



## QUARTERLY BULLETIN 1998-3

**Bank van de Nederlandse Antillen**

## REPORT OF THE PRESIDENT

The recession in the Netherlands Antilles continued in the third quarter of 1998, as reflected in a drop of 0.7% in real Gross Domestic Product on an annual basis. This drop was attributable to weak domestic spending, resulting from the persistent uncertainties of consumers and investors concerning the authorities' approach to the financial-economic crisis. In contrast, the performance of the export sector improved but could not mitigate the decline in domestic spending. The continuing recession was accompanied by a further increase in the unemployment rate. The inflation rate increased markedly in the third quarter of 1998. Nevertheless, the annualized rate of inflation continued to decrease owing to the decrease in the inflation rates in our main trading partners and in world oil prices.

The overall improvement in our export performance was attributable to tourism and merchandise exports. Foreign exchange revenues generated in the tourist sector increased, despite the passing of hurricane Georges in St. Maarten in September. This increase in foreign exchange revenues can be attributed primarily to the buoyant development in cruise tourism in Curaçao. In contrast, stay-over tourism continued to decline. In St. Maarten, both the number of stay-over and cruise tourists declined due to the hurricane, but the amount of foreign exchange generated continued to increase. In Bonaire, all tourism indicators developed negatively. The development in stay-over tourism in Curaçao and Bonaire can be related, among other things, to increased competition from comparable destinations and a lack of airlift. In this respect, the Bank welcomes the recent increase in charter flights. This increase, together with the efforts aimed at improving tourism facilities, could contribute to a recovery of this prominent sector of our economy. In addition, merchandise exports continued to increase, owing primarily to the activities in the free zone. The latter also recorded an increase in the number of visits.

The other sectors of the export industry showed mixed developments. The international financial and business services sector recorded a marked slowdown in activities. This slowdown was reflected by a drop in both income received from services rendered and profit taxes transferred to the government. Foreign exchange income earned in the transportation sector decreased slightly, due mainly to the decrease in bunker and oil transshipment activities. Foreign exchange income from oil storage, however, increased considerably. In addition, the harbor of Curaçao performed well, reflected by an increase in the number of ships piloted and the amount of cargo handled. The national carrier Air ALM transported more passengers, but less freight. Furthermore, activities in the ship repair sector, as measured in man-hours sold, declined, while foreign exchange income earned increased. The oil refinery performed well, as the amount of oil refined rose substantially and operational costs decreased. The improved cost efficiency, however, resulted in lower foreign exchange revenues.

The deficit on the current account of the balance of payments improved considerably in the third quarter of 1998. In addition to the growth in exports, this improvement resulted from a decline in merchandise imports and a higher surplus on the income balance. The decline in merchandise imports is partly the result of the hesitant consumption and investment behavior in light of the persistent uncertainties in the economy. The improvement in the income balance was attributable to relatively large but transitory interest and dividend

receipts from abroad. In addition, the capital account recorded a larger surplus, owing entirely to the private capital balance. The official capital balance deteriorated, due to a decline in development aid received from the Dutch government. Developments in the current and capital account of the balance of payments contributed to an increase in our foreign exchange reserves. It should be noted, however, that the positive development in our balance of payments was primarily the result of weak domestic spending and transitory large inflows. A lasting improvement in our balance of payments and, hence, our foreign exchange position can be attained only through the implementation of a viable restructuring program. This program will gradually restore investors' confidence and, consequently, strengthen our export sector.

The development in government finances remained worrisome. The deficit of the General Government on a cash basis deteriorated, due entirely to a decline in direct tax revenues. Profit tax revenues recorded the largest decline, due primarily to the international financial and business services sector. Given the persistent financing constraints, the government was forced to reduce its expenditures, mostly through postponing payments, to compensate for part of the revenue loss. Such an approach, however, will lead to a deterioration of the financial position of institutions like the civil servants pension fund APNA and private companies, which will aggravate the recession. To prevent a liquidity crisis, urgent corrective actions are warranted. These actions should focus on a structural reduction in expenditures by streamlining the government apparatus through the further privatization of government agencies, complemented by the further restructuring of the pension scheme and the health care system. A strengthening of government revenues by, among other things, enhancing tax administration and tax enforcement should support the reduction in expenditures. Only a credible policy aimed at reducing the unsustainable deficits can restore confidence and, hence, increase the availability of funds at competitive interest rates and lay a foundation for sustainable growth.

The money supply remained unchanged in the third quarter of 1998, because the increase in international reserves was offset by a contraction in domestic money creation. The latter contraction was due to a decline in credit extension to the private sector related to the soaring economy and miscellaneous factors. In contrast, the government sector exerted an expansionary impact caused mainly by the withdrawal of deposits at the banking system to finance part of the liquidity deficit. Effective November 16, 1998, the reserve requirement was increased from 6% to 8%. This tightening was accompanied by a further phasing out of the monetary cash reserve arrangement. In November, an additional reduction in the cash reserve percentage scheme became effective, which reduced the penalty on excess credit. As of January 1, 1999, direct restrictions on credit to the private sector will be abolished. However, the ceiling on net credit to the government will remain in place to prevent monetization of the budget deficits. The short-term monetary stance will depend on the economic impact of the government's recovery program. This program will be supported by an appropriate tight monetary policy.

To restore economic growth, the authorities should take steps to restore the confidence of the economic agents. This can be realized only through the implementation of a credible and comprehensive structural adjustment program. The recovery program presented by the national government on November 30, 1998, is a first step in that direction, but it needs

further elaboration. For example, the reduction of the budget deficit should be more ambitious, the measures need to be worked out in more detail and accompanied by a time schedule for their implementation, and the financing of the program should be in line with market possibilities. The Bank believes that these adjustments will underpin the authorities' commitment to the program. This will, in turn, restore confidence, promote investments, and, hence, create a climate conducive to growth and employment.

*E.D. Tromp*  
*President*

## DEVELOPMENTS IN THE REAL SECTOR

### General economic developments

The economy of the Netherlands Antilles continued to register a slowdown in activities, accompanied by a weak labor market and moderate inflation. Real GDP fell by 0.7% in the third quarter of 1998. The annual inflation rate shrank to 1.3% in the period July-September of 1998, down from 3.7% in the third quarter of 1997. The growth in the export services sector could not offset the decline in domestic spending, resulting in fewer production activities. The lower production was not favorable to the already frail labor market, which is clear from the declining employment opportunities and the growing unemployment rate (15.8%).<sup>1)</sup>

### National production and spending

The Antillean economy remained weak in the third quarter of 1998, with the external service sector showing some expansion. Despite the international financial turmoil, the foreign demand for the service sector has grown. Domestic demand continued to decline, led by deteriorating consumer spending. The decline in consumer spending was the result of a poor job market and lack of confidence, among other things. During this period, government investment and government consumption slipped by 3.4% and 8.0%, respectively. The lack of a credible policy to underpin the government economic recovery plan had a dampening effect on producers' confidence and might lead to further deterioration in the economic position. Thus, reforms must be incorporated soon to resolve the country's structural inefficiencies, which include the educational system, the labor market, and the government apparatus.

### Inflation

Consumer prices in the Netherlands Antilles followed a downward trend in the third quarter of 1998. The annual inflation of the Netherlands Antilles slowed from 3.7% in the third quarter of 1997 to 1.3 % in the third quarter of 1998. Inflation was kept in check by the following factors: the waning effects of the sales tax and the turnover tax, and the lower foreign (U.S.A.) inflation rate. In the third quarter of 1998, the highest annual inflation occurred in St. Maarten (1.9%), while Curaçao and Bonaire posted 1.3% and 1.0%, respectively.

Although the Netherlands Antilles showed a declining annual inflation, the third quarter's inflation rate accelerated, compared to the previous quarter. A quarterly analysis of inflation rates by island shows that St. Maarten had an inflation rate of 2.1% in the third quarter of 1998 (table 1), contrasting with a -0.1% inflation in the previous quarter.

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

**Curaçao Bonaire St.**

		<b>Maarten</b>	
Food	0.4%	0.9%	0.3%
Beverages & tobacco	-0.2%	1.1%	-0.5%
Clothing & footwear	-0.7%	0.0%	0.0%
Housing	0.4%	-1.4%	0.2%
Housekeeping & furnishings	0.2%	0.1%	0.4%
Health	0.1%	0.3%	0.8%
Transport & communication	3.6%	8.9%	10.3%
Recreation & education	0.7%	0.9%	0.6%
Other	0.4%	0.3%	0.7%
General inflation rate	0.8%	1.2%	2.1%

The largest price increase was in the category "transport & communication"(10.3%), owing to the introduction of a completion fee by the telephone company in August. Lower long distance fees did not offset the introduction of the completion fee. The lowest rate of inflation, however, occurred in the item "beverages & tobacco"(-0.5%), which was caused by a price drop in beverages.

In Curaçao, the inflation rate in the July-September quarter of 1998 went up by 0.8%, due mainly to the item "transportation & communication"(3.6%). "Transportation & communication" also was led by the introduction of the completion fee. On the other hand, the inflation rates of -0.7% and -0.2% in "clothing & footwear", and "beverages & tobacco", respectively, were caused by cheaper clothing and beverages.

For the third quarter of 1998, Bonaire's inflation rate surged by 1.2%, up from 0.2% in the second quarter of 1998. "Transport & communication" (8.9%), and "beverages & tobacco" (1.1%) contributed to the price jump in the island. By contrast, the "housing" sector accounted for the lowest inflation rate of -1.4%, a result of lower energy prices.

### **Labor market**

The labor market in the Netherlands Antilles worsened in 1998, with the unemployment rate soaring to 15.8%, compared to 14.7% in 1997. This development was reflected by the rising request for dismissals in the third quarter of 1998, especially in Curaçao (179 employees), measured against the same period a year ago (138 employees). The request for dismissals was confined to the trade, hotel & restaurant, and social services sectors.

The closing down of some supermarkets and the restructuring of a casino resulted in staff layoffs in the trade, and hotel & restaurant sectors. The dismissal of personnel in the social service sector was related to the closure of some security-service companies.

The labor market survey (AKO) conducted by the Central Bureau of Statistics reveals that Curaçao's unemployment ticked up by 1.4 percentage points to 16.7% in 1998. In 1998, many people migrated, but this has not reduced the number of unemployed, mainly because of a simultaneous decrease of job opportunities with the less-than-proportionate growth of migration.

## **Developments by sector**

### ***Mining***

The mining sector posted mixed results in the third quarter of 1998. Salt production dwindled by 74.6%, a marked decline over the 5.0% increase in the same quarter of 1997, while salt exports increased by 11.4% in July-September 1998, measured against the 15.3% rise in the third quarter of 1997.

### ***Industry***

In the oil sector, oil production improved in the third quarter of 1998; the amount of oil refined expanded by 22.5%, following a growth of 4.6% in the third quarter of 1997. Total operational costs fell by 9.3%, caused largely by a reduction in the refinery's material costs.<sup>2)</sup>

In the third quarter of 1998, the ship repair industry in Curaçao deteriorated, as the number of man-hours sold and the quantity of ships repaired dipped by 20.9% and 13.9%, contrasting with the increases of 1.3% and 16.2%, respectively, in the third quarter of 1997. Contrary to the weak performance of the ship repair industry, ship repair earnings improved by 17.3% during this period.

### ***Utilities***

In 1998's third quarter, production in the utility sector broadened, as both electricity and water production grew. Electricity production in the Netherlands Antilles picked up by 5.2% in the quarter ending September of 1998, compared to an increase of 2.8% in the third quarter of 1997.

An analysis by island shows that the electricity production growth was caused mainly by the 8.9% upturn in Bonaire's electricity production. In Curaçao, electricity production grew by 4.9 percentage points when compared to no change in the third quarter of 1997. Electricity production in the Windward Islands advanced by 5.0%, down from the 13.9% surge a year earlier.

The Antillean water production was up by 2.5% in the months July-September 1998, following a 1.9% surge in the same quarter of 1997. This increase was led largely by the 5.4% increase in St. Maarten's water production. Curaçao's and Bonaire's water production

expanded by 2.0% and 2.3%, respectively, after increases of 3.4% and 8.1%, respectively, in the corresponding quarter of 1997.

### ***Trade***

The third quarter Free Zone results were modest in 1998, when re-exports edged up by 3.1%, down from a 44.0% rise in the same quarter of 1997. Alongside the slight increase in re-exports, the Free Zone visits soared by 30.6%. The number of Free Zone visits from Brazil continued to decline, while the other main markets expanded -- Guyana (3.6%), Haiti (78.8%), Jamaica (7.5%), the Dominican Republic (46.2%), Trinidad & Tobago (62.8%), and Venezuela (31.6%).

### ***Tourism***

The tourist sector in the Netherlands Antilles weakened in the quarter ending September 1998, reflecting falls of 5.1% and 24.7%, respectively, in stay-over and cruise tourism (excluding Bonaire). In spite of the sluggish tourism industry, tourism income swelled by 27.7%. An analysis by island shows that all islands registered a negative growth in stay-over tourism, while Curaçao was the only island that recorded a flourishing third quarter cruise industry.

St. Maarten's tourism industry shrank in the third quarter of 1998; both the number of stay-over and cruise tourists lowered by 2.7% and 12.3%, respectively. Hurricane Georges, which swept through the island in September 1998 may have been the prime cause for this quarter's weak tourism. The decreases in stay-over tourism were originated from Europe (8.8%), South America (1.2%), and the Caribbean (0.6%). Conversely, the North American market advanced in the third quarter of 1998 by 2.5% (table 2), after a 13.9% gain in the corresponding quarter of 1997. While the US market remained with the largest share in the North American market, the increase in the number of North American travelers was mostly from the Canadian market.

**Table 2**  
***Growth in stay-over tourism by island (% change)***

	Bonaire	Curaçao	St. Maarten
	1997-1998-III	1997-1998-III	1997-1998-III
North America, of which:	-1.4%	-3.5%	-1.2%
-U.S.A.	-0.3%	-3.5%	-1.6%
-Canada	-	-3.3%	8.1%
	42.4%		32.7%
Europe, of which:	-6.4%	-6.4%	-8.5%
			16.0%
			13.9%
			2.5%
			14.0%
			1.2%
			-13.1%
			21.9%
			6.0%
			8.8%

-The Netherlands	-7.3%	-8.4%	-7.7%	-25.4%	-0.4%
			16.3%		
-France	-8.3%	-	-	4.6%	-
		40.5%			16.0%
-Germany	5.0%	-	-	-	--
		23.5%	10.4%	26.6%	
-Other Europe	-6.4%	26.0%	-4.9%	0.9%	25.8%
		15.2%			
South & Central America, of which:	-12.9%	4.1%	-5.2%	21.0%	-1.2%
-Venezuela	-45.0%	9.7%	7.1%	79.4%	-
	26.7%				11.4%
-Brazil	-5.5%	-	-	-68.4%	-
		37.2%	24.5%	31.8%	60.2%
-Other S&C America					
Caribbean, of which:	-	-3.7%	-	9.8%	-0.6%
	20.3%	25.9%	12.7%		
-Aruba	-	-0.5%	-	--	--
	23.2%	23.8%	24.5%		
-Santo Domingo	16.3%	-9.0%	-12.5%	-6.6%	
	50.9%	19.1%			
-Other Caribbean					
Rest of World	--6.3%	--1.0%	15.6%	-7.0%	
	42.2%	15.7%			
Total	-7.0%	-4.8%	-4.6%	-9.1%	11.4%
					-2.7%

Bonaire's tourism continued to fall in the months July to September 1998 with the number of stay-over visitors decreasing by 4.8%. The slump in stay-over tourism was linked to the reduction in the number of arrivals from the largest markets -- the US (3.5%) and the Netherlands (8.4%). This reduction was followed by a 23.8% decline in the number of visitors from Aruba. By contrast, the South American market surged by 12.9%, owing mainly to the 45.0% jump in arrivals from Venezuela.

In Curaçao, the tourist sector offered a mixed picture in the months July to September 1998. Cruise tourism drifted up by 15.0%, as opposed to a fall of 43.8% in the third quarter of 1997. During the third quarter of 1998, the number of stay-over tourists dipped by 9.1%, down from the 4.6% slide in the same quarter of 1997. The contraction in stay-over tourism was accompanied by a fall in the number of visitor nights (10.6%). Stay-over tourism from

the European market deteriorated by 16.0% in the third quarter of 1998, following an 8.5% decline in the corresponding quarter of 1997. The decrease in the Dutch market (16.3%), the largest European market, was attributable to competition, lack of airlift, and appreciation of the US dollar against the Dutch guilder. In addition to the poor European market, the Caribbean market shrank by 12.7%. The number of arrivals from the US and Venezuela, on the other hand, edged up by 5.7% and 7.1%, respectively.

### ***Transportation***

During the third quarter of 1998, the air transportation sector showed mixed results -- the number of passengers transported by the airline "Air ALM" gained by 11.0% and cargo shipments transported tightened by 11.3%. Curaçao's airport activities picked up by 4.0% in the third quarter of 1998, ascribable to a growth of 23.9% in the number of transit passengers.

Both Curaçao's and Statia's oil transshipment and oil storage activities increased in the July-September quarter of 1998. Conversely, oil transshipment in Bonaire plunged by 43.7% in the third quarter of 1998, in contrast to a jump of 98.6% in the same quarter in 1997. This decline led to the overall poor performance in oil transshipment in the Netherlands Antilles.

In the quarter ending September 1998, Curaçao's harbor activities improved, as the number of ships piloted into the harbor rose by 16.8%. The surge in the number of ships was caused primarily by the large quantity of freight vessels that visited the harbor. This surge was reflected by the 6.2% rise in total freight movements, most likely from an expansion in the Free Zone re-exports.

1) *Estimate of the BNA*

2) *General material, chemicals, and additives are required for the plant's regular maintenance and production process*

## **PUBLIC FINANCE**

### **General Development in the public sector**

The deficit on a cash basis of the General Government in the third quarter of 1998 increased by almost 50% when compared to the third quarter of 1997. The deficit expanded by 49.6% (NAf.12.8 million). Financing constraints and a substantial drop of 10.4% (NAf.33.6 million) in revenues forced a drop in expenditures of 6.0% (NAf.20.8 million). The drop in revenues was caused by fewer direct taxes generated, namely, the profit tax and the wage tax. The proceeds from indirect taxation developed satisfactorily in the third quarter of 1998, despite the prevailing economy.

***Table 3***  
***Operations of the General Government (in millions NAf.)***

	change	change
1998-	1997-	NAf. %

	III	III		
REVENUES	288.5	322.1	-33.6	-10.4%
Tax revenues	245.9	278.2	-32.3	-11.6%
Nontax revenues	41.2	42.3	-1.1	-2.6%
Capital revenues	0.0	0.0	0.0	
Grants	1.4	1.6	-0.2	-12.5%
EXPENDITURES	327.1	347.9	-20.8	-6.0%
Current expenditures	318.7	339.1	-20.4	-6.0%
Capital expenditures	8.4	8.8	-0.4	-4.5%
BALANCE	-38.6	-25.8	-12.8	49.6%
% of GDP	-4.0%	-2.6%		

### Operations of the Central government

Operations of the Central Government in the third quarter of 1998 were influenced partly by the transformation of the post offices operation from an agency into a government-owned company. In July 1998 the final draft law was enacted. Effective January 1998, the post office became a separate government-owned company. To this end, all transactions related to its operation had to be removed from the government accounts. This operation influenced, among other things, wages and salaries, social security contributions, and goods and services purchased.

The deficit of the Central Government deteriorated by NAf.3.2 million in the third quarter of 1998 when compared to the third quarter of 1997. This deterioration was the result of a marginal increase of NAf.0.4 million (0.3%) in total revenues, on the one hand, and higher expenditure outlays of NAf.3.6 million (2.8%), on the other. When comparing the development in tax revenues in the third quarter of 1998 with the same quarter in 1997, a drop of NAf.4.0 million (10.3%) in excises is noticeable. Further analysis of this development in excises shows that the excises on gasoline dropped by NAf.3.3 million (10.5%) and excises on tobacco recorded a downturn of NAf.0.6 million (15.0%). The drop in excises on gasoline was the result of lower revenues collected in St. Maarten. Because excises on gasoline were raised in January 1997, the French side of the island of St. Maarten has started to import gasoline, narrowing the base for the revenues from excises on St. Maarten.

Sales tax revenues increased by 5.6% in the third quarter of 1998 compared with the third quarter of 1997 (refer to table 4).

**Table 4**  
**Breakdown of the revenues from the sales tax**  
**in the Netherlands Antilles, in millions NAf.**

	1998-	1997-	change	change
	III	III	NAf.	%

Sales Tax Curaçao and Bonaire (ABB)	24.8	23.7	1.1	4.8%
Turnover Tax St. Maarten, Saba, and St. Eustatius (BBO)	8.9	8.2	0.7	8.9%
Total sales tax revenues	33.7	31.9	1.9	5.6%

Import duties increased by NAf. 2.8 million (10.7%) in the third quarter of 1998 when compared to the corresponding quarter of 1997.

Nontax revenues dropped slightly by 0.4% (NAf.0.1 million) in the third quarter of 1998. This drop is the result of an increase of NAf.9.2 million (85.2%) in entrepreneurial and property income, a drop of NAf.6.4 million (71.9%) in fees, charges, and sales, and NAf.2.9 million less in receipts in the category of other nontax revenues. The income received as entrepreneurial and property income was NAf.16.5 million higher because of license fees collected by the Central Bank and NAf.3.5 million in receipts due to a bond issued above par.

Receipts from the category fees, charges, and sales dropped by NAf.6.4 million in the third quarter of 1998 when compared to the third quarter of 1997. This drop is explained partly by the transformation of the post office into a government-owned company.

On the expenditure side, higher expenditure outlays were caused by an increase of NAf.3.4 million (14.3%) in goods and services purchased, higher interest payments (NAf.1.0 million), and NAf.3.7 million higher transfers. Wages dropped by NAf.10.5 million in the third quarter of 1998 when compared to the third quarter of 1997. This substantial (18.5%) drop in wages was caused partly by elimination of the post office wages from government operations.

In the third quarter of 1998, NAf.6.5 million more in payments on pension premiums were made to the pension fund than in the third quarter of 1997. Furthermore, an amount of NAf.3.7 million more was transferred to other levels of government as compared to the same quarter in 1997.

Capital expenditures dropped slightly by NAf.0.3 million in the third quarter of 1998 when compared to the third quarter of 1997, the result of NAf.0.5 million less in investment outlays.

**Table 5**  
**Operations of the Central Government (in millions NAf.)**

			changechange	
	1998-	1997-	NAf.	%
	III	III		
REVENUES	128.9	128.5	0.4	0.3%

	104.8	104.1	0.7	0.7%
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**Tax revenues,**

of which:

-excises	34.7	38.7	-4.0	-10.3%
-import duties	28.9	26.1	2.8	10.7%
-property transfer tax	3.2	3.2	0.0	0.0%
-sales tax	33.7	31.9	1.8	5.6%
	22.7	22.8	-0.1	-0.4%

**Non tax revenues**

-entrepreneurial and property income	20.0	10.8	9.2	85.2%
-fees, charges, and sales	2.5	8.9	-6.4	-71.9%
-other non tax revenues	0.2	3.1	-2.9	-93.5%
	0.0	0.0	0.0	

**Capital revenues**

	1.4	1.6	-0.2	-12.5%
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**Grants**

EXPENDITURES	130.9	127.3	3.6	2.8%
	124.9	121.0	3.9	3.2%

**Current expenditures,**

of which:

-wages and salaries	65.8	70.0	-4.2	-6.0%
wages	46.4	56.9	-10.5	-18.5%
social security	2.0	2.2	-0.2	-9.1%
pension	17.4	10.9	6.5	59.6%
-goods and services	27.1	23.7	3.4	14.3%
-interest payments	15.3	14.3	1.0	7.0%
-subsidies	0.0	0.0	0.0	
-transfers	16.7	13.0	3.7	28.5%
other government levels	8.8	4.8	4.0	83.3%
households	2.4	2.5	-0.1	-4.0%
nonprofit institutions abroad	5.5	5.7	-0.2	-3.5%
	6.0	6.3	-0.3	-4.8%

**Capital expenditures,**

of which:

-investments	5.8	6.3	-0.5	-7.9%
-capital transfers	0.0	0.0	0.0	
BALANCE	-2.0	1.2	-3.2	- 266.7%

A slight increase of 2.8% (NAf.3.6 million) in expenditures was offset only by a marginal increase of NAf.0.4 million (0.3%) in revenues, which caused the deficit of the Central Government to deteriorate by NAf.3.2 million in the third quarter of 1998 when compared to the third quarter in 1997. The outcome of the Central Government's operations in the third quarter of 1998 was a deficit of NAf.2.0 million compared to a positive balance of NAf.1.2 million in the third quarter of 1997.

The Central government ended up with a negative cash fiscal balance of NAf.2.0 million at the end of the third quarter of 1998. This deficit was financed completely monetarily as can be seen in table 6. The deficit was financed by, among other things, running down on the deposits at the Central Bank to the amount of NAf.4.0 million, and an increase in the advance account. In addition the Central Government borrowed NAf.4.1 million from the general public in the third quarter of 1998.

**Table 6**  
**Changes in outstanding balances of the**  
**Central Government (in millions NAf.)**

	1998- III	1997- III
FISCAL BALANCE	-2.0	1.2
MONETARY FINANCING,	10.8	1.9
of which:		
Central Bank	7.0	10.5
Commercial banks	3.8	-8.6
Coins & notes	1.0	0.1
NONMONETARY FINANCING,	-8.8	-3.1
of which:		
Government securities with the public	4.1	-9.4
Other	-12.9	6.3

## Operations of the Island Government of Curaçao

Total revenues decreased by NAf.30.3 million (15.7%) in the third quarter of 1998 as compared to the same period in 1997. The deterioration in total revenues was due to a decrease of 19.0% (NAf.33.0 million) in tax revenues, a decrease of NAf.1.0 million in nontax revenues, mitigating an increase of NAf.3.7 million in grants. Although expenditure outlays were NAf.20.7 million less, the decrease in tax revenues caused the deficit to deteriorate by NAf.9.6 million in the third quarter of 1998 when compared with the third quarter in 1997. The deficit of the Island Government of Curaçao in the third quarter of 1998 was NAf.36.6 million.

When reviewing the different categories of tax revenues, the substantial change in the profit tax is noticeable. This drop in profit tax revenues by NAf.23.6 million (32.1%) can be related to the downturn in the economy.

Income tax increased by NAf.2.7 million (93.1%) in the third quarter of 1998 when compared to 1997. Wage tax dropped by 7.6% (NAf. 6.5 million) while land tax paid in the third quarter of 1998 dropped by NAf.0.9 million when compared with the same quarter in 1997.

The drop in non tax revenues was caused by a decrease of NAf.5.2 million (91.2%) in other non tax revenues. Entrepreneurial and property income, and fees, charges, and sales developed satisfactorily, increasing by NAf.2.8 million and NAf.1.4 million, respectively. The increase in entrepreneurial and property income occurred because the Island Government of Curaçao received a NAf.6.0 million dividend from Curoil N.V. in the third quarter of 1998.

**Table 7**  
**Operations of the Island Government of**  
**Curaçao (in millions NAf.)**

			changechange	
	1998-	1997-	NAf.	%
	III	III		
REVENUES	163.3	193.6	-30.3	-15.7%
<b>Tax revenues,</b>	141.1	174.1	-33.0	-19.0%
of which:				
-profit tax	49.9	73.5	-23.6	-32.1%
-income tax	5.6	2.9	2.7	93.1%
-wage tax	78.6	85.1	-6.5	-7.6%
-land tax	0.6	1.5	-0.9	-60.0%
-motor vehicle tax	1.9	2.0	-0.1	-5.0%
<b>Nontax revenues,</b>	18.5	19.5	-1.0	-5.1%
of which:				
-entrepreneurial and property income	10.0	7.2	2.8	38.9%
-fees,charges, and sales	8.0	6.6	1.4	21.2%
-other nontax revenues	0.5	5.7	-5.2	-91.2%
<b>Capital revenues</b>	0.0	0.0	0.0	

<b>Grants</b>	3.7	0.0	3.7	
<b>EXPENDITURES</b>	199.9	220.6	-20.7	-9.4%
<b>Current expenditures,</b>	197.5	218.1	-20.6	-9.4%
of which:				
-wages and salaries	62.9	71.4	-8.5	-11.9%
wages	65.6	65.7	-0.1	-0.2%
pension premiums	-2.7	5.7	-8.4	-
				147.4%
-goods and services	46.9	55.2	-8.3	-15.0%
-interest payments	48.2	44.7	3.5	7.8%
-subsidies to public companies	16.8	20.7	-3.9	-18.8%
-transfers	22.7	26.1	-3.4	-13.0%
to other government levels	4.8	6.3	-1.5	-23.8%
to households	9.5	12.3	-2.8	-22.8%
to nonprofit institutions abroad	8.4	7.5	0.9	12.0%
<b>Capital expenditures,</b>	2.4	2.5	-0.1	-4.0%
of which:				
-investments	2.6	2.4	0.2	8.3%
-capital transfers	0.0	0.0	0.0	
-net lending	-0.2	0.1	-0.3	-
				300.0%
<b>BALANCE</b>	-36.6	-27.0	-9.6	35.6%

Current expenditures as well as capital expenditures dropped by NAF.20.6 million and NAF.0.1 million, respectively.

In the current expenditures category, all categories except interest payments dropped. Wages dropped by NAF.0.1 million while pension premium contributions dropped by NAF.8.4 million when comparing the third quarter of 1998 with the same quarter of 1997. Furthermore, expenditures on goods and services dropped by NAF.8.3 million (15.0%), subsidies to public companies by NAF.3.9 million (18.8%), and transfers by NAF.3.4 million (13.0%) in the third quarter of 1998 when compared to the third quarter of 1997. Contrary to this development, higher interest payments of NAF.3.5 million (7.8%) were registered.

Capital expenditures dropped by 4.0% (NAF.0.1 million) in the third quarter of 1998 mainly because of a NAF.0.2 million increase in investments, offsetting a reduction of NAF.0.3 million in net lending in the third quarter as compared to the third quarter in 1997.

**Table 8**  
**Changes in outstanding balances of the**  
**Island Government of Curaçao (in millions**  
**NAf.)**

	1998- III	1997- III
FISCAL BALANCE	-36.6	-27.0
MONETARY FINANCING,	16.8	0.5
of which:		
Central Bank	1.8	7.6
Commercial banks	15.0	-7.1
NONMONETARY	19.8	26.5
FINANCING,		
of which:		
Government securities with the	-5.9	0.0
public		
Other	25.7	26.5

The financing of the fiscal balance of the Island Government of Curaçao in the third quarter of 1998 was covered both monetarily and non monetarily. Among other things, the island government of Curaçao ran down its funds at the commercial banks to the amount NAf.12.9 million. Government securities with the public dropped by NAf.5.9 million in the third quarter of 1998.

### **Total outstanding public debt and guarantees**

The total outstanding debt of the Netherlands Antilles increased by NAf.61.9 million (2.1%) during the third quarter of 1998 when compared to the second quarter in 1998. Domestic debt increased by NAf.18.3 million (0.8%) while foreign debt increased by NAf.43.6 million (7.7%). Total debt as a percentage of GDP reached 69.7% at the end of the third quarter of 1998.

**Table 9**  
**Total outstanding consolidated public debt**  
**and guarantees<sup>1</sup> (in millions NAf.)**

	1998- III	1998- II	change NAf.	change %
Domestic	2436.1	2417.8	18.3	0.8%
consolidated debt,				
of which:				

-Central Government	998.2	1019.2	-21.0	-2.1%
-Curaçao	1350.4	1331.1	19.3	1.4%
-Bonaire	72.8	71.7	1.1	1.5%
-St. Maarten	15.7	14.4	1.3	9.0%
-St. Eustatius	2.2	2.1	0.1	4.8%
-Saba	1.6	1.5	0.1	6.7%
Foreign debt	608.2	564.6	43.6	7.7%
Total debt (consolidated)	3044.3	2982.4	61.9	2.1%
(% of GDP)	69.7%	68.5%		
Guarantees	357.1	346.5	10.6	3.1%
Total debt and guarantees	3401.4	3328.9	72.5	2.2%
(% of GDP)	77.9%	76.5%		

*<sup>1)</sup> Estimate, consolidated for the debt of the Central Government to the Island Governments of St. Maarten and Curaçao.*

The Central Government managed to reduce its debt to other government levels by NAf.17.4 million in the third quarter of 1998. During that quarter, the Central Government did not incur any new debt to the civil servant pension fund (APNA). On the other hand, government securities with the public issued by the Central Government increased by NAf.3.0 million during the third quarter of 1998.

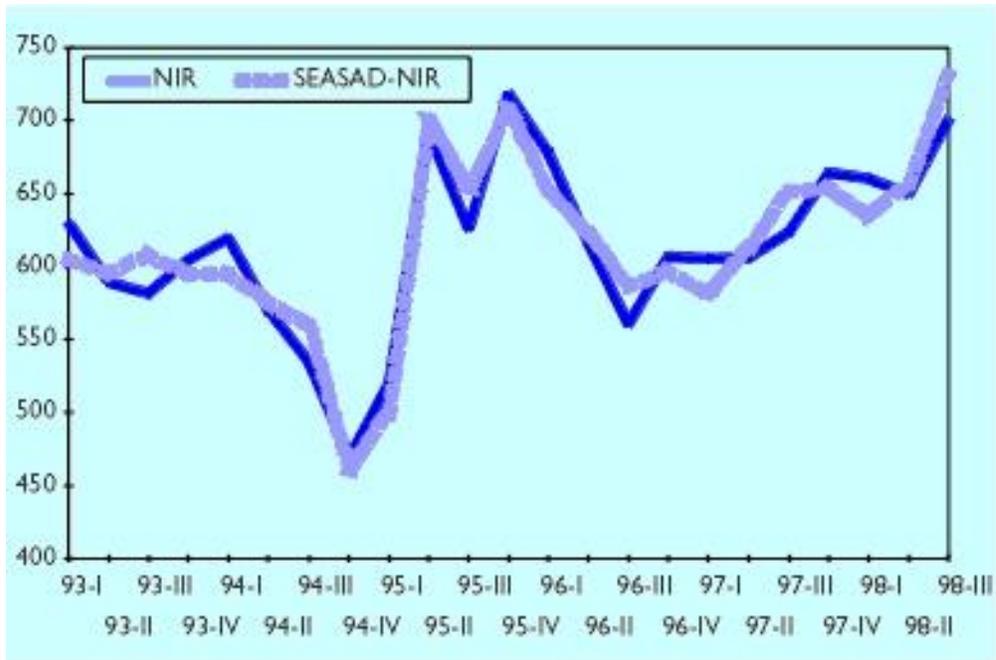
The total domestic debt of the Island Government of Curaçao increased by NAf.19.3 (1.4%) in the third quarter of 1998 because of, among other things, an increase in the debt to the pension fund (APNA) of NAf.21.7 million and an increase of NAf.2.1 million in commercial bank securities, offsetting a drop of NAf.5.9 million in the debt incurred through securities with the public.

## **DEVELOPMENTS IN THE EXTERNAL SECTOR**

### **Introduction**

During the third quarter of 1998, our net international reserves increased considerably by NAf.51.1 million to NAf.701.0 million, compared to the second quarter of 1998. This increase was the result of a marked rise of NAf.68.9 million in the foreign exchange reserves held at the commercial banks, mitigating a drop of NAf.17.8 million in the official reserves (see graph 1).

***Graph 1***  
***Development in the net international reserves (in millions NAf.)***



The deficit on the current account declined by Naf.25.7 million in the third quarter of 1998, explaining almost entirely the increase in the net international reserves of Naf.34.0 million, as compared to the same period in 1997 (see table 10).

**Table 10**  
**Balance of payments summary<sup>1)</sup> (in millions NAF.)**

	1997- III	1998- III	Diff.
Current account	-41,5	-15,8	25,7
Capital account	60,1	65,0	4,9
Statistical discrepancies	-1,5	1,9	3,4
Balance of Payments	17,1	51,1	34,0
Change in reserves <sup>2)</sup>	-17,1	-51,1	-
			34,0
-with commercial banks	-22,2	-68,9	-
			46,7
-with Central bank	5,2	17,8	12,6
Memorandum Items			
Official reserves (excl. gold)			
-in millions NAF.	305,5	352,4	46,9
-in months of merchandise imports	1,5	1,7	0,2

<sup>1)</sup> Cash basis

<sup>2)</sup> -Sign denotes an increase in reserves (excluding gold)

## The current account

The current account of the balance of payments recorded a deficit of NAf.15.8 million in the third quarter of 1998, a substantial improvement of NAf.25.7 million compared to the same period in 1997. As illustrated in table 11, this development in the current account was due primarily to an improved trade balance of NAf.46.0 million and the extraordinary rise in the income balance.

**Table 11**  
**A breakdown of the current account <sup>1)</sup> (in millions NAf.)**

	1997- III	1998- III	Diff.
Merchandise balance	-462,0	-416,0	46,0
Exports	113,9	127,0	13,1
Imports	575,9	543,0	-32,9
Services balance	414,7	380,0	-34,7
Receipts, of which:	666,4	673,4	7,0
Transportation	149,4	141,7	-7,7
Travel	220,3	281,4	61,1
Int. fin. & bus. services sector	176,5	136,1	-40,4
-Taxes	48,5	23,7	-24,8
-Operational income	128,0	112,4	-15,6
Expenditures, of which:	251,7	293,4	41,7
Travel	108,8	143,4	34,6
Int. fin. & bus. services sector	55,6	36,4	-19,2
Income balance <sup>2)</sup>	36,0	61,7	25,7
Unrequited transfers <sup>3)</sup>	-30,2	-41,5	-11,3
Current account balance	-41,5	-15,8	25,7

<sup>1)</sup> Cash basis

<sup>2)</sup> Income: investment and labor income.

<sup>3)</sup> Unrequited transfers: private remittances (excl. labor income and life insurance).

## The trade balance

The trade balance improved by NAf.46.0 million in the third quarter of 1998, compared to the same period in 1997. This improvement was primarily the result of a NAf.32.9 million drop in imports, together with a rise in exports. A breakdown of the merchandise balance by

island (table 12) reveals that the imports decreased on all islands, particularly Curaçao and the Windward Islands, due mainly to fewer oil imports.

**Table 12**  
**Merchandise balance per island<sup>1)</sup> (in millions NAf.)**

	Inflows			Outflows			diff.
	1997-1998-		1997-1998-		diff.		
	III	III	III	III			
<b>Curaçao</b>							
Merchandise	103,7	115,8	12,1	427,9	408,8		-19,1
-Non-oil products	103,7	115,8	12,1	379,1	371,5		-7,6
Free Zone re-exports	78,3	80,7	2,4	90,9	98,9		8,0
Adj. non-oil prod.	25,4	35,1	9,7	288,2	272,6		-15,6
-Oil products	0,0	0,0	0,0	48,8	37,3		-11,5
<b>Bonaire</b>							
Merchandise	1,3	2,1	0,8	7,1	4,4		-2,7
-Non-oil products	1,3	2,1	0,8	7,1	4,4		-2,7
-Oil products	0,0	0,0	0,0	0,0	0,0		0,0
<b>Windward Islands</b>							
Merchandise	8,9	9,1	0,2	140,9	129,8		-11,1
-Non-oil products	4,6	8,6	4,0	106,1	104,4		-1,7
-Oil products	4,3	0,5	-3,8	34,8	25,4		-9,4
<b>Netherlands Antilles</b>							
Merchandise	113,9	127,0	13,1	575,9	543,0		-32,9
-Non-oil products	109,6	126,5	16,9	492,3	480,3		-12,0
-Oil products	4,3	0,5	-3,8	83,6	62,7		-20,9

<sup>1)</sup> Cash basis

Table 12 reveals that the improvement in the merchandise balance was concentrated primarily in Curaçao and on the Windward Islands. Curaçao's merchandise balance

improved by NAf.31.2 million as a result of higher exports and lower imports. Non-oil-related imports decreased by NAf.7.6 million in the third quarter of 1998. However, if adjusted for imports for Free Zone-related activities, non-oil-related imports actually had declined by NAf.15.6 million. The decline was concentrated primarily in the imports by the transportation and telecommunication sector, which dropped by approximately NAf.8.6 million. Furthermore, oil imports dropped by NAf.11.5 million during the third quarter of 1998, as compared to 1997.

The trade balance on Bonaire also improved, primarily as a result of low imports, whereas on the Windward Islands a NAf.11.3 million improvement in the trade balance was recorded, due to higher non-oil-related exports and a significant drop in oil imports.

### The services balance

The surplus on the services balance recorded a big drop of NAf.34.7 million in the third quarter of 1998. This deterioration was largely the result of a drop in foreign exchange receipts from the international financial and business services sector and transportation sector by NAf.40.4 million and NAf.7.7 million, respectively. Both these developments mitigated the considerable increase in foreign exchange receipts by the tourist sector to an amount of NAf.61.1 million.

### Tourism

The tourism sector recorded a significant improvement in the overall balance of payments performance. As can be seen in table 13, foreign exchange receipts from the tourism sector in the Netherlands Antilles increased by NAf.61.1 million (21.7%) in the third quarter of 1998, mainly as a consequence of a rise in tourist receipts in Curaçao and on the Windward Islands.

**Table 13**  
**Third quarter foreign exchange revenues**  
**from tourism per island<sup>1)</sup> (in millions NAf.)**

	1994- III	1995- III	1996- III	1997- III	1998- III
Bonaire	14.0	14.7	16.2	19.0	16.3
Curaçao	85.3	67.9	73.2	71.3	114.0
Windward Islands	156.4	127.6	126.2	130.0	151.1
Netherlands Antilles	255.7	210.2	215.6	220.3	281.4
Percentage growth		7.1%-21.6%	2.5%	2.1%	21.7%

<sup>1)</sup> Cash basis

Foreign exchange generated by the tourism industry on the Windward Islands jumped by 14% in the third quarter of 1998. In contrast, both the number of stay-over and cruise visitors dropped in the third quarter of 1998.

The foreign exchange development in tourism activities on the Windward Islands was enhanced by developments on the Leeward Islands, although foreign exchange earnings on Bonaire dropped slightly by NAf.2.7 million. This performance was reflected in both the stay-over visitors and cruise tourism. Curaçao recorded considerable growth in foreign exchange earnings following a sluggish second quarter performance; foreign exchange revenues increased by NAf.42.7 million (37.5%) in the third quarter of 1998. The number of stay-over tourists dropped even further compared to the third quarter of 1997. However, cruise tourism flourished during the third quarter of 1998, accounting fully for the rise in foreign exchange generated by the tourism industry.

Expenses by residents abroad continued to increase compared to the same period in 1997. Despite the reduced spending capacity, outflow by residents related to travel abroad continued to rise.

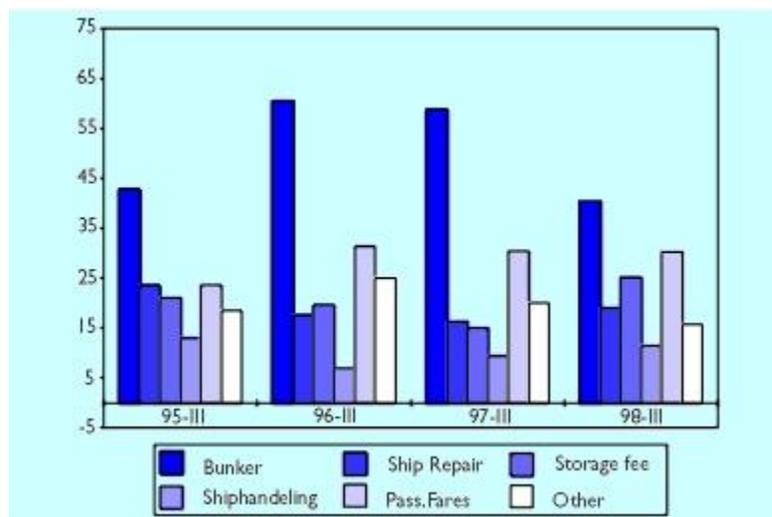
### Transportation

The transportation sector recorded a disappointing performance in the third quarter of 1998 (graph 2). Foreign exchange earnings from transportation activities decreased by NAf.7.7 million in the third quarter of 1998 compared to the same period in 1997. The drop in foreign exchange receipts was primarily the result of the less buoyant performance by the bunker activities.

Overall payments for transportation services received from abroad increased by NAf. 3.8 million in the third quarter of 1998.

#### Graph 2

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

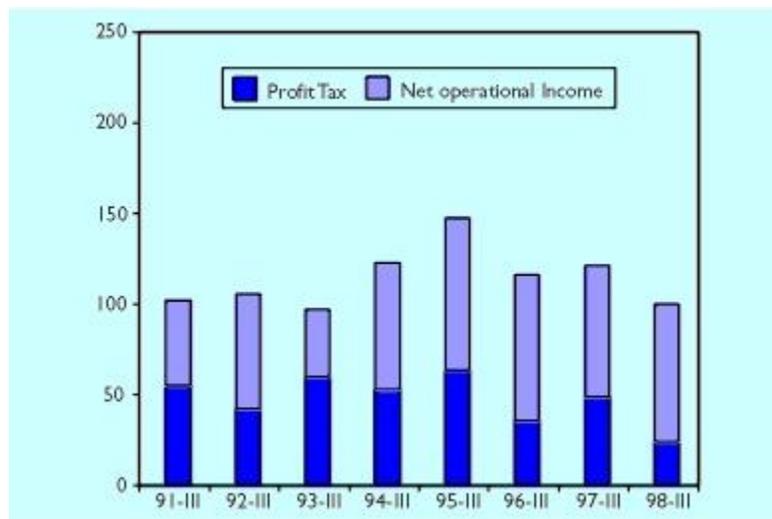


### The international financial and business services sector

Foreign exchange earnings from the international financial and business services sector recorded a net drop of approximately NAf.40.4 million in the third quarter of 1998, compared to the third quarter of 1997. The deterioration in foreign earnings occurred due mainly to a drop of NAf.25.0 million in the receipts of profit taxes, whereas operational income declined by NAf.15.6 million.

#### *Graph 3*

*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 substantial surplus as compared to the third quarter of 1997. The surplus amounted to NAf.61.7 million, an increase of NAf.25.7 million compared to the same period in 1997. This increase can be ascribed entirely to investment income. As table 14 reveals, the increase in investment income was the result of higher profit and interest receipts from abroad.

**Table 14**  
*Breakdown of the income account<sup>1)</sup> (in millions NAf.)*

	1997-III	1998-III	Diff.
Investment income	33,8	65,3	31,5
-Direct investment income	0,1	24,5	24,4
Received	10,0	33,2	23,2

Paid	9,9	8,7	-1,2
-Other investment income	33,7	40,8	7,1
Received	40,2	61,0	20,8
Paid	6,5	20,2	13,7
Labor income	2,2	-3,6	-5,8
Received	3,6	1,1	-2,5
Paid	1,4	4,7	3,3
Total income balance	36,0	61,7	25,7

<sup>1)</sup> *Cash basis*

The investment income balance increased by Naf.31.5 million during the third quarter of 1998. On the one hand, interest receipts by local investment companies from abroad increased by Naf.20.8 million, while on the other hand, profit receipts from abroad by resident companies increased by Naf.23.2 million in the third quarter of 1998.

### **The capital account**

The capital account of the balance of payments recorded a surplus of Naf.65.0 million in the third quarter of 1998, an improvement of Naf.4.9 million compared to the third quarter of 1997. This small improvement can be attributed to the private capital balance, because the official capital balance declined by Naf.7.5 million as a result of fewer funds transferred by the Dutch Government

Table 15 reveals that the improvement in the private capital balance of Naf.12.4 million in the third quarter of 1998 was primarily the result of an increase in the net portfolio balance and other capital inflows related to various ongoing projects. Both these developments mitigated the drop of Naf.24.1 million in the net foreign borrowing activities, as compared to the same period in 1997.

**Table 15**  
**Major components of the capital account <sup>1)</sup>**  
**(net flows in millions Naf.)**

	1997-III	1998-III	Diff.
Private capital,	24,2	36,6	12,4
of which:			
-direct investm.(Real estate)	6,3	5,3	-1,0
-portfolio investm.(Sec.)	-0,3	4,1	4,4
-loans (net)	15,0	-9,1	-24,1
-comm. banks borrowings	-2,2		2,2
-other private capital	5,4	36,3	30,9
Official capital,	35,9	28,4	-7,5
of which:			

-loans & grants	36,7	28,4	-8,3
-other gov. capital	-0,8		0,8
<b>CAPITAL BALANCE</b>	<b>60,1</b>	<b>65,0</b>	<b>4,9</b>

<sup>1)</sup> *Cash basis*

## **MONETARY DEVELOPMENTS**

### **Introduction**

Monetary developments during the third quarter of 1998 must be seen against the background of a lack of confidence by economic agents, in particular entrepreneurs, in our still sagging economy. This situation is, among other things, reflected in a marked increase in time deposits by companies and financial institutions other than banks, at the expense of investments in productive assets. Further, domestic credit to the private sector grew only marginally. However, net domestic credit to the general government increased primarily as a result of an increase in the demand for liquid assets by the island governments. Net foreign assets grew markedly during the third quarter of 1998.

During the third quarter of 1998, the Bank introduced a new monetary policy. The main components of this new policy are the modification of the reserve requirement and the deactivation of the limitation on the foreign exchange working balances of commercial banks (the so-called B-9 position). It is the Bank's intention gradually to phase out the monetary cash reserve arrangement, currently the most important monetary instrument. The reserve requirement policy is a policy instrument aimed at reducing overliquidity in the banking system and, hence, limit the possibility of excess credit extension by the commercial banks.

Effective August 17, 1998, the Bank allows the banks to hold certificates of deposits (CDs) issued by the Bank to meet up to 25% of its reserve requirement on the first day of the reserve requirement period. As these CDs will be negotiable among domestic commercial banks, commercial banks will have more flexibility in the management of their liquidity position.

Effective September 16, 1998, the Bank raised the reserve requirement percentage from 2% to 6%. The foreign exchange reserves position of the banks rose markedly at the expense of the official foreign exchange reserves position in the first weeks after the deactivation of the B-9 policy. As a result, the Bank decided to increase the reserve requirement further to 8% effective November 15, 1998.

### **Money supply**

During the third quarter of 1998, total money supply (M2) remained practically unchanged, compared to a 0.2% (NAf.4.2 million) expansion during the third quarter of 1997. This development can be attributed to a turnaround in the money component of the money

supply from a 0.9% (NAf.9.5 million) expansion during the third quarter of 1997, to a 0.3% (NAf.3.6 million) contraction during the third quarter of 1998.

This contraction of the money component of the money supply in the third quarter of 1998 is primarily the result of a 3.3% (NAf.5.3 million) contraction in the demand deposits denoted in foreign currency. Between the end of September 1997 and the end of September 1998, the money component of the money supply contracted by NAf.17.9 million. This contraction in our transaction balances is in line with the recession our country has been facing since mid-1996.

The 0.3% (NAf.4.1 million) expansion of the near-money component of the money supply during the third quarter of 1998 can be attributed almost entirely to the 0.7% (NAf.3.6 million) expansion in time deposits, because savings deposits remained unchanged. A comparison of the level of both savings and time deposits at the end of the third quarter of 1997 with the levels at the end of the third quarter of 1998, reveals an increase of NAf.12.2 million to NAf.1104.2 million and an increase of NAf.110.9 million to NAf.523.1 million, respectively. The marked increase in time deposits, held primarily by nonindividuals during the mentioned 12-month period is to a great extent the result of a NAf.67.1 million increase in the time deposits held by business enterprises and a NAf.55.8 million increase in time deposits held by financial institutions (non-banks). This increase reflects the reticent attitude towards risky investments of many entrepreneurs as a consequence of the uncertainties related to the public finance and the difficulties facing the economy.

**Table 16**  
**Quarterly changes in the components of the money supply (in millions NAf. and in percentages)**

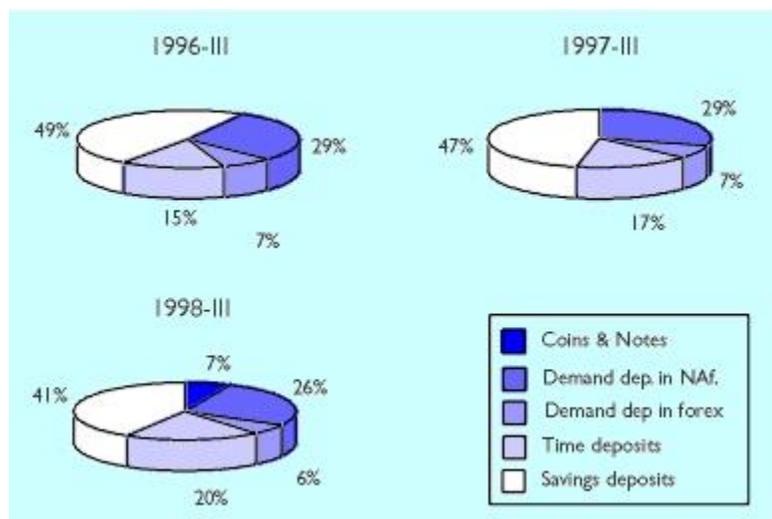
	1998-III		1997-III	
Coins and notes with the public	0.2	0.1%	-12.9	-7.0%
Demand deposits held by the public, of which:	-3.8	-0.4%	22.4	2.6%
-Neth.Ant.guilders	1.5	0.2%	10.0	1.4%
-Foreign currency	-5.3	-3.3%	12.4	7.6%
Money	-3.6	-0.3%	9.5	0.9%
Time deposits	3.6	0.7%	-2.8	-0.7%
Savings	0.5	0.0%	-2.5	-0.2%
Near money	4.1	0.3%	-5.3	-0.4%
Money supply	0.5	0.0%	4.2	0.2%

The only marginal rise in saving deposits on an annual base can be attributed to the contraction of our economy, the continued efforts of the government to speed up the collection of tax arrears and social premiums, and the rise in the cost of living as a result of the introduction of a sales tax on July 1, 1996.

Graph 4 reveals a 4 percentage points increase to 20% in the share of time deposits in the composition of the money supply at the end of the third quarter of 1998, compared to the end of the same quarter in 1997. This increase was primarily at the expense of the share of demand deposits denominated in local currency, which dropped by 2 percentage points to 26%. This confirms the earlier-mentioned precautionary attitude of entrepreneurs towards risky investments.

**Graph 4**

***Third-quarter developments in the composition of the money supply***



**Factors affecting the demand for liquid assets**

The total demand for liquid assets remained practically unchanged during the third quarter of 1998, compared to a 0.2% (NAf.4.2 million) expansion during the same period of 1997 (see table 17). The zero growth during the third quarter of 1998 is the net result of a 8.9% (NAf.51.1 million) increase in net foreign assets on the one hand, and a 2.4% (NAf.50.6 million) contraction in the demand for liquid assets by the domestic sector, on the other.

The marked increase in our net foreign position during the third quarter of 1998 is almost entirely the result of a NAf.65.0 million surplus in the capital account of the balance of payments, on the one hand, and a NAf.15.8 million deficit on the current account of the balance of payments, on the other.

The marked contraction in the demand for liquid assets by the domestic sector during the third quarter of 1998 is primarily the result of the contractionary impact of the miscellaneous item. This development can be attributed primarily to an administrative reclassification concerning transfers of retained earnings of the Central Bank to the Central Government.

**Table 17**  
**Quarterly changes in the demand for liquid assets by sector (in millions NAf. and in percentages)**

	1998-III		1997-III	
Government sector,	26.0	16.0%	17.4	10.1%
of which:				
-Central Government	8.2	9.4%	-0.9	-0.9%
-Island governments	17.8	23.7%	18.3	23.5%
Private sector	-19.5	-0.8 %	4.1	0.2%
Miscellaneous	-57.1	14.8%	-36.8	9.0%
Domestic sector	-50.6	-2.4%	-15.3	-0.8%
Net foreign assets,	51.1	8.9%	19.5	3.7%
of which:				
-Gold	0.0	0.0%	0.0	0.0%
-Official reserves	-17.8	-4.8%	-5.2	-1.7%
-Net foreign assets banks	68.9	465.5%	24.7	93.2%
Total liquid assets	0.5	0.0%	4.2	0.2%

The marked rise in the net foreign assets position of the commercial banks, which was at the expense of the official foreign exchange reserves, can be attributed to the deactivation of the limitation on the foreign exchange working balances of commercial banks (the so-called B-9 policy). As the official exchange reserves fell to a level below what the Bank considers prudent, the Bank decided effective November 16, 1998, to raise the reserve requirement for commercial banks from 6% to 8% of the adjusted domestic debt.

The demand for liquid assets by the private sector contracted by 0.8% (NAf.19.5 million) compared to a 0.2% (NAf.4.1 million) expansion in the third quarter of 1997. The slight contraction in the third quarter of 1998 is the net result of decreases in loans to the private sector and amounts receivables by NAf.17.5 million and NAf.2.3 million, respectively, on the one hand, and an increase in securities and participations by NAf.0.3 million, on the other. During the first three quarters of 1998, domestic credit to the private sector expanded by 1.1%, which is half of the permissible growth rate of 2.2% set by the Bank for the entire year 1998. This moderate growth in credit extension must be seen against the background of a soaring economy.

The demand for liquid assets by the government sector expanded by 16.0% (NAf.26.0 million) compared to a 10.1% (NAf.17.4 million) expansion in the third quarter of 1997. This acceleration can be ascribed mainly to the turnaround from a 0.9% (NAf.0.9 million) contraction to a 9.4% (NAf.8.2 million) expansion in the demand for liquid assets by the Central Government. The latter expansion is almost entirely the result of increases in the net liability of the Central Government at both the commercial banks and the Central Bank by

NAf.3.4 million and NAf.3.7 million, respectively. The demand for liquid assets by the island governments increased by 23.7% (NAf.17.8 million) during the third quarter of 1998, a slight acceleration compared to the 23.5% (NAf.18.3 million) expansion during the third quarter of 1997. The increase in the demand for liquid assets by the island governments during the third quarter of 1998 can be explained entirely by the decreases in their deposits at both the commercial banks and the Central Bank of NAf.13.9 million and NAf.1.8 million, respectively, and the rise by NAf.2.1 million in the liabilities of the Island Government of Curaçao to the banking system.

### **Domestic credit extension by the commercial banks**

The total amount of outstanding domestic loans (i.e., government paper and domestic credit to the private sector excluding special foreign borrowings, amount receivables, and securities and participations) at the commercial banks contracted by 0.9% (NAf.21.2 million) during the third quarter of 1998, compared to a zero growth in the same quarter of 1997. This contraction is primarily the result of a turnaround from a 1.7% (NAf.14.9 million) expansion to a 1.6% (NAf.15.0 million) contraction in the growth rate of mortgages. The growth rate of consumer loans increased from 0.5% (NAf.2.2 million) during the third quarter of 1997 to 1.0% (NAf.5.2 million) during the third quarter of 1998 while the contractionary impact of business loans decreased from 1.6% (NAf.12.4 million) to 1.0% (NAf.8.5 million). On an annual basis (i.e., from October 1, 1997 to September 30 1998), the amount of outstanding loans to the private sector expanded by 1.6% (NAf.35.3 million).

**Table 18**  
**Private sector loans and government paper at commercial banks as per end of period (in millions NAf. and percentages)**

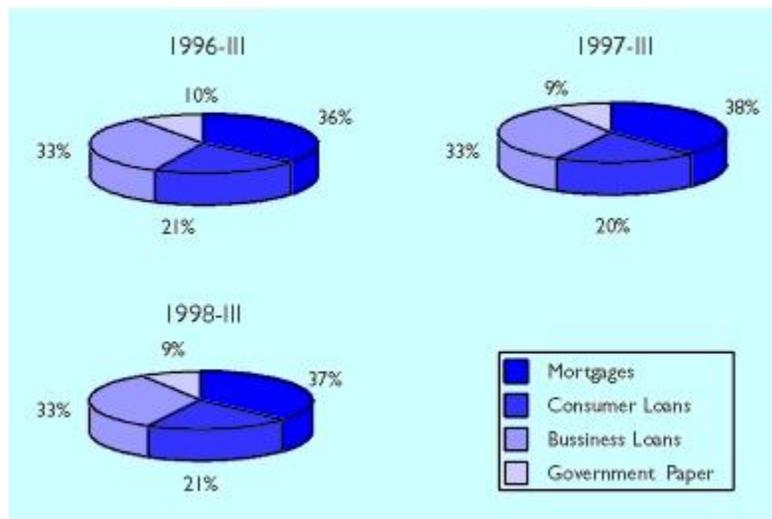
	1998-III	1997-III	% change	
			1998-III	1997-III
Private sector loans,	2,222.3	2187.0	-0.8%	0.2%
of which:				
-Mortgages	900.0	910.6	-1.6%	1.7%
-Consumer loans	512.4	489.3	1.0%	0.5%
-Business loans	809.9	787.1	-1.0%	-1.6%
Government paper	218.3	228.5	-1.4%	-1.9%
Total domestic loans	2,440.6	2,415.5	-0.9%	0.0%

The amount of government paper held in portfolio by the commercial banks contracted by 1.4% (NAf.3.0 million) in the third quarter of 1998 compared to a 1.9% (NAf.4.3 million)

contraction during the third quarter of 1997. For the 1998 monetary cash reserve arrangement, net domestic credit to the general government ( i.e., the total amount of government paper in the commercial banks' portfolio netted by the total amount of government deposits at commercial banks) was not allowed to surpass its end of October 1996 level. The amount of government paper in the commercial banks' portfolio at the end of September 1998, however, was NAf.29.2 million below its October 1996 level. This development may be a reflection of the reluctance of commercial banks to refinance government paper in light of the uncertainties concerning government finances

Graph 5 reveals that no major shifts occurred in the shares of the different components of the loan portfolio of the commercial banks.

**Graph 5**  
*Developments in commercial banks' lending portfolio*



A breakdown of private sector lending by commercial banks by island group reveals that on the Leeward Islands, the growth in total loans turned around from a 0.5% expansion in the third quarter of 1997 to a 0.9% contraction in the third quarter of 1998. This contraction is primarily the result of the turnaround from a 2.4% expansion to a 1.7% contraction in mortgages. Consumer loans grew by 2.2% during the third quarter of 1998 compared to a 0.5% growth in the same period the year before. Business loans contracted by 1.8%, 0.5 percentage points more than during the third quarter of 1997. Over the October 1997 to September 1998 period, the outstanding amount of loans to the private sector on the Leeward Islands expanded by 2.2% (NAf.36.9 million).

**Table 19**  
*Private sector loans at commercial banks on the Leeward Islands as per end of period (in millions Naf. and percentages)*

		% change	
1998-III	1997-III	1998-III	1997-III
		III	III

Private sector loans,	1,699.2	1,662.3	-0.9%	0.5%
of which:				
-Mortgages	627.9	637.7	-1.7%	2.4%
-Consumer loans	406.4	371.0	2.2%	0.5%
-Business loans	664.9	653.6	-1.8%	-1.3%

On the Windward Islands, credit extension to the private sector contracted during the third quarter of 1998 with the same rate -- 0.7% -- as in the third quarter of 1997. The contraction during the third quarter of 1998 is the net result of contractions in mortgages and consumer loans by 1.5% and 3.1%, respectively, on the one hand, and an increase in business loans by 2.8%, on the other. The total outstanding loans to the private sector on the Windward Islands contracted over the period October 1, 1997, to September 30, 1998, by 0.3% (NAf.1.7 million).

**Table 20**  
**Private sector loans at commercial banks on the Windward Islands as per end of period (in millions NAf. and percentages)**

			% change	
	1998-III	1997-III	1998-III	1997-III
Private sector loans,	523.0	524.7	-0.7%	-0.7%
of which:				
-Mortgages	272.1	272.9	-1.5%	0.0%
-Consumer loans	106.0	118.3	-3.1%	0.3%
-Business loans	145.0	133.5	2.8%	-2.8%

## INTERNATIONAL AND REGIONAL DEVELOPMENTS

### Introduction

International economic and financial conditions worsened notably in the third quarterly of 1998. Financial market conditions remain difficult, and confidence is at a low ebb. Growth prospects for both advanced and developing nations deteriorated. Recessions deepened in many Asian emerging market economies and in Japan. The recessions were exacerbated by Russia's financial crisis, which raised the shadow of default. Negative spillovers were felt in the world stock markets, in pressures on several currencies, and in further drops in already weak commodity prices. Among the industrial countries of North America and Europe, the

crisis effects of the emerging markets has had relatively little impact on growth so far. Sustainable growth has continued in the advanced economies of North America and Europe. Also, the labor market and domestic spending remained favorable. However, the deteriorating economic conditions in Asia weakened the North American and the industrial European external positions.

The Asian slump and the depressed oil prices contributed to the downturn of Latin American economies, including Colombia, Mexico, Brazil, and Venezuela. After enduring the Asian crisis, the Latin American economies confronted renewed financial market pressures with the Russian crisis in August 1998. Financial market pressures coupled with lower commodity prices broadened Latin America's already large fiscal and current account deficits. Also, Brazil's exchange market was punished by Russia's debt default. To protect major devaluation and to reduce its fiscal deficit, the Brazilian authorities responded by raising the interest rates to counteract capital flight.

### **Economic performance in Venezuela**

Amidst the campaigns of the presidential election, the Venezuelan economy contracted further, as GDP declined by 1.0%. The collapse in the price of oil in the first half of 1998, and the domestic restraint to address the fiscal deficit and to defend the bolivar resulted in a recession in the Venezuelan economy. With the drop in production, unemployment rose to 11.3%, still below the estimated year-end level of 12.5%.

Although the trend in the third quarter's inflation rate was lower than the second quarter's, it still appears out of reach for the official end-1998 target of 33.0%, because the annualized inflation rate was 34.3%. Besides, the bolivar recovered from mid-September lows near VEB590/US\$ to VEB570/US\$. As many analysts foresee that the currency pressures have been receded, the Central Bank has taken the opportunity to signal the desire to lower interest rates. Commercial loan rates were down, but still remain at approximately 55.0% (average lending rate was 57.5%).

### ***The oil sector***

Oil prices strengthened through late September, due to temporary supply factors, namely, civil unrest in Nigeria, storms in the Gulf of Mexico, and maintenance in the North Sea. The boost in oil prices proved short-lived as the \$12.38 per barrel price slipped back to \$12.00 per barrel. There was considerable political pressure to reverse Venezuelan cuts under the new OPEC quotas, as a result of lower revenues from the state oil company caused by lower oil prices and the revised OPEC quotas. The state oil-company PDVSA has been hit hard during the current crisis; the government slashed the company's 1998 capital spending budget. This shortfall can affect the company's credit rating, as PDVSA is forced to look for additional borrowing to meet the extraordinary payments and heavy 1999 obligations. With the possible change in post-election policy, the ambitious oil expansion plans are on hold. In the meantime PDVSA has continued to increase its refining capacity to ensure a market for future production: it has a 50% stake in Mobil Corp.'s refinery in Louisiana, and an impending agreement with Amerada Hess Co. in the Virgin Islands. Further investments in the oil sector were delayed or suspended, as the government maintained its decision to keep

domestic fuel prices under government control and to put a squeeze on the state oil company PDVSA's funds.

### **Economic performance in the Netherlands**

The Dutch economy continued to grow in the third quarter of 1998, as real GDP increased by 3.4%, similar to last year's third quarter. However, economic growth decelerated from 4.9% in the first quarter of 1998 to 3.4% in the third quarter of 1998 (table 21). The lower growth rate was the net result of lower external demand, on the one hand, and increased domestic demand, on the other. The crisis in Asia lowered the demand for exports, visible from the 12.0% decline in the value of exports. Concomitant with the decline in production activities, the rate of utilization declined to 84.9%. Despite the decline in foreign demand, a tight labor market continued to exist. The inflation rate continued to decline, as the increase in wage cost was outweighed by the declining prices of raw material. The increase in wage costs was, among other things, the result of higher contract wages.

**Table 21**  
**Key figures of the Dutch economy**

	1998-I	1998-II	1998-III
GDP growth	4.9	3.8	3.4
Industrial production	4.7	4.0	1.7
Private consumption	3.8	4.2	5.0
Investment	9.1	-1.4	*
Unemployment	4.8	4.2	3.9
Inflation	2.1	2.2	1.8
Producer prices	0.9	-1.2	-3.6
Hourly wages	3.2	3.2	3.5
Loans to the private sector	12.5	13.1	14.7
Long-term interest rate (%)	5.0	4.9	4.5

*Source: "Kwartaalbericht December 1998", DNB*

### **Monetary developments**

Loans to the private sector continued to increase considerably in the third quarter of 1998. Despite a slight dip in the growth of total mortgages, new mortgages increased by 10.0% in the third quarter of 1998. Over the years, households have invested to a great extent in mortgages; the debt in mortgages increased to 91.0% of household disposable income in 1998, compared to 56.0% in 1990.

### **Public finance**

The "miljoenennota 1999" presented a scenario based on a 2.25% growth rate. According to the government, in the case of moderate wage developments, the EMU deficit will reach 1.3% of GDP in 1999 and 1.0% of GDP in 2002. However, some of the effects of the budget cannot be measured, such as a more efficient "Rijksoverheid" and a more efficient procedure for implementing the social security system.

## **Economic performance in Asia**

Japan's continuing recession is affecting international economic performance. Japan did not perform that well in the third quarter of 1998; its annualized GDP contracted by 1.8%. Japan's economy shrank 0.5% in the July-September period of 1998 from the second quarter. Unemployment rose to a postwar high, and wages dwindled. The unemployment rate swelled to 4.3% in September of 1998, up from 3.4% in 1997.

Consumer and producer confidence is low, as people brace for a long recession. Household spending fell for 9 months in the row compared to last year. Compared to a year earlier, both consumer and corporate capital spending fell, causing industrial production to decline. Annual inflation in the July-September quarter of 1998, on the other hand, eased to -2.2%. Rapid action to sort out its banking sector and further fiscal impetus would help Japan and the rest of Asia to recover.

## **Economic performance in the United States**

America's economy still seems buoyant enough; however, deterioration of global financial conditions is affecting its external position. The United States real GDP grew by 3.3% in the third quarter of 1998. A few factors contributed to the third-quarter growth: an increase in demand for services by 4.1%, a rise in inventories on vehicles after a major U.S. car maker strike, and a pick-up in aircraft exports in September. Higher consumer spending (3.9%) was fuelled by several factors: (1) a rise in personal income, related to a tight labor market, (2) an upsurge in personal wealth, owing to the strong confidence in share market prices, and (3) an increase in consumer credit financed by cheap borrowing costs.

As a result of the tight labor market, unemployment slipped to 4.6% in September 1998, and this forced labor costs to go up. So far, a combination of higher wages and the inability to pass the higher costs on to the consumers had their biggest effect on corporate profits. In the period July-September of 1998, the U.S. economy showed moderate price inflation, as the quarterly annualized inflation amounted to 0.8%. Despite the growth, the spillover of the Asian crisis affected mainly the American goods and services trade. Net exports decreased by 2.9% of GDP in the third quarter of 1998. The widening goods and services trade deficit was caused by the following factors: (1) a decline in exports to Asia accompanied by strong imports, and largely attributable to the Asian slump and the strong dollar, (2) a drop in net investment income in the United States. As a result, the U.S. required a big inflow of foreign capital to finance its growing trade gap. This capital inflow provided a major lift for U.S. stocks and bonds. The resulting gain in stock prices and downward push on interest rates has buoyed demand in the United States.

In September 1998, the U.S. Federal Reserve cut interest rates by a quarter percentage point to 5.25%. The U.S. Federal Reserve lowered interest rates for three reasons: (1) to prevent a global credit crunch, (2) to boost confidence and stop any further financial disintegration and, (3) to reduce borrowing costs for less credit-worthy companies.

The U.S. Federal Reserve organized a bail-out of Long Term Capital Management (LTCM), a large hedge fund, on September 23, 1998. According to sources at the fund, the fall of the

hedge fund was caused mainly by its risky strategies, affecting the value of its portfolio, which eventually elevated its debt-equity ratio. Leading banks were persuaded to inject \$3.65 billion to keep LTCM alive. Without the U.S. Federal Reserve assistance, LTCM would have been pushed into bankruptcy, which would have had a large impact on the markets. LTCM's losses were huge, and much of the capital that banks lent to the fund was lost. The near collapse of the LTCM increased fears about America's domestic financial system and has raised the question of whether the financial institutions are as good as they claim at managing risk.

Some analysts fear a sudden weakening of the U.S. dollar, stemming from the growing current account deficit. Nevertheless, the negative trade position is wearing down fast because of the strong U.S. domestic demand for services and domestically produced goods. Consumer confidence still appeared healthy enough, evident from the continuous booming housing market, although at a slower pace. The lower productivity and poor profits outlook, on the other hand, have been reducing the capital spending power slowly. This reduction may result in a slowdown in the American economy in the coming months.

## **DEVELOPMENTS IN THE FINANCIAL SECTOR**

During the third quarter of 1998, the Bank continued to monitor developments in both the domestic and international financial sector of the Netherlands Antilles.

The Bank issued a "policy memorandum on the implementation of the fit and proper test," which applies to all financial institutions supervised by the Bank. The purpose of this memorandum is to address the Bank's considerations in assessing the knowledge, skills, and probity of the persons determining or co-determining the policy and the affairs of supervised credit institutions, supervisory directors, and principal shareholders being natural persons. It also provides some transparency in the decision-making structure as to the "fit and proper test," which is carried out by the Bank when evaluating prospective candidates.

Following the conclusion in 1997 of the memoranda of understanding covering the exchange of information between the Bank and the Nederlandsche Bank N.V. (Dutch Central Bank) and the Bank and the Superintendencia de Bancos of Venezuela, a memorandum of understanding was concluded between the Bank and the Centrale Bank of Aruba. The purpose of those memoranda are to provide an institutionalized vehicle for the exchange of information between supervisory authorities of credit institutions operating in the jurisdiction of one party but with branches or subsidiaries in the jurisdiction of the other party.

Furthermore, the Bank continued to monitor the readiness of the supervised financial institutions for the Year 2000.

### **Developments in the domestic banking sector**

Total assets of the local commercial banks decreased by NAf 19.7 million to NAf 4,421.6 million in the third quarter of 1998. However, compared to the same quarter of 1997, these assets reflected a growth of 6.5% (table 22).

Contrary to the first and second quarters of 1998, total loans extended by local commercial banks decreased by NAf. 18 million to NAf 2,873.3 million in the third quarter of 1998 mainly because of a decrease in current account overdrafts by business enterprises. Mortgages extended to business enterprises decreased by NAf. 23.7 million, whereas mortgages extended to individuals increased by NAf. 12.2 million. Furthermore, non-interest-bearing cash declined by NAf. 26.3 million, whereas interest-bearing cash increased by NAf. 52.5 million. Non-interest-bearing cash decreased due mainly to a decrease in the current accounts of local banks held at the Bank.

On the liability side, demand and time deposits reflected decreases of NAf. 46.1 million and NAf. 6.3 million, respectively, while savings deposits increased by NAf. 3.5 million. Furthermore, borrowing dropped by NAf. 18.4 million while other liabilities increased by NAf. 5.7 million.

The aggregate figures for the domestic banking sector reflect a sound capitalization. The capitalization of the sector increased by NAf. 42 million during the third quarter of 1998, reaching NAf. 412.1 million. The increase was mainly the result of an increase in the paid-in capital of one commercial bank.

**Table 22**  
**Aggregate balance sheet of commercial banks operating in the domestic banking sector of the Netherlands Antilles at quarter-end (in millions NAf.)**

	1998-III		1998-II		1997-III	
	NAf.	%	NAf.	%	NAf.	%
<b>ASSETS</b>						
Non-int.-bearing cash	306.0	6.9	332.3	7.5	270.6	6.5
Interest-bearing cash	685.8	15.5	633.3	14.3	559.5	13.5
Investments	300.9	6.8	310.3	7.0	299.2	7.2
Loans	2,873.3	65.02	2,891.3	65.02	2,772.4	66.8
Investm. unconsol. sub.	12.6	0.3	12.1	0.3	24.7	0.6
Fixed assets	168.6	3.8	171.8	3.9	154.0	3.7
Other assets	74.4	1.7	90.2	2.0	71.4	1.7
Total assets	4,421.6	100.04	4,441.3	100.04	4,151.8	100.0
<b>LIABILITIES</b>						
Demand deposits	1,190.0	26.91	1,236.1	27.81	1,160.7	28.0
Savings deposits	1,650.7	37.31	1,647.2	37.11	1,615.7	38.9
Time deposits	868.9	19.7	875.3	19.7	706.5	17.0
Total deposits	3,709.6	83.93	3,758.6	84.63	3,482.9	83.9
Borrowing	119.4	2.7	137.8	3.1	111.3	2.7

Other liabilities	180.5	4.1	174.8	3.9	168.0	4.0
Total liabilities	4,009.5	90.74	4,071.2	91.63	3,762.2	90.6
Minority interest	4.9	0.1	5.6	0.1	4.8	0.1
Subord. debentures	8.1	0.2	8.1	0.2	9.9	0.2
General provisions	108.4	2.5	97.1	2.2	100.0	2.4
Capital & reserves	290.7	6.6	259.3	5.9	274.9	6.7
Total capital	412.1	9.3	370.1	8.4	389.6	9.4
Total liabilities and capital	4,421.6	100.04	4,441.3	100.04	3,151.8	100.0

### **Developments in the international banking sector**

Following a slight contraction in the second quarter of 1998, total assets of the international banking sector increased by NAf. 7.1 billion to NAf. 69.8 billion in the third quarter of 1998. The increase in assets was mainly the result of increases in the total assets of two banks. The asset growth in this sector was funded primarily through demand and time deposits. The sector's total capital increased slightly by 0.4%, and this sector reflected sound capitalization at the end of the third quarter of 1998.