the second quarter of 1998 was almost entirely the result of a drop of their demand deposits both at the Central Bank and at the commercial banks by NAf.8.5 million and NAf. 10.6 million, respectively.

The growth in the demand for liquid assets by the private sector turned around from a 0.7% (NAf.16.0 million) contraction in the second quarter of 1997 to a 0.8% (NAf.19.4 million) expansion in the second quarter of 1998. The increase during the second quarter of 1998 can be ascribed to an increase of NAf.25.7 million in loans to the private sector. Overall, net credit to the private sector stayed just within the limits of the monetary cash reserve arrangement.

The net foreign assets position of the banking system contracted by 1.3% (NAf.7.6 million) in the second quarter of 1998, compared to a 0.1% (NAf.0.7 million) increase in the same quarter of 1997. The decline in foreign exchange reserves during the second quarter of 1998 is the net result of a NAf.32.1 million decrease in the net foreign assets of the commercial banks and a NAf.24.5 million increase in official foreign exchange reserves.

Domestic credit extension by commercial banks

Table 20 shows the outstanding amounts and the growth rates of the various components of the domestic loan portfolio of the commercial banks. As can be seen from this table, total domestic credit extension by commercial banks increased by 0.9% (NAf.22.2 million) during the second quarter of 1998, compared to a 0.8% (NAf.19.3 million) decline in the second quarter of 1997.

The total amount of outstanding domestic loans to the private sector at local commercial banks increased by 1.1% (NAf.23.9 million) during the second quarter of 1998, compared to a 0.7% (NAf.15.0 million) contraction during the second quarter of 1997. This turnaround can be attributed primarily to the acceleration in the growth of mortgages from 0.1% (NAf.0.7 million) expansion during the second quarter of 1997 to a 2.1% (NAf.18.5 million) expansion during the second quarter of 1998. The increase in outstanding mortgages during the second quarter of 1998 may be the result of the increase in total construction licenses granted during the second quarter of 1998. It may also be a reflection of collateral requested by commercial banks, especially to businesses facing the effect of the recession. Consumer loans increased by 0.1% (NAf.0.6 million) during the second quarter of 1998 compared to a 3.0% contraction during the second quarter of 1997. This marginal increase, which must be seen in light of the still-weak performance of our economy, reflects the reticent attitude of economic agents towards loans for consumptive purposes. Business loans grew by 0.6% (NAf.5.1 million), a modest turnaround compared to the 0.1% (NAf.0.9 million) contraction during the second quarter of 1997. On an annual basis, total domestic credit extension increased by 2.1% (NAf.51.7 million).

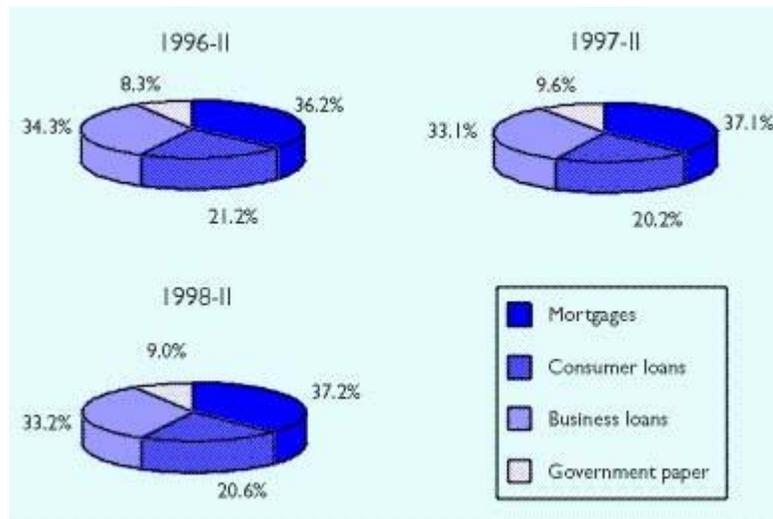
Table 20
Breakdown of the domestic loan portfolio of commercial banks as per end of period (in millions NAf.), and percentage quarterly changes

	1998-II	1997-II	1996-II
Domestic private sector loans,	2,239.81	2,182.4	-2,192.54
	1.1%	0.7%	3.1%

of which:			
-Mortgages	915.52.1%	895.70.1%	864.99.0%
-Consumer loans	507.00.1%	487.1	507.23.5%
		3.0%	
-Business loans	817.60.6%	799.5	820.4
		0.1%	0.2%
Government paper	221.3	232.8	198.72.2%
	0.8%	1.8%	
Total domestic loans	2,461.10.9%	2,415.2	2,391.24.0%
		0.8%	

The amount of government paper held by the commercial banks decreased by 0.8% (NAf.1.7 million) in the second quarter of 1998, compared to a 1.8% (NAf.4.3 million) decrease during the second quarter of 1997.

Graph 6
Composition of the domestic lending portfolio of commercial banks



Graph 6 reveals that the shares of mortgages, consumer loans, and business loans in the loan portfolio of the commercial banks increased marginally at the expense of the share of government paper.

Leeward Islands

A breakdown of domestic private sector lending by commercial banks by island group reveals that the growth in loans to the private sector on the Leeward Islands increased by

1.4% (NAf.23.9 million) during the second quarter of 1998, a turnaround compared to the 1.1% (NAf.18.2 million) contraction during the same quarter of 1997. The increase during the second quarter of 1998 is primarily the result of a 3.0% expansion in mortgages. This expansion is in line with the substantial increase in construction licenses granted as mentioned earlier.

Table 21
Domestic private sector loans at commercial banks on the Leeward Islands as per end of period (in millions NAf.) and percentage quarterly changes

	1998-II	1997-II	1996-II
Domestic private sector loans, of which:	1,714.0	1,654.0	-1,670.3
	1.4%	1.1%	31.7%
-Mortgages	638.9	622.7	593.0
	3.0%	0.1%	3.1%
-Consumer loans	397.8	369.1	-389.7
	0.5%	4.3%	2.0%
-Business loans	677.3	662.2	-687.6
	0.5%	0.3%	0.2%

Windward Islands

Table 22 reveals that credit extension to the private sector on the Windward Islands increased by 0.1% (NAf.0.7 million) in the second quarter of 1998, compared to a 0.6% (NAf.3.0 million) expansion in the second quarter of 1997.

Table 22
Private sector loans at commercial banks on the Windward Islands per end of period (in millions NAf.) and percentage quarterly changes

	1998-II	1997-II	1996-II
Domestic private sector loans, of which:	526.6	528.3	522.2
	0.1%	0.6%	12.9%
-Mortgages	276.1	-273.0	271.9
	0.3%	0.1%	24.4%
-Consumer loans	109.4	-118.0	117.5
	1.2%	1.5%	8.6%
-Business loans	141.1	137.3	132.8
	2.0%	0.8%	-2.4%

INTERNATIONAL AND REGIONAL DEVELOPMENTS

Introduction

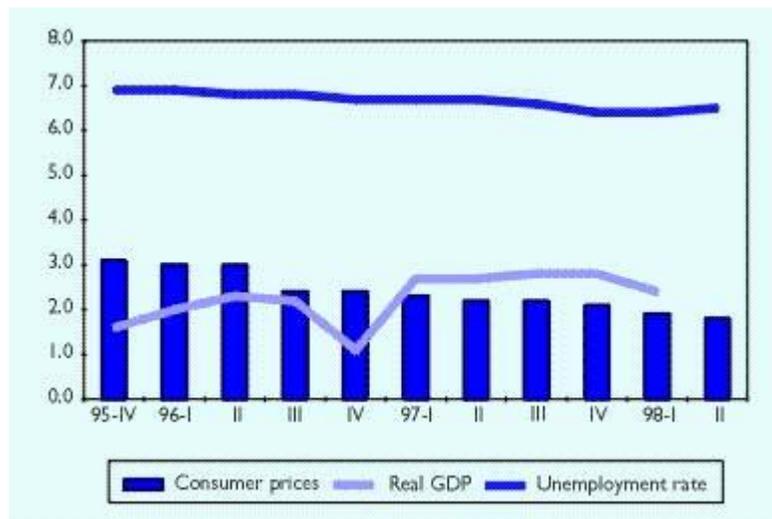
The economies of the industrialized countries of the OECD are expected to grow 2.4% in 1998, down from 3.1% in 1997. This growth is less than expected due to the crisis in Asia and the slump in the US stock market, which could temper consumer spending in the US. The expected growth rate will be 2.5% in 1999. The unemployment rate of the industrialized countries is expected to be 7.1% in 1998 and stabilize around 7% in 1999. The stabilization of the unemployment rate also can be attributed to expected slower growth of the economies and the tumbling of currencies in several Asian countries.

The US economy slowed somewhat in the second quarter of 1998, but less than expected due to the still strong consumer spending. The strong consumer spending partly mitigated the effects of the Asian crisis.

The Japanese economy is still in recession. It contracted at a 3.3% annualized rate in the second quarter of 1998, the third consecutive quarterly contraction. The recession is due to the sharp decrease in private consumption and corporate investments. For the remainder of 1998, declining exports are expected, primarily because of the deepening recession in other key Asian markets, which are important export markets for Japan. The weak domestic demand, a widening output gap, and lower oil prices and non-oil commodity prices indicate that inflationary pressures will remain muted up to 2002.

Graph 7

Selected OECD Major Seven economic key figures (% changes)



The economies of the 11 European Union countries that will switch to the single currency in 1999 grew by 1.8% in the second quarter of 1998 compared to the same quarter of 1997. These economies are experiencing higher consumer spending, particularly in the Netherlands,

Germany, and France. On the other hand, the Asian crisis is also having a dampening effect on these economies. The effects of the Asian crisis are being mitigated, because the EU also are exporting to other regions such as the US and East European countries.

Economic performance in the United States

Overview

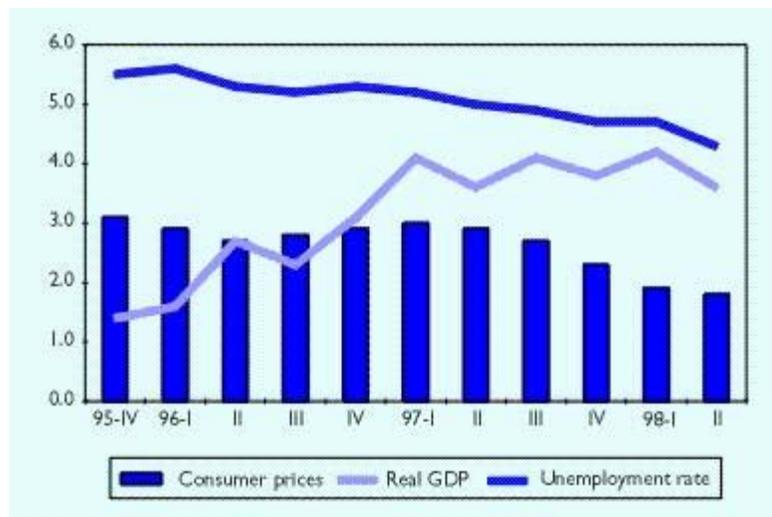
It is expected that the Asian crisis will have a negative impact on the US economy during 1998. Exports to the emerging markets of Asia and Japan already are decreasing. It also is expected that imports will slowly rise, as the increased competitiveness of Asian firms will increase their share of the US market. In addition, US exporters will have to cope with increased competition from Asian producers in third markets, such as the European Union. On the other hand, domestic demand is expected to remain strong, although a slowdown is foreseen at the end of 1998 due to a worsening performance in the tradables sector and lower equity prices.

Second quarter development

The growth of the US economy slowed in the second quarter of 1998, although less than expected, as the still strong consumer spending mitigated part of the shock of the Asian crisis. Real gross domestic product grew by 3.6% in the second quarter of 1998, compared to 4.2% in the first quarter. Stock prices were influenced negatively by concerns that slower growth might have repercussions on corporate profits.

Graph 8

Selected economic key figures of the United States (% changes)



Concomitant with the slower growth of the US economy, industrial production growth declined from 4.7% in the first quarter of 1998 to 4.0% in the second quarter. The decline in industrial output growth can be attributed to the effects of the General Motors Corporation strike and the Asian economic crisis. On an annual basis, industrial production growth declined only slightly by 0.1 percentage point to 4.8%.

Despite the slowdown in the US economy, the US labor market remained tight in the second quarter of 1998. The number of unemployed is still decreasing, indicating that the demand for jobs remained strong, especially when the General Motors Corporation strike ended. The US unemployment rate is now at its lowest in almost three decades, declining from an average of 4.7% in the first quarter to an average of 4.3% in the second quarter of 1998.

Consumer prices accelerated from 0.1% in the first quarter of 1998 to 0.5% in the second quarter. This acceleration can be attributed mainly to the increase in prices of health care, housing, and other services, since the prices of goods remained fairly constant. It is expected that, due to the low unemployment, wages and benefits demands can cause a further rise in the near future. However, on an annual basis, the CPI continued to decelerate by 0.2 percentage point to 1.8% in the second quarter of 1998.

Producer prices increased marginally by 0.1% in the second quarter of 1998, compared to the previous quarter. This increase is due mainly to the sharp increase in electricity prices, that resulted because of a heat wave. On an annual basis, producer prices that resulted continued to fall from -0.6% in the first quarter of 1998 to -0.9% in the second quarter.

The composite leading indicator, which projects economic performance in the short term, reveals that the growth of the US economy will slow down. This is reflected by the smaller growth of this indicator of 0.2% in the second quarter of 1998, compared to 0.4% in the previous quarter.

Economic performance in the Netherlands

Overview

The Dutch economy is expected to slow down from its fastest rate of growth since 1990. This slowdown can be attributed to the Asian downturn and falling global markets, which threaten Dutch exports. The Netherlands, which has the fifth-largest economy among the 11 countries joining the single currency in 1999, is expected to experience a real GDP growth rate of 4% in 1998, slowing to 3% in 1999. The decline in growth will bring the Netherlands more in line with its slower-growing European partners Germany and France, which also are coping with the increased competition from lower-priced imports. A similar development is expected for Dutch interest rates.

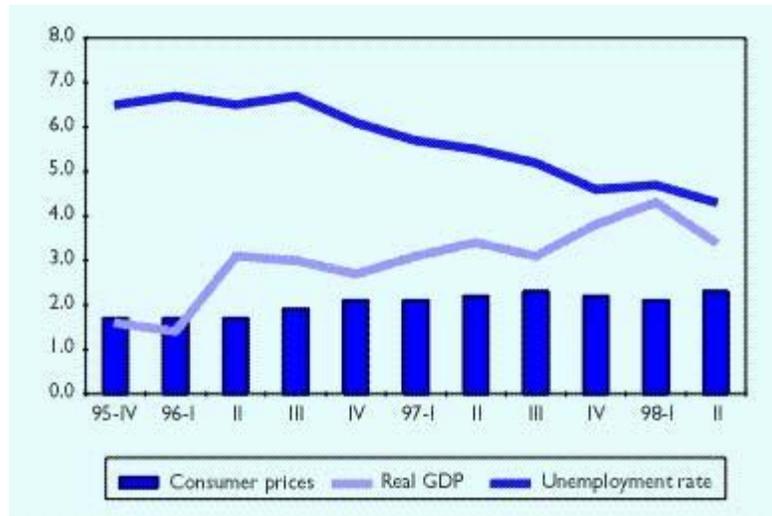
Second quarter development

Dutch gross domestic product (GDP) grew by 3.4% in real terms in the second quarter of 1998 compared to the second quarter of 1997, driven by rising household spending and the lowest unemployment in more than 17 years. Consumer spending, fueled by the abundance of job opportunities, continued to grow while industrial production was lagging. Consumer

spending is expected to keep the economy on track for the rest of 1998. The growth of the Dutch economy was, however, less than the 4.3% growth in the first quarter of 1998.

Graph 9

Selected economic key figures of the Netherlands (% changes)



The less robust growth of the economy also was felt in the industrial production sector. Industrial production growth declined from 5.1% in the first quarter of 1998 to 4.3% in the second quarter. The month-by-month industrial production growth rates were very volatile during the second quarter of 1998. In May, industrial production dropped, while in June a growth was recorded due to gains in construction and the clothing sector. On an annual basis, however, industrial production growth increased slightly from 4.5% in the first quarter to 4.6% in the second quarter of 1998.

Due to the still strong economic growth, the unemployment rate in the Netherlands reached its lowest level in more than 17 years in June 1998. The robust economy increased the demand for workers, especially in the high-tech industry. The Dutch unemployment rate averaged 4.3% in the second quarter of 1998, compared to 4.8% in the first quarter. The sharp decline in the unemployment rate could trigger wage pressures and, hence, an increase in inflation. However, lower energy prices and rents are expected to keep inflation tamed for the rest of 1998.

Due to the strong growth of the Dutch economy, consumer prices accelerated from 0.1% in the first quarter of 1998 to 0.8% in the second quarter. Because of the continued strong economic growth, the Dutch consumer price inflation became one of the highest among the 11 countries joining the Euro on January 1, 1999. On an annual basis, inflation accelerated from 2.2% in the first quarter to 2.3% in the second quarter of 1998.

Dutch producer prices declined by 1.1% in the second quarter of 1998, the same as in the previous quarter. This can be attributed to the fall in oil and energy prices. As a result,

producer prices continued to decelerate on an annual basis, from 2.4% in the first quarter of 1998 to 1.4% in the second quarter.

Economic performance in Venezuela

Overview

Due to the continued weak oil prices and production cutbacks, the economic growth in Venezuela has been revised further downwards, resulting in an expected contraction for 1998. The multiplier effect of the budget cuts, high interest rates, uncertainty about the forthcoming elections, declining oil prices, and slow progress in the privatization process, will reduce domestic demand. The agreement to reduce global oil output will limit export volume growth of Venezuela, while import expansion will stay firm as the currency remains strong in real terms.

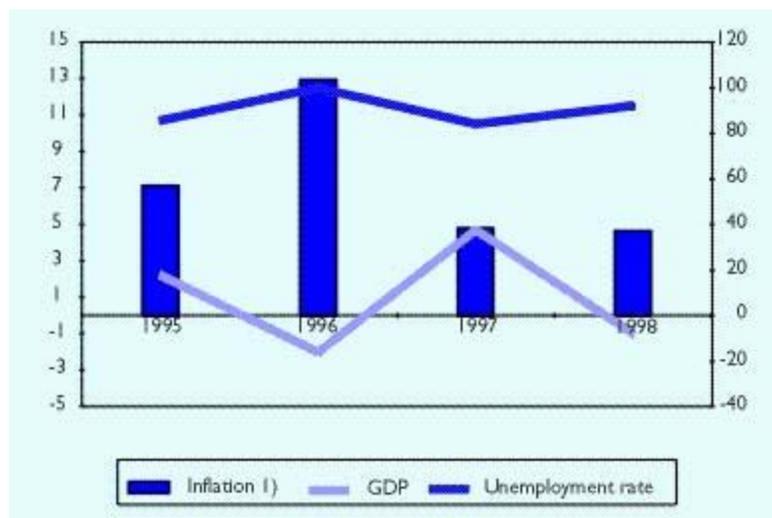
Growth is expected to recover slowly starting in 1999, in line with the gradual strengthening in oil demand and prices. The fiscal deficit is expected to reach 5.0% of GDP, and unemployment is expected to rise further to 11.5% in 1998.

Second quarter development

The Venezuelan economy is expected to contract by 1% in real terms in 1998. Initially, a growth of 6% was forecast, but sharp declining oil prices reduced public revenues so much that the Venezuelan government had to take austerity measures. The decrease in oil prices of about 30% this year prompted the government to cut spending, raise taxes, and increase interest rates amid concerns about a devaluation of the currency. This, combined with political uncertainty surrounding the upcoming elections, is affecting investments and pushing the economy towards a contraction.

Graph 10

Selected economic key figures of Venezuela (% changes)



The monthly rate of inflation averaged 2.7% in the first five months of 1998, generating an accumulated inflation of around 14%. In June, however, the inflation rate decreased, reaching its lowest level in six years, as investment and consumer spending decreased sharply under the strain of rising interest rates and the austerity measures of the government. It is expected that the targeted inflation rate of 30% for 1998 will be exceeded, due to the high liquidity in the financial markets, the 33% rise in the minimum wages in May 1998, and the likelihood of further currency pressures in the period prior to the elections in November and December 1998. The year-end inflation rate is forecast at 37%.

Due to the slowdown of the Venezuelan economy, the unemployment rate is expected to increase to 11.5% at the end of 1998, compared to 10.6% at the end of 1997.

Venezuela may lose about \$300 million a month in foreign reserves in the second half of 1998, as decreasing oil prices, the weakening currency, and increased capital flight are pushing the international reserves to their lowest level in more than two years. The international reserves amounted to \$18 billion in the beginning of 1998, and are expected to fall to \$13 billion at the end of 1998. As of the end of June 1998, reserves totaled around \$15 billion. Nevertheless, Venezuela's foreign reserves still cover nearly 15 months of imports.

The high inflation rate in Venezuela is putting pressure on the Bolivar, which depreciated approximately 10% during the first half of 1998. Also the increasing trade deficit, due to the falling oil prices, is influencing the Bolivar negatively. At the end of the second quarter of 1998, the Bolivar had depreciated to Bs 553 per US dollar.