QUARTERLY BULLETIN 2004-2

Bank van de Nederlandse Antillen

REPORT OF THE PRESIDENT

The economy of the Netherlands Antilles continued to grow in the second quarter of 2004, reflected by an increase in real Gross Domestic Product of 1.5% on an annual basis. However, compared to the 2.7% expansion in the second quarter of 2003, the growth rate weakened. The overall growth was entirely the result of the growth in domestic expenditures as net exports declined slightly because the expansion of imports exceeded that of exports. Government consumption contributed primarily to the growth in domestic expenditures resulting from the expansionary fiscal policy. The growth in private expenditures also was related to consumption as private investment increased only marginally. Private consumption was primarily credit-driven because disposable income declined. Private investment remained weak in the face of persistent uncertainties surrounding the sustainability of the recovery. The inflation rate continued to moderate, reaching 1.2% on an annual basis at the end of June. Lower inflation of our trading partners, the Netherlands and Venezuela, and lower utility prices were the main contributors to the moderation.

An analysis of the economic growth by sector indicates that the expansion was attributable primarily to the growth in activities in the wholesale & retail, restaurants & hotels, and construction sectors. The tourism industry, represented mainly by the restaurants & hotels and wholesale & retail sectors, continued its strong performance. Both stay-over and cruise tourism expanded. Stay-over tourism expanded on all the islands, particularly on St. Maarten. All markets contributed to the growth, but the increase in the number of American travelers was most pronounced, attributable to the strong growth of the U.S. economy and the increased interest in destinations closer to home in light of the continuing threat of terrorist attacks. St. Maarten also recorded the highest growth in the number of cruise tourists. In contrast, Curacao noted a further decline in cruise tourism, which may be attributed to strong competition from Aruba. The good performance of the construction sector can be explained by several major ongoing projects, particularly in the transportation and utilities sectors.

Manufacturing activities showed a modest growth. The oil refinery recorded a slightly higher production level, but its operational expenses increased more significantly related to repairs and maintenance. In addition, activities in the ship repair industry improved. Financial intermediation also grew moderately as the improved performance of the domestic banking sector was mitigated by the continuing decline in activities in the international financial and business services sector. This decline was related to the slow progress in negotiating new tax treaties that should create new business to compensate for ending the low tax regime for offshore activities.

Activities in the transport, storage, & communication sector declined. The performance of the local carrier, Dutch Caribbean Airlines (DCA), continued to deteriorate as reflected by a significant reduction in the number of passengers and the amount of freight transported. Increasing delays and cancellation of flights due to technical problems and the bankruptcy of its transatlantic partner, Sobelair, contributed to this decline. Ultimately, in October, DCA itself went bankrupt when the government refused to continue funding the company's losses. The Bank wants to emphasize that a well-managed local airline is an asset for our economy as it guarantees the maintenance of crucial regional connections, promotes competition and, hence, better service at competitive prices, creates jobs, and generates foreign exchange revenues. Therefore, the Bank welcomes the current efforts to establish a new Curacao-based airline, under the condition that it will be run professionally and profitably without political interference.

In addition, the harbor sector performed poorly as reflected by a decline in both the number of ships piloted and the amount of freight handled. Moreover, oil transshipment and oil storage activities decreased. Despite the dismal performance of DCA, airport activities increased except in Bonaire. The overall increase indicates that the decline in DCA flights was picked up by other airlines, thus reducing the negative impact on tourism. The decline in Bonaire was accounted for entirely by transit passengers, related to the reduction in the number of KLM flights through Bonaire to Latin American destinations.

The balance of payments recorded a marginal surplus in the second quarter of 2004, a marked deterioration compared to the second quarter of 2003. The turnaround of the current account balance from a surplus to a deficit contributed primarily to this outcome. The deterioration of the current account was accounted for by the worsening of the trade balance, the current transfers balance, and the income balance. The trade deficit increased as a result of higher imports related to the growth in tourism and domestic spending, while the surplus in current transfers declined due to a drop in family transfers from abroad. The worsening of these balances was mitigated by an improvement in the services balance resulting mainly from the expansion in tourism. In line with the developments in the current account, the capital and financial account deteriorated also, due mainly to the decline in foreign reserves accumulation. In addition, foreign bank balances declined as (1) institutional investors increased their portfolio investments in light of the improving outlook on the international securities markets, and (2) local banks repatriated funds from abroad to invest in higher yielding domestic government securities. Besides the increase in portfolio investments, the improvement in direct investments and the decline in net trade credit received mitigated the decreases in reserves accumulation and foreign bank balances.

The general government's cash deficit deteriorated in the second quarter of 2004 compared to the second quarter of 2003 because expenditures increased more than revenues. The higher expenditures were accounted for entirely by current expenditures, reflected mainly by increases in transfers, payments for goods and services, and higher payroll expenses. The increase in transfers can be explained primarily by a contribution to the health care insurance fund of retired government employees (FZOG) to reduce its deficit. The increase in revenues was attributable to more tax revenues, as nontax revenues declined. Higher proceeds from sales tax and import duties, related to the growth in domestic spending, contributed particularly to the increase in tax revenues. Income and profit tax revenues also rose, due in part to improved tax compliance.

The outlook for the entire year indicates a financing deficit of NAf.525 million (10% of GDP), more than two-and-a-half times the approved budget deficit of NAf.200 million. The difference is explained by shortfalls, the settlement of claims, and payment arrears. Given the record net borrowing on the domestic capital market, it is unlikely that the entire amount can be financed this year, so that the difference will carry over into 2005. For 2005, the combined governments committed to a maximum budget deficit of NAf.215 million, in line with the target in the revised policy scenario of the Debt Commission. However, the carry-over from 2004 will result in a higher financing deficit. This outlook underscores that our public finances are still precarious and strict fiscal discipline is required to prevent further aggravation. In addition to strict adherence to all laws, rules, and policy decisions regarding the budget, fiscal discipline should be strengthened through the legal anchoring of budgetary targets. This approach will promote the drafting of realistic budgets, including provisions for risks, and will force compensatory measures in case of shortfalls.

In the monetary field, the money supply recorded moderate growth due almost entirely to the expansion in the domestic sector. The domestic expansion was accounted for by the expansionary impact of the government sector, resulting mainly from the net increase in government securities with the commercial banks, because private demand for credit stagnated. The Bank tightened its monetary stance slightly in the second quarter of 2004 with an increase in the reserve requirement percentage of 0.125 percentage point to 10.375% on May 17. This step was taken in light of the continuing increase in credit extension to the governments and to mop up excess liquidity in the domestic banking sector. Since these developments did not abate during the following months, the reserve requirement percentage has since been increased further in three steps to 11.25% as of November 16, 2004. Moreover, the Bank increased its official lending rate in two steps from 2.25% to 2.75% as of November 15 in light of the rising interest rates abroad and their impact on the domestic money and capital market.

While some progress has been made in the implementation of the urgency program of the government, this is insufficient to accelerate the pace of economic growth. Without further structural reform, there can be no progress on the economic front. Structural reform of our labor and product markets to improve their functioning is the horse that can pull the cart of economic expansion. Moreover, the continuation of our fiscal ills has also increased instability and uncertainty and hence clouded the investment climate.

What we need is a strong commitment of the authorities for the implementation of a gradual fiscal consolidation, an acceleration of reforms in the economic field to raise potential growth, and social equity. To further our goals, we must take into account the growing links between these policy areas.

To move forward, progress must be made on the constitutional issue. The report of the Jesserun Commission on the future constitutional relations within the Kingdom has been issued without a clear claim of ownership. This has led to a laxity of the parties involved and only made progress on this front less likely. It is evident that this stalemate must be broken swiftly because clarity on our constitutional future is crucial for addressing our macroeconomic imbalances in a lasting way.

E.D. Tromp
President

INTERNATIONAL ECONOMIC DEVELOPMENTS

Real GDP of the United States grew at a 4.8% annual rate in the second quarter of 2004, up from 2.3% in the same quarter of 2003. Increases in consumer spending (3.6%) and non-residential fixed investment (10.8%) were mainly responsible for the second-quarter growth. Consumer spending growth was sustained by favorable interest rates and a recovery in the labor market, as the unemployment rate fell to 5.6%. Moreover, the confidence of the business sector continued to improve, leading to more investment in equipment and software. The annual inflation rate remained stable at 2.2% in the June quarter of 2004, despite rising energy and food prices. The stable inflation was related mainly to the strong productivity growth (4.0%), although the increase was slower than last year. Moreover, strong competition also may have prevented businesses from raising their prices. However, inflationary expectations based on stronger demand and rising oil prices led the Federal Reserve to raise the Fed funds rate by a quarter percentage point to 1.25% in June 2004, the first increase in four years.

Table 1 Selected indicators of various countries

	United States		Netherlands		Venezuela	
	2003-II	2004-II	2003-II	2004-II	2003-II	2004-II
Real GDP (% change)	2.3	4.8	-0.2	1.3	-5.2	13.6
Consumer prices (%)	2.2	2.2	2.7	1.6	31.5	25.3
Unemployment rate (%)	6.3	5.6	5.3	6.4	19.2	16.6

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

During the months April-June 2004, the Dutch economy rose by 1.3%, the highest growth rate since the third quarter of 2001. This economic growth was driven mostly by exports, largely from re-exports. The manufacturing, trade, transport, and financial services sectors gained from the stronger foreign demand. However, the job market lagged behind as the jobless rate worsened to 6.4%. The largest job loss occurred in the private sector, mainly in the construction industry. The annual inflation rate fell from 2.7% in the June quarter of 2003 to 1.6% in the corresponding quarter of 2004. According to the European Union standards, the Dutch inflation rate was the second lowest in the Euro area.

The Venezuelan economy continued to recover from the recession caused by internal conflict in 2003. In the April-June period of 2004, real GDP grew by 13.6%, encouraged mostly by the non-oil industry. Activities in the manufacturing, transport, retail, communication, and construction sectors expanded, the latter led largely by increased government spending. The fiscal accounts benefited from high oil prices and recovering production levels. According to some analysts, public spending accounts for approximately 30% of GDP. Accompanied by the economic rebound, the unemployment rate fell from 19.2% in the second quarter of 2003 to 16.6% in the same period of 2004. Venezuela's consumer prices remained high at 25.3%, although lower than in 2003.

GENERAL ECONOMIC DEVELOPMENTS IN THE NETHERLANDS ANTILLES

In the second quarter of 2004, the Netherlands Antillean economy continued to expand, albeit at a slower pace than the year before. Both private and public spending were the principal forces behind the 1.5% real GDP growth in the second quarter of 2004. In contrast, net foreign demand shrank, which partially reduced the GDP expansion. The second-quarter increase was accompanied by a lower inflation rate of 1.4%.[1] Lower inflation of our main trading partners as well as a decline in utility prices were responsible for this outcome.

All domestic demand components, except public investment, contributed to the favorable second-quarter economic development. Consumer spending continued to grow, stemming from more consumer loans, but was dampened partly by a fall in disposable income. The slight increase in private investment was reflected in more business loans. Uncertainty continued to prevail among investors, as shown by the weak private investment growth. Public expenditure grew by 1.8%, due to an upturn in government consumption. An increase in outlays on wages & salaries and on goods & services led to the higher government consumption. Meanwhile, net foreign demand dropped, as rising import demand (7.0%) offset the expansion in exports (6.7%). The sizeable import of merchandise was driven largely by the growth in the tourism industry on the Windward Islands.

Table 2 GDP growth by expenditure *) (real percentage changes)

	2003-II	2004-II
Domestic expenditure, of which:	0.2	1.8
Private sector	-0.8	1.0
- Investment	-2.0	0.3
- Consumption	1.2	0.7
Government sector	1.0	0.8
- Investment	-0.1	-1.0
- Consumption	1.1	1.8
Changes in inventory	-2.1	0.1
Foreign net expenditure, of which:	4.7	-0.3
Export of goods and services	0.0	6.7
Import of goods and services	-4.7	7.0
GDP by expenditure	2.7	1.5
Net primary income	-0.4	-1.2
Gross national income	2.4	0.3
Net current transfers from abroad	0.7	-3.3
Gross national disposable income	3.1	-3.0

BNA estimates
*) Expenditure categories data are weighted contributors to GDP growth.

[1] Second quarter of 2004 compared to second quarter of 2003.

Domestic production

The second-quarter economic increase was attributed to more private-sector production activities and an expansionary fiscal policy. The higher public sector spending was related to a rise in outlays on wages & salaries. The private sector growth was mostly the result of a strong performance in the construction, wholesale & retail, and restaurants & hotels sectors (see table 3).

Table 3 GDP by sector (real percentage changes)

Sector	2003-II	2004-II
Agriculture, fishery, & mining	-3.3	3.7
Manufacturing	3.4	0.3
Electricity, gas, & water	0.0	1.1
Construction	-4.7	3.9
Wholesale & retail trade	4.1	4.5
Restaurants & hotels	5.0	5.1
Transport, storage, & communication	2.6	-0.6
Financial intermediation	1.5	0.9
Real estate, renting, & business act.	0.5	0.6
Private households	4.7	-0.6
Total private sector	2.0	1.6
Public sector	8.8	2.2
Taxes minus subsidies	-2.6	0.5
GDP	2.7	1.5

BNA estimates

During the months April-June 2004, activities in the construction industry expanded for the second consecutive quarter. This expansion was the result of several major ongoing non-residential projects, such as in the utilities and transportation sectors. Furthermore, the value of completed projects grew significantly during this quarter, supported by both residential and non-residential projects in Curacao.

Growth in the tourism sector contributed favorably to the real increases in added value in the wholesale & retail and hotels & restaurants sectors. The number of stay-over tourists in the Netherlands Antilles continued to expand (10.1%) in the second quarter of 2004, as a result of more tourist arrivals from all markets. Strong economic growth in the United States may have led to more American travelers visiting the islands. The number of European visitors grew, but at a lower rate than the previous year. The growth in the second quarter of 2004 may be connected to the continued depreciation of the US dollar against the euro. The improvement in the South American market was linked to the economic rebound in Venezuela that began in the first quarter of 2004. Similar to stay-over tourism, cruise tourist arrivals rose by 14.5% in the second quarter of 2004, up from 9.7% in the same quarter of 2003. This favorable performance was fueled largely by tourism on the island of St. Maarten.

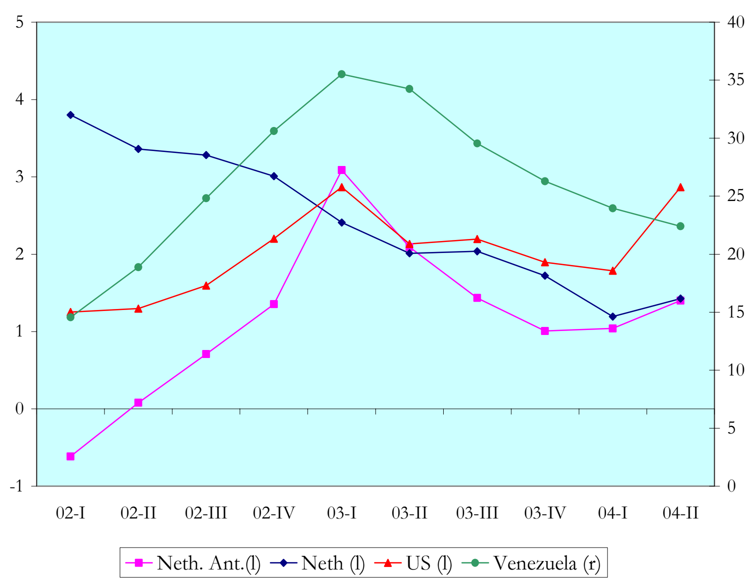
An analysis by islands indicates that stay-over tourism was robust on all islands in the second quarter of 2004. St. Maarten recorded a significant increase in the number of stay-over tourists (13.1%), attributable to the North American, European, and Caribbean markets. Curacao's stay-over tourism improved by 5.1%, owing particularly to an increase in the number of visitors from the United States and Venezuela. Growth in the North American market was largely responsible for more stay-over arrivals in Bonaire (7.1%). In addition, more cruise passengers visited St. Maarten and Bonaire, while the opposite occurred in Curaçao.

The transport, storage, and communication sectors dampened the second-quarter growth of 2004. This result stemmed from fewer activities in the air transportation and harbor sectors. The number of passengers transported on regional connections by the national airline, Dutch Caribbean Airlines (DCA), declined. This drop was related to the discontinuation of some routes in early 2004. Moreover, the number of passengers transported on the transatlantic flights contracted noticeably, stemming from the disruption of flights related to the insolvency of DCA's partner, Sobelair, in the first quarter of 2004. Nevertheless, airport activities in the Netherlands Antilles increased because the decline in DCA flights was picked up by other carriers. Developments in the harbor sector were discouraging in the quarter ending June 2004. Both oil storage and transshipment activities recorded negative results. Furthermore, fewer ships were piloted into the harbors, and total cargo movements in Curaçao deteriorated by 3.4%.

Inflation

The annual inflation rate in the Netherlands Antilles decelerated from 1.8% in the quarter ending June 2003 to 1.2% in the second quarter of 2004. The primary factors behind the second-quarter's price deceleration were (1) lower inflation of our main trading partners, the Netherlands and Venezuela; and (2) lower utility prices.

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



Source: Central Bureau of Statistics, US Bureau of Labor Statistics, Central Bureau of Statistics Netherlands, and Banco Central de Venezuela.

On a quarterly basis, consumer price inflation fell from 2.1% in the second quarter of 2003 to 1.4% in the same quarter of 2004. Cheaper utility costs contributed to the lower inflation in the category "housing". An analysis by islands shows that during the months April-June of 2004, Curacao had the lowest quarterly inflation rate of 1.3%, followed by St. Maarten at 1.5%, and Bonaire at 2.0%. See table 8 in the appendix for a detailed overview.

DEVELOPMENTS IN PUBLIC FINANCE

In the second quarter of 2004, expansionary fiscal policy led to a deterioration of the general government deficit on a cash basis, by NAf.15.7 million to NAf.138.5 million as compared to the second quarter of 2003. A breakdown by level of government shows that the deficit of the central government deteriorated by NAf.18.8 million, while the deficit of the island government of Curaçao improved by NAf.3.1 million. See table 9 in the appendix for a detailed overview.

A review of general government expenditures reveals that the increase in expenditures stemmed from a rise in current expenditures, while capital expenditures showed a decline. In general, higher government expenditures were related mainly to expenses for medical services. A breakdown by level of government shows that the current expenditures of the central government contributed mostly to the higher public spending. The expansion of central government spending was due to, among other things, increased transfers to other government levels. These higher transfers (NAf.27.6 million) were related to the reduction of the deficit of the health care insurance fund of retired government employees (FZOG). In addition, the central government recorded higher outlays on wages and goods and services. The higher expenditures were mitigated partly by a decline in domestic interest payments of NAf.4.1 million compared to the second quarter of 2003. This drop in interest payments was related to a retroactive payment to the Social Security Bank (SVB) in 2003. Adjusted for this transitory factor, domestic interest payments increased due to the higher amount of outstanding government paper and an increase in the average interest rate.

A closer look at the expenditures of the island government of Curaçao reveals that the rise in expenditures was led by outlays for goods and services, owing mainly to medical service expenses. Part of the increased expenses for goods and services was the result of a change in the accounting method: some outlays classified as subsidies are now classified as expenditures for goods and services. Therefore, the item subsidies showed a decline in the June quarter of 2004. Furthermore, the increase in expenditures was offset partly by a drop in domestic interest payments of the island government of Curaçao caused by back payments to the government pension fund in 2003.

Contrary to the increase in current expenditures, the general government reported a drop in capital expenditures. Broken down by level of government, the decline in capital transfers was related mainly to the transitory settlement of guarantees in the second quarter of 2003[2] by the central government, while the capital expenditures of the island government of Curaçao remained about the same. Overall, the expansionary fiscal policy contributed positively to economic growth in the second quarter of 2004.

The public sector revenue growth of NAf.7.2 million lagged behind its expenditure growth. The slight increase in revenues stemmed mainly from a large rise in tax revenues, while nontax revenues showed a sharp decrease. A further analysis by level of government reveals that the rise in tax revenues was due mainly to higher proceeds from sales tax and taxes on international trade and transactions by the central government, related to increased private spending. In contrast, the nontax revenues of the central government showed a drop as the government did not receive any advances on the license fee collected by the central bank in the second quarter of 2004. The tax revenues of the island government of Curaçao showed an increase caused by higher income and profit tax revenues. The latter is related to improved tax compliance. The nontax revenues of the island government of Curaçao declined moderately.

[2] These capital transfers were related to guarantees extended to the former national airline, Air ALM.

The budget deficit of the general government in the second quarter of 2004 was financed both monetarily and nonmonetarily, as shown in table 4. However, there was a shift from non-monetary to monetary financing compared to the second quarter of 2003. A breakdown by level of government shows that the increase in monetary financing was related partly to a net increase in holdings of central government securities by the commercial banks, while the central bank decreased its outstanding loans to the central government. The nonmonetary financing of the central government's deficit was due to an increase in central government securities held with the public, although the increase was smaller than in the second quarter of 2003 because institutional investors showed less interest in these securities. The deficit of the island government of Curaçao was financed mainly by a net withdrawal of deposits at the commercial banks of NAf.38.1 million, which explains also the increased monetary financing. Furthermore, securities of the island government of Curaçao held with the public rose by NAf.12.5 million.

Table 4 Financing of the cash balances (in millions NAf.)

	Central government		Island government of Curaçao	
	2003-II	2004-II	2003-II	2004-II
Monetary financing	8.8	45.3	29.6	41.7
Central bank	-27.0	-23.1	-19.5	0.6
Commercial banks	36.1	68.2	49.1	41.1
Coins and notes	-0.3	0.2	-	-
Nonmonetary financing	56.5	38.8	27.9	12.7
Government securities with the public	49.3	23.3	6.4	12.5
Other	7.2	15.5	21.5	0.2
Budget balance	-65.3	-84.1	-57.5	-54.4

Public sector debt

The total outstanding debt of the general government increased by NAf.69.4 million and amounted to 91.1% of GDP at the end of the second quarter of 2004. The accumulation of debt was the result of an increase of NAf.75.4 million in the total consolidated domestic debt and a drop of NAf.6.0 million in the outstanding foreign debt. See table 10 in the appendix for a detailed overview.

Further analysis by level of government reveals that the higher domestic debt of the central government was caused largely by borrowing on the capital market. The net rise in debt securities issued by the central government amounted to NAf. 83.9 million in the April-June period of 2004. The net increase of NAf.53.9 million in treasury bills was the first increase since the fourth quarter of 2002. To be able to react swiftly on favorable developments in the international financial markets, investors prefer short-term paper because it can be transformed more quickly into liquid assets and reinvested abroad. The debt of the island government of Curaçao dropped slightly as the net increase in short-term securities was offset by, among other things, a decline in the debt to the central government.

The drop in the foreign debt was the result of a slight appreciation of the Netherlands Antillean guilder vis-à-vis the euro during the second quarter of 2004, which caused a decline in the debt to the Netherlands.

DEVELOPMENTS IN THE BALANCE OF PAYMENTS

Net exports of goods and services showed a slight decrease in the second quarter of 2004 as the growth in imports outweighed the increase in exports compared to the second quarter of 2003. The decline in net foreign demand contributed partly to the deceleration in economic activities. The decline in net foreign demand, accompanied by the worsening of both the income and current transfers balances, led to the current account deficit in the second quarter of 2004, in contrast to the surplus in the same quarter of 2003. In line with the current account deficit, the capital and financial account deteriorated, due mainly to a large deceleration in foreign reserves (see table 5).

Table 5 Balance of payments summary (in millions NAf.)

	2002-II	2003-II	2004-II
Current account	-66.3	19.2	-51.3
Capital account	19.1	16.2	38.2
Financial account, of which:	-4.9	-72.0	-38.6
- Change in reserves [1)]	-28.4	-79.2	-1.8
Statistical discrepancies	52.1	36.6	51.7
Memorandum items			
Change in reserves [1)]:			
- with commercial banks	13.2	-81.8	73.3
- with central bank	-41.6	2.6	-75.1

1) A minus sign implies an increase.

Current account

Import of goods and services increased by NAf.87.8 million, largely as a result of the higher demand for goods (for more details see table 11 in the appendix). The growth in tourism and domestic spending resulted in increased merchandise imports (NAf.52.4 million). The demand for goods increased mostly on the Windward Islands caused by the high growth in both stay-over and cruise tourism. Furthermore, the free-zone companies in Curaçao imported more goods to meet domestic demand and to replenish their inventories.

Export of goods and services increased by NAf.83.7 million in the second quarter of 2004 compared to the second quarter of 2003. This increase was related mainly to the sustained rise in foreign exchange revenues from tourism. The tourism sector continued to perform particularly well on the Windward Islands where tourism revenues increased by 15%. Noteworthy is that declining free-zone re-exports negatively impacted merchandise exports. The decline in free-zone re-exports was mitigated by a growth in export of ship-repair activities.

The worsening of the trade balance outweighed the improvement of the services balance, resulting in a decline in net goods and services export earnings of NAf.4.1 million. In addition, the income balance showed a deterioration as interest earnings on foreign investments declined, while dividend payments to foreign investors increased. Furthermore, current transfers from abroad showed a large decrease, resulting from a drop in family transfers. Overall, the current account balance turned around from a surplus in the second quarter of 2003 to a deficit in the second quarter of 2004.

Capital and financial account

In accordance with the current account deficit, the financial account deteriorated with NAf.33.4 million, due mainly to a large drop in foreign reserves accumulation (NAf.77.4 million). The deterioration of the financial account also was related to a worsening of the other investment balance. These developments were mitigated by an improvement of the portfolio investment and direct investment balances, and the net lending and borrowing account.

The worsening of the other investment balance (NAf.26.2 million) was related mainly to a continued decline in balances on resident companies' foreign bank accounts. This decline was partly the result of a shift in investments of institutional investors from low-risk and low-yielding time deposits to higher risk and higher-yielding securities like bonds and equities as the outlook on the international financial markets became more favorable. Contrary to institutional investors, the banking sector purchased more local government securities at the expense of funds formerly invested abroad, which may be related to the higher domestic yield on government bonds. The repatriation of foreign funds contributed also to a worsening of the other investment balance.

The shift in investments of institutional investors in foreign bonds and equity led to the improvement of the portfolio investment balance (NAf.39.9 million). Moreover, the improvement of the direct investment balance (NAf.16.8 million) resulted from a decline in imports by resident companies from their foreign affiliates.

The net lending and borrowing balance, which includes trade credit and foreign loans, improved by NAf.13.5 million compared to the second quarter of 2003. This improvement can be attributed mostly to a large decline in net trade credit received because of repayments, which may indicate an improvement in the financial situation of companies operating in the trade sector.

MONETARY DEVELOPMENTS

Monetary policy and money supply

In the second quarter of 2004, the Bank adapted its main instrument of monetary policy, i.e., the reserve requirement[3], with an increase of the reserve requirement percentage by 0.125 percentage point to 10.375% as per May 17. This measure was taken primarily as a reaction to the continuing increase in credit extension to the governments and to mop up excess liquidity in the domestic banking market.

The money supply increased by NAf.67.5 million in the April-June period of 2004, a deceleration compared to the increase of NAf.143.5 million recorded during the corresponding period of 2003. The increase in 2004 was due primarily to an expansion of NAf.65.7 million in net domestic assets. In addition, net foreign assets rose by NAf.1.8 million. During the second quarter of 2003, these components rose by NAf.64.3 million and NAf.79.2 million, respectively. Noteworthy is the substantial deceleration in net foreign assets, which can be related to the deterioration of the current account of the balance of payments.

Factors affecting the money supply

The increase in net domestic assets resulted primarily from an increase of NAf.84.3 million in net credit extension to the government sector; net private credit extension grew by a mere NAf.0.4 million.

The increase in net credit extension to the governments resulted from rises at both the central government and the island government of Curaçao by NAf.38.6 million and NAf.45.7 million, respectively. The trend of decreasing interest in government securities, which started in the

[3] Under this instrument, commercial banks have to place a noninterest-bearing deposit, the reserve requirement, on a blocked account at the Bank. The size of the reserve requirement is calculated by multiplying the adjusted domestic debt of the commercial banks by the reserve requirement percentage.

second half of 2003, was reversed during the second quarter of 2004 with a rise of NAf.66.6 million in the commercial banks' portfolio. This turnaround was due to, among others things, the stagnant demand for credit from the domestic private sector. In addition, the still relatively low international interest rates suppressed foreign investments. These developments sustained the high liquidity in the domestic banking sector.

The stagnant private demand for credit resulted from contrasting developments in the respective island groups: private loans extended on the Leeward Islands expanded by NAf.16.8 million offsetting the drop of NAf.15.8 million recorded on the Windward Islands. The increase on the Leeward Islands was the result of an increase in only one loan component, i.e. consumer loans, which offset the drop in business loans and mortgages. The increase in consumer loans may be the result of increased promotion campaigns by some banks. The decline in private loans on the Windward Islands was attributable to fewer mortgages.

Net foreign assets recorded a small expansion of NAf.1.8 million in the second quarter of 2004. This expansion resulted from an increase of NAf.75.1 million in net foreign assets at the Bank, which exceeded the drop of NAf.73.3 million in the net foreign assets position of the commercial banks. This development is a reversal of the recent trend of an expanding commercial banks' net foreign assets position at the expense of the Bank's official reserves. The drop in the commercial banks' net foreign assets can be attributed to the increase in government securities in their portfolios, as funds formerly invested abroad were directed into the domestic sector.

Developments in domestic interest rates

The Bank's pledging rate remained unchanged at 2.25% during the April-June period of 2004, the same rate as in the past five consecutive quarters. The maximum rate the Bank offers on its Certificates of Deposit (CDs) also remained unchanged (1.25%)[4] because it is equal to the pledging rate minus 100 basis points.

The trend of a decreasing average rate on passbook savings continued during the second quarter of 2004. On an annual basis, this drop amounted to 0.5 percentage point. The average rate on time deposits remained unchanged compared to the first quarter, but dropped by 0.8 percentage point on an annual basis. These developments can be related to the persistently high liquidity in the domestic banking sector.

The average rates on mortgages and time loans also reveal a downward trend. This development can be explained partly by the excess liquidity in combination with the stagnant demand for private credit. As a result, competition among commercial banks increased, leading, among other things, to lower lending rates.

The average yield on domestic government bonds and 1-month treasury bills rose by 0.7 and 0.8 percentage point, respectively, in the second quarter of 2004 compared to the second quarter of 2003. This development was due to decreasing interest in government securities by institutional investors because of the deterioration of the public finances and the improving returns abroad. However, as noted, the interest in government securities by the banks increased again in the second quarter of 2004, particularly in short-term paper. The latter explains the decrease in the 1-month treasury discount rate in the second quarter of 2004 compared to the two previous

[4] To offer domestic investment alternatives for the commercial banks, the Bank auctions CDs through bi-weekly tenders.

quarters. To be able to react swiftly on favorable developments in the international financial markets, commercial banks invested in short-term paper because these can be transformed more quickly into liquid assets and reinvested abroad.

DEVELOPMENTS IN THE COMMERCIAL BANKING SECTOR

During the April-June period of 2004, total assets of the commercial banking sector dropped by 1.6%, a turnaround compared to the increase of 0.5% recorded during the corresponding period of 2003. The drop in 2004 was due mainly to decreases in noninterest-bearing cash (12.9%) and in other assets (49.6%), mitigated by the growth in investments (11.9%). The decrease in total assets was in line with the decline in total deposits (2.0%), the commercial banks' funding source. See table 15 in the appendix for more details.

The commercial banking sector registered an increased profitability in the second quarter of 2004 compared to the second quarter of 2003, contributing to the growth in value added by the private sector. Net operating income improved by 25.9%, the result of increases in net interest income (5.9%) and other income (18.1%), on the one hand, and a rise in operational expenses (6.6%), on the other hand. Net income after taxes increased by 45.5%.

Macroprudential indicators

The macroprudential indicators provide an indication of the general performance of the domestic commercial banking sector. These indicators cover the following areas: capital adequacy, asset quality, earnings, and liquidity. Most indicators reveal a slight improvement in the sector's soundness during the second quarter of 2004 compared to the second quarter of the previous year.

The capital-to-total assets ratio improved by 0.2 percentage point to 7.5% in the second quarter of 2004, the same level as in the second quarter of 2003.

During the April-June period of 2004, the nonperforming loans ratio dropped further to 4.4%, continuing the trend of improving asset quality as of the third quarter of 2003. Both a decrease in nonperforming loans and a rise in total loans contributed to this result. The improved asset quality also is revealed by the further improvement in the provisions for loan losses-to-non-performing loans ratio to 80.4% in the second quarter of 2004. The drop in nonperforming loans and the slightly higher provisioning contributed to this improvement.

The earnings-related ratios showed mixed results in the commercial banks' profitability during the second quarter of 2004, compared to the second quarter of 2003. The gross-earnings-assets yield[5] decreased as a result of the expansion of the loan portfolio, while interest income increased only marginally because of the decline in interest rates. The net interest margin, defined as net interest income as a percentage of average earning assets, remained unchanged at 5.0%. Finally, the return-on-assets ratio improved from 1.4% in the second quarter of 2003 to 1.8% in the second quarter of 2004, due to the increased net operating income.

Table 6 Macroprudential indicators (in %, end of period)

	2003-I	2003-II	2003-III	2003-IV	2004-I	2004-II

[5] Gross interest income as a percentage of average earning assets.

Capital adequacy						
Total capital/ total assets	7.4	7.5	7.6	7.2	7.3	7.5
Asset quality						
Nonperforming loans/ total loans	6.2	6.8	6.1	6.1	5.0	4.4
Provisions for loan losses/ non-performing loans	58.8	55.5	64.1	61.1	72.0	80.4
Earnings						
Gross-earnings-assets yield	8.2	8.0	7.9	7.4	7.9	7.6
Net interest margin	5.1	5.0	4.9	4.7	5.1	5.0
Return-on-assets	1.6	1.4	1.6	1.5	2.0	1.8
Liquidity						
Total loans/ total deposits	64.5	64.2	63.9	63.9	65.3	65.7

Although the excess liquidity in the domestic banking sector continued in effect in the April-June quarter of 2004, the further increase in the total loans-to-total deposits ratio implies that the trend of increasing liquidity has been reversed.

APPENDIX

Table 7 Developments in stay-over tourism per island (% change)[6]

	Curaçao				St. Maarten				Bonaire			
	2003-II		**2004-II**		**2003-II**		**2004-II**		**2003-II**		**2004-II**	
North America, of which:	7.4	(0.4)	8.9	(0.5)	12.6	(4.7)	11.6	(4.4)	0.1	(0.0)	12.4	(0.5)
-U.S.A.	6.8	(0.4)	7.3	(0.4)	13.2	(4.6)	10.9	(3.8)	---	---	---	---
Europe, of which:	25.6	(3.1)	-0.3	(0.0)	4.7	(0.5)	13.1	(1.6)	127.8	(5.5)	-2.8	(-0.1)
-The Netherlands	32.6	(3.2)	-1.7	(-0.1)	28.0	(0.5)	47.7	(1.1)	---	---	---	---
South & Central America, of which:	-29.8	(-1.6)	19.7	(1.1)	-10.1	(-0.1)	24.9	(0.4)	10.3	(0.1)	21.1	(0.1)
-Venezuela	-18.3	(-0.6)	26.8	(1.1)	-28.5	(-0.1)	28.1	(0.1)	---	---	---	---
-Colombia	-71.0	(-0.4)	-21.1	(-0.1)	---	---	---	---	---	---	---	---
Caribbean, of which:	-5.4	(-0.3)	0.3	(0.0)	25.0	(1.4)	25.6	(1.6)	49.4	(0.3)	14.6	(0.1)
-Dominican Republic	-24.7	(-0.2)	6.6	(0.1)	19.1	(0.1)	104.3	(1.2)	---	---	---	---
Total	0.3	(0.1)	5.1	(1.5)	11.7	(7.1)	13.1	(8.2)	41.8	(3.8)	7.1	(0.6)

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

Table 8 Netherlands Antilles consumer prices (annual quarterly percentage change)

	2003-I	2003-II	2003-III	2003-IV	2004-I	2004-II
Food	1.8	1.7	2.2	2.7	3.0	4.1
Beverages & tobacco	-0.8	-0.7	-0.4	-0.1	-0.2	-0.6
Clothing & footwear	-1.2	0.5	0.8	0.8	0.7	-0.1
Housing	9.0	6.7	4.0	2.4	1.6	1.7
Housekeeping & furnishings	1.0	2.7	2.1	2.5	1.3	-0.4
Health	0.1	0.0	1.5	1.3	1.2	1.1
Transport & communication	1.4	-1.8	-1.7	-2.0	-0.6	0.9
Recreation & education	0.3	0.2	0.1	-0.2	0.0	0.1
Other	1.0	0.8	0.6	0.4	0.5	0.6
General inflation rate	3.1	2.1	1.4	1.0	1.0	1.4

Source: Central Bureau of Statistics

[6] Weighted growth rates between brackets.

Table 9 Budgetary overview (in millions NAf.)

	2001-II	2002-II	2003-II	2004-II
General government				
Revenues	256.0	300.7	300.9	308.1
Tax revenues, of which:	239.9	281.7	258.7	287.7
Taxes on income and profits	97.3	129.6	126.5	137.3
Taxes on goods and services	97.4	107.1	96.2	108.3
Taxes on international trade and transactions	30.6	35.0	26.9	31.5
Nontax revenues	16.0	19.0	42.2	20.4
Expenditures	294.1	364.7	423.7	446.6
Current, of which:	288.5	349.3	396.7	441.2
Wages and salaries	99.1	123.7	148.3	157.7
Goods and services	66.7	75.5	91.8	109.5
Transfers	62.5	63.1	65.2	94.5
Interest payments	46.3	64.4	76.3	70.0
Capital	5.6	15.4	27.0	5.4
Budget balance	-38.2	-64.0	-122.8	-138.5
Central government				
Revenues	140.0	155.6	157.0	154.7
Tax revenues, of which:	126.9	140.2	125.4	144.2
Taxes on goods and services	91.4	99.3	92.6	104.2
Taxes on international trade and transactions	30.6	30.8	27.1	31.5
Nontax revenues	13.1	15.4	31.6	10.5
Expenditures	142.7	177.7	222.3	238.8
Current, of which:	139.2	165.8	199.4	237.1
Wages and salaries	53.9	60.4	70.7	80.7
Goods and services	22.3	24.6	25.3	30.7
Transfers	50.7	52.5	57.1	84.7
Interest payments	12.3	19.1	44.9	40.8
Capital	3.5	11.9	22.9	1.7
Budget balance	-2.7	-22.1	-65.3	-84.1
Island government of Curaçao				
Revenues	143.3	176.6	177.1	184.5
Tax revenues, of which:	113.0	129.6	133.3	143.5
Taxes on income and profits	97.3	129.6	126.5	137.3
Nontax revenues, of which:	30.3	35.1	43.8	40.9
Grants	27.3	31.5	33.2	31.0
Expenditures	178.7	218.5	234.6	238.8
Current, of which:	176.6	215.0	230.5	235.1
Wages and salaries	45.2	63.3	77.6	77.0
Goods and services	44.4	50.9	66.5	78.8
Transfers	39.1	42.1	41.3	40.9
Interest payments	34.0	45.3	31.4	29.2
Capital	2.1	3.5	4.1	3.7
Budget balance	-35.5	-41.9	-57.5	-54.4

Source: Central Government and island government of Curaçao.

Table 10 Total outstanding consolidated public debt* (in millions NAf.)

	2003-II	2003-III	2003-IV	2004-I	2004-II
Domestic consolidated debt	3,501.6	3,461.1	3,554.8	3,663.8	3,739.2
-Central government, of which:	1,847.7	1,857.8	1,925.3	1,960.5	2,025.7
Long-term securities	1,503.5	1,521.7	1,586.1	1,631.4	1,661.4
Short-term securities	76.2	70.2	44.7	33.6	87.5
APNA	144.8	139.6	149.7	141.3	133.1
SVB	24.4	14.8	26.2	17.8	20.9
-Curaçao, of which:	1,987.1	1,905.4	1,951.0	2,030.0	2,027.4
Long-term securities	602.8	583.3	586.8	633.7	632.1
Short-term securities	83.0	88.4	86.2	109.1	128.0
APNA	805.1	788.6	807.8	814.7	815.7
Central Government	378.9	348.1	362.3	375.5	366.0
Foreign debt	771.1	730.7	806.7	760.9	754.9
Total debt (consolidated)	4,272.7	4,191.8	4,361.5	4,424.7	4,494.1
(% of GDP)	89.1%	86.7%	89.5%	90.2%	91.1%

*) Consolidated for debt between the central government and the island governments.
Source: Central government and island government of Curaçao

Table 11 **Balance of payments (in millions NAf)**

	2002-II	2003-II	2004-II
Trade balance	-489.2	-437.3	-495.8
-Exports	255.1	318.7	318.7
-Imports	744.4	756.0	814.5
Services balance	366.4	384.6	439.0
Receipts, of which:	693.6	708.7	792.4
-Travel	311.5	345.8	385.2
-Transportation	78.7	57.2	74.2
-Other services, of which:	303.4	305.7	333.0
-Int. fin & bus. services sector	124.9	108.0	88.2
Expenses, of which:	327.3	324.0	353.4
-Travel	109.0	132.1	122.0
-Transportation	48.9	39.7	44.4
-Other services, of which:	169.3	152.2	187.0
-Int. fin & bus. services sector	46.0	29.3	39.8
Income balance[1)]	5.4	1.9	-12.4
Current transfers balance[2)]	51.2	70.0	17.9
Current account balance	**-66.3**	**19.2**	**-51.3**
Capital & financial account balance	**14.2**	**-55.8**	**-0.4**
Capital balance	19.1	16.2	38.2
Financial balance	-4.9	-72.0	-38.6
Net errors & omissions	**52.1**	**36.6**	**51.7**

1) Labor and investment income.
2) Public and private transfers.

Table 12 Breakdown of net changes in the financial account (in millions NAf)

	2002-II	2003-II	2004-II
Direct investment			
- Abroad [1)]	0.2	0.1	-0.7
- In the Netherlands Antilles [2)]	-18.2	-45.9	-61.9
Portfolio investment [1)]	-33.8	5.8	-34.1
Other investment, of which:	86.1	54.3	80.5
- Assets [1)]	27.0	3.3	21.2
- Liabilities [2)]	59.1	51.0	59.3
Net lending/borrowing, of which:	-10.8	-7.1	-20.6
- Assets [1)]	-6.9	-83.0	-24.0
- Liabilities [2)]	-3.9	75.9	3.4
Reserves [3)]	-28.4	-79.2	-1.8
Balance	-4.9	-72.0	-38.6

1) A minus sign implies an increase in assets.
2) A minus sign means a decrease in liabilities.
3) A minus sign means an increase in reserves.

Table 13 Monetary survey (in millions NAf.)

	2003-I	2003-II	2003-III	2003-IV	2004-I	2004-II
Money supply (M2)	3,920.6	4,064.1	4,036.0	4,092.9	4,188.3	4,255.7
Money (M1)	1,530.7	1,617.1	1,555.9	1,525.3	1,559.8	1,589.5
Coins & notes with the public	219.7	232.5	213.1	232.9	211.9	221.0
Total demand deposits, of which :	1,311.0	1,384.6	1,342.8	1,292.4	1,347.9	1,368.5
- Netherlands Antillean guilders	1,056.9	1,108.8	1,103.6	989.3	1,037.7	1,088.5
- Foreign currency	254.1	275.8	239.2	303.1	310.2	280.0
Near money	2,389.9	2,447.0	2,480.1	2,567.6	2,628.4	2,666.2
Time deposits	1,398.0	1,425.4	1,442.2	1,501.4	1,552.2	1,568.8
Savings	991.9	1,021.6	1,037.9	1,066.2	1,076.2	1,097.4
Factors affecting the money supply						
Net domestic assets	2,725.4	2,789.7	2,821.3	2,772.5	2,833.4	2,899.1
General government	409.1	453.2	476.8	470.1	482.6	566.9
- Central government	270.6	281.6	293.1	272.4	292.5	331.1
- Island governments	138.5	171.6	183.7	197.7	190.1	235.8
Private sector	2,786.2	2,782.8	2,787.8	2,834.4	2,874.5	2,874.9
Net foreign assets	1,195.2	1,274.4	1,214.7	1,320.4	1,354.8	1,356.6
Central bank	852.7	850.1	778.3	904.5	854.0	929.1
Commercial banks	342.5	424.3	436.4	415.9	500.8	427.5
Memorandum items						
Government loans by commercial banks	427.5	475.4	477.7	489.5	483.1	552.8
- Central government	240.7	268.6	260.3	282.3	232.2	298.8
- Island governments	186.8	206.8	217.4	207.2	250.9	254.0
Private sector loans - Leeward Islands	1,989.7	1,978.4	1,977.2	1,981.4	1,996.9	2,013.7
- Mortgages	793.3	797.1	802.1	778.1	752.0	751.5
- Consumer loans	495.4	513.8	526.9	541.5	544.9	577.3
- Business loans	701.0	667.5	648.2	661.8	700.0	684.9
Private sector loans - Windward Islands	689.7	698.9	710.3	755.0	771.5	755.7
- Mortgages	346.6	349.9	357.8	373.1	382.2	304.3
- Consumer loans	107.5	107.3	112.9	145.4	162.8	165.7
- Business loans	235.6	241.7	239.6	236.5	226.5	285.7

Table 14 Developments in domestic interest rates (in %)

	2003-II	2003-III	2003-IV	2004-I	2004-II
Central bank					
- Pledging rate	2.25	2.25	2.25	2.25	2.25
- Maximum CD rate	1.25	1.25	1.25	1.25	1.25
Commercial bank borrowing rates					
- Passbook savings	3.6	3.6	3.4	3.3	3.2
- Time deposit (12 months)	5.4	5.1	4.9	4.6	4.6
Commercial bank lending rates					
- Mortgages	9.4	9.6	9.5	9.1	9.1
- Time loans	12.9	13.0	12.9	12.3	11.9
Government securities					
- Government bonds (5-year effective yield)	6.7	6.6	6.9	7.3	7.4
- Treasury bills (1 month)	2.0	1.9	3.0	3.0	2.8

Table 15 Aggregate balance sheet domestic commercial banks (in millions NAf.)

	2003-I	2003-II	2003-III	2003-IV	2004-I	2004-II
Assets						
Non-interest-bearing cash	407.8	415.0	379.4	431.5	462.8	403.3
Interest-bearing cash	1,537.5	1,516.1	1,423.8	1,431.1	1,486.6	1,492.3
Investments	535.6	606.3	612.4	611.3	602.9	674.6
Loans	3,494.7	3,504.7	3,615.5	3,697.5	3,774.7	3,784.6
Investments in unconsolidated subsidiaries and affiliates	13.4	12.3	12.0	13.5	18.6	17.3
Fixed assets	170.3	168.7	166.9	169.6	169.5	169.6
Other assets	173.0	138.7	127.8	147.2	278.1	140.2
Total assets	6,332.3	6,361.8	6,337.8	6,501.6	6,793.1	6,681.9
Liabilities						
Demand deposits	1,816.1	1,869.1	1,823.6	1,839.4	1,968.0	1,953.7
Savings deposits	2,217.4	2,267.9	2,286.3	2,334.8	2,367.7	2,481.5
Time deposits	1,460.9	1,397.0	1,403.1	1,473.7	1,524.3	1,305.5
Total deposits	5,494.4	5,534.0	5,513.0	5,647.9	5,859.9	5,740.7
Borrowings	118.2	118.0	111.7	125.4	102.1	87.9
Other liabilities	237.9	222.1	217.7	246.7	335.0	209.7
Total liabilities	5,850.5	5,874.1	5,842.4	6,020.0	6,297.0	6,038.3
Minority interest	6.8	6.9	6.1	6.4	6.7	7.0
Subordinated debentures	9.7	9.7	9.4	9.4	9.4	9.1
General provisions	135.0	140.6	143.8	140.3	143.8	144.1
Capital & reserves	330.2	330.5	336.1	325.5	336.2	353.8
Total capital	481.7	487.7	495.4	481.6	496.1	514.0
Total liabilities and capital	6,332.2	6,361.8	6,337.8	6,501.6	6,793.1	6,552.3

Table 16 Aggregate income statement domestic commercial banks*
(accumulated, in millions NAf.)

	2003-I	2003-II	2003-III	2003-IV	2004-I	2004-II
Interest income	116.5	227.2	339.1	427.2	116.8	229.5
Interest expenses	44.7	86.2	129.8	161.2	42.2	81.6
Net interest income	71.8	141.0	209.3	266.0	74.6	147.9
Other income	41.6	79.8	122.0	162.1	47.7	92.8
Total operational income	113.4	220.8	331.3	428.1	122.3	240.7
Salaries & other employee expenses	50.6	100.4	147.8	194.4	53.0	104.5
Occupancy expenses	13.6	26.9	40.3	51.9	14.8	28.9
Other operating expenses	16.8	33.3	47.6	58.3	15.9	33.4
Net addition to general provisions	6.5	14.2	18.3	34.9	5.2	15.2
Total operational expenses	87.5	174.8	254.0	339.5	88.9	182.0
Net operating income	25.9	46.0	77.3	88.6	33.4	58.7
Net extraordinary items	0.2	0.7	2.2	0.5	1.7	3.7
Applicable profit taxes	6.0	12.1	21.1	22.6	7.7	13.9
Net income after taxes	20.1	34.6	58.4	66.5	27.4	48.5

* Cumulative quarterly figures.