QUARTERLY BULLETIN 2012-3

Centrale Bank van Curacao en Sint Maarten

REPORT OF THE PRESIDENT

Global economic growth decelerated during the third quarter of 2012. Economic conditions weakened in most advanced economies because of fiscal adjustments, sluggish labor markets, and fragile financial environments. In the key emerging markets and developing economies, output growth slowed also.

Developments in the monetary union of Curaçao and Sint Maarten were mixed during the July – September period of 2012. Real economic growth in Curaçao decelerated from 0.6% in the third quarter of 2011 to 0.1% in the third quarter of 2012. In contrast, the available indicators for Sint Maarten pointed to a pickup of economic activity during the September quarter of 2012.

The economic slowdown in Curaçao can be ascribed to weakened net foreign demand combined with a contraction in domestic demand. Similar to 2011, net foreign demand expanded during 2012's third quarter as the rise in exports exceeded the increase in imports. However, the gain in net foreign demand was less pronounced in this period compared to the third quarter of 2011. Domestic demand contracted due to a decline in public expenditures mitigated by a growth in private spending. Public expenditures declined as both public consumption and investment dropped. The contraction in public consumption was the result of lower expenditures on wages & salaries, while the decline in investments by the government was related to reduced spending on development projects. The growth in private spending was the result of more private sector investments, particularly in non-residential construction projects. In contrast, private consumption dropped. The meager third-quarter economic expansion was accompanied by a lower inflation rate of 2.4%, reflecting mainly reduced energy prices in Curaçao. However, the annualized inflation rate climbed to 3.2%.

A review by sector shows that the restaurants & hotels, transport, storage & communication, and manufacturing sectors contributed mainly to 2012's third-quarter economic expansion in Curaçao. The growth in the restaurants & hotels sector stemmed from the positive development in tourism, reflecting increases in both stay-over and cruise tourism.

The transport, storage & communication sector performed well as both air transportation and harbor activities expanded. Air transportation and airport-related activities increased, backed by the rise in stay-over arrivals. Meanwhile, the harbor registered a growth in oil storage and cargo movements. The increase in oil storage activities can be ascribed largely to the upgrading and expansion of oil storage facilities in the port of Bullenbaai and an increase in the number of ships piloted into the port, in particular oil tankers and freighters. Growth in the manufacturing sector was caused mainly by an increase in the activities at the Isla refinery stemming from maintenance work on the cat cracker plant.

Output growth in the wholesale and retail trade sector decelerated considerably as a result of declines in domestic demand and re-export by the free-zone companies, mitigated by the increase in tourism. Meanwhile, real value added expanded in the financial services sector, albeit at a slower pace than in the third quarter of 2011, backed solely by an increase in domestic financial services. In contrast, international financial services posted negative results as indicated by a decline in wages and salaries. After a contraction in the third quarter of 2011, activities expanded somewhat in the construction sector, due mainly to increased investments in commercial properties. The gain in the construction sector was in line with the growth in business loans extended and the increased imports of construction material.

The upturn in private sector activities in Sint Maarten was the result of output growth in the main sectors of the economy, including the restaurants & hotels, transport, storage & communication, financial services, and construction sectors. Meanwhile, inflationary pressures eased as the inflation rate dropped from 5.6% in the third quarter of 2011 to 2.8% in the third quarter of 2012. The lower inflation was the result of a drop in international oil prices, mitigated by higher international food prices.

Growth in the restaurants & hotels sector of Sint Maarten was driven by increases in the number of cruise and stay-over tourists. The latter increase was due to, among other things, increased airlift in the September quarter of 2012 compared to 2011's third quarter. The growth in cruise tourism was the result of a rise in the number and size of the cruise ships visiting the port of Sint Maarten. More airport-related and harbor activities contributed to a growth in the transport, storage & communication sector. Activities at the Princess Juliana International Airport expanded during the third quarter of 2012 as a result of increased passenger traffic. This increase was in line with the growth in stay-over arrivals. The harbor also performed well because of more ship calls and container movements.

The financial services sector performed well as the net interest income of the domestic commercial banks rose. The utilities sector also expanded as the production of both water and electricity increased. The construction sector showed signs of recovery due mainly to more residential construction projects.

The developments in Curacao's public finances during the third quarter of 2012 were marked by the official instruction of the Kingdom Council to the Curacao government to balance its budget of 2012 and to take measures to compensate for the deficits incurred in 2010 and 2011. Contrary to the balanced budget rule agreed upon in the Kingdom Act Financial Supervision for Curaçao and Sint Maarten, the Curaçao government posted a budget deficit in 2010 and 2011 and without proper and timely measures, would have ended 2012 with a deficit as well.

The deficit of the Curacao government widened further in the third quarter of 2012 compared to 2011's third quarter, resulting from a rise in expenditures. The main expenditure increases occurred in goods & services and other expenditures. Meanwhile, government revenues remained practically unchanged compared to 2011 because a growth in nontax and other revenues was offset by a decline in tax revenues. The latter decline was largely the result of fewer revenues from profit tax, import duties, and property tax. In contrast, sales tax revenues rose largely because of the increase in the sales tax rate in January 2012.

The government of Sint Maarten recorded a budget deficit of NAf.20.1 million in the September quarter of 2012, a turnaround compared to the surplus of NAf.12.3 million registered in the September quarter of 2011. This turnaround was the result of increased expenditures combined with a decline in revenues. Fewer entrepreneurial and property income and less revenue from income and profit taxes were the main causes of the decline in revenues. In contrast, taxes on goods and services and the property transfer tax increased.

The current account deficit of the balance of payments narrowed during the third quarter of 2012 compared to the third quarter of 2011. The increase in net foreign demand and an improvement in the income balance led to the smaller current account deficit. Net foreign demand rose as the increase in export of goods and services offset the rise in imports. The surge in exports was related to, among other things, increased foreign exchange earnings from the tourism and transportation sectors in both Curaçao and Sint Maarten. In addition, the refining fee increased to cover, among other things, maintenance work on the cat cracker at the Isla Refinery in Curaçao.

Imports rose mainly because of more merchandise imports by the free-zone companies in Curaçao combined with increased imports of construction material. The increased imports of construction material were mainly attributable to the ongoing investments in commercial properties in Curaçao. Meanwhile, the income balance improved because of a rise in interest income received on foreign investments, combined with a drop in dividend payments to abroad.

The current account deficit was financed largely by official foreign exchange reserves. As a consequence, gross reserve assets dropped in the third quarter of 2012. The remainder of the deficit was covered by external financing of the private sector, reflected by a worsening in the direct investment, loans and credits, and portfolio investment balances. The direct investment balance deteriorated as local companies increased their liabilities with their direct investors and nonresidents purchased real estate in Curaçao and Sint Maarten. The worsening of the loans and credits balance was due to domestic companies' withdrawals from their foreign bank accounts and a rise in net trade credits received from abroad. The portfolio investment balance deteriorated largely as a result of matured foreign debt securities held by local institutional investors and not reinvested abroad.

The money supply contracted in the third quarter of 2012 as both net foreign assets and net domestic assets dropped. Net foreign assets declined because of a drop in the net foreign holdings of the commercial banks, mitigated by an improvement in the central bank's net foreign position. Meanwhile, net domestic assets shrank due to declines in miscellaneous balance sheet items and net credit extended to the governments. The drop in net domestic assets was mitigated, however, by a growth in net credit extension to the private sector. The latter growth was the result of a rise in loans extended in both Curaçao and Sint Maarten. All loan components in Curaçao registered an increase. Meanwhile, in Sint Maarten, the expansion in private credit extension was attributable to a rise in business loans, mitigated by a contraction in mortgages and consumer loans extended.

During the September quarter of 2012, the Bank continued to direct its monetary policy at the tightening of the surplus on the money market, given the persistent high deficit on the current account of the balance of payments and the declining international reserves. Therefore, the reserve requirement was increased monthly to reach 12.25% in September 2012. Moreover, the credit restriction that was introduced for the period March – August 2012 was extended for another 6-month period. However, as the growth in private credit extension and the decline in international reserves showed some moderation, the credit restriction was adapted slightly by allowing a maximum growth of domestic private credit extension of 1.00% for the period September 2012 – February 2013. The other monetary policy instrument, the auctioning of certificates of deposit (CDs), was not actively deployed during the quarter under review. During the biweekly auctions, the Bank aimed only at the refinancing of maturing CDs.

In pursuance of the instruction promulgated by the Kingdom Council of Ministers, the Curaçao government has embarked on a fiscal consolidation path to bring the 2012 budget in line with the norms established in article 15 of the Kingdom Act financial supervision Curacao and Sint Maarten. Several far-reaching measures to improve the country's fiscal situation and, at the same time, safeguard the social security system have been taken. These measures include an increase in the retirement age for old age pension and the introduction of a general health insurance scheme. While these measures were urgently needed, in the short term they have created a false sense of security. It would be a mistake to think that strict adherence to those measures alone will bring about the much needed growth to create the fiscal room to address other policy areas. The disproportionate emphasis on fiscal consolidation without due regard to institutional building and structural measures has created a situation where growth prospects in the monetary union is tilted to the downside.

The anemic growth in the monetary union has been fueled by strong credit growth in Curacao and revival of the tourism sector in Sint Maarten. However, the persistent deficit in the current account of the balance of payments has put a limit on the effectiveness of further credit growth to shoulder growth in Curacao.

While elsewhere the focus is on a new chapter of prosperity and opportunity, we seem to be constantly revisiting our constitutional arrangement and bogged down in fiscal consolidation. Scarce resources and time are diverted from a much-needed revised vision for sustainable economic growth. Therefore, the next step the government should take is to stimulate economic growth by investing in education and health care, creating the right business climate, and ensure that growth is sustainable. In the immediate run, the government also should accelerate pending investment projects that can give a positive boost to the economy. These include the construction of a new hospital and several infrastructure projects. With respect to a new hospital, lengthy discussions have taken place for decades without any real progress on this project, so important to the wellbeing of our citizens. Decisions must be taken without further delay so that the project can finally be started and help put the economy on a path of sustainable economic growth. Fiscal consolidation will also bring its pressure to bear on the most vulnerable of the society. Effective social safety nets are critical. We must protect people from the sudden changes in fortune and ensure that they are not excluded from future success.

The government of Sint Maarten also has been facing major challenges with regard to the public finances. The 2013 budget is still in the process of obtaining the necessary approval by the financial supervision body, CFT. The challenge for Sint Maarten remains, creating new opportunities for growth. This means creating better environment for entrepreneurship and further diversification of the economy. This offers tremendous potential for growth. In addition, the country must reform its tax system to structurally increase its income base. At the same time, the process of setting up and strengthening of the public institutions and government apparatus must continue.

Sint Maarten is already working on reforms of its pension and health care systems, despite having a relatively young population. The recent developments in Curacao show that timely implementation of reforms in these areas is crucial to prevent uncertainty about the future of the government fiscal policy. Therefore, Sint Maarten should implement these reforms in a timely fashion to safeguard balanced budgets in the years ahead.

E.D. Tromp
President

INTERNATIONAL ECONOMIC DEVELOPMENTS

The US economy grew by 2.6% during the third quarter of 2012, compared with 1.6% in the third quarter of 2011 (see Table 1). The 2012 third-quarter growth was a result of increased domestic demand, driven primarily by more residential investments. These investments reflected, among other things, the accommodative monetary policy stance of the Federal Reserve that has driven mortgage rates to record lows. In contrast, nonresidential investment dropped, reflecting the uncertainty among businesses over possible solutions for the fiscal situation in the United States. Private consumption rose, albeit at a slower pace than in the third quarter of 2011. Lower energy prices and the improved labor market situation helped to lift consumer sentiment. In contrast, government spending declined as a result of a drop in local and state government expenditures, mitigated by a growth in federal spending. The increase in federal spending was driven primarily by increased outlays on defense. Meanwhile, net export growth remained flat as the increase in export of goods and services was counterbalanced by additional imports. During the third quarter of 2012, US export growth decelerated due to a weakened global demand, reflecting the economic slowdown in China and a real GDP contraction in Europe. The unemployment rate dropped to 7.8% in September 2012, the lowest since January 2009. This decline was due mainly to the surge in part-time work, particularly in the healthcare, transportation and warehousing sectors. Inflation decelerated to 2.4%, reflecting lower energy prices. However, increased prices of non-oil commodities, in particular medical and food costs, had an upward effect on inflation.

Table 1 Selected indicators of various countries

	United States		Netherlands		Venezuela	
	2011-III	2012-III	2011-III	2012-III	2011-III	2012-III
Real GDP (% change)	1.6	2.6	0.9	-1.5	4.4	5.2
Consumer prices (%)	2.7	2.4	2.1	2.4	26.0	23.2
Unemployment rate (%)	9.1	7.8	4.6	5.4	8.3	7.3

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

The Dutch economy contracted by 1.5% in the third quarter of 2012 due to a decline in private spending. Private consumption dropped as consumers spent less on durable goods, particularly cars. Meanwhile, private investment shrank, reflecting declines in investment in dwellings, commercial buildings, and civil engineering projects. In contrast, public demand rose, due mainly to increased government expenditures on health care. Exports of goods and services expanded, albeit at a slower pace than in the third quarter of 2011. The growth in exports was due to increased re-exports as the export of goods produced in the Netherlands fell. With the exception of the public sector and the care sector, output contracted in all sectors of the Dutch economy. The economic contraction was accompanied by a higher unemployment rate of 5.4% as the number of jobs dropped in all but the healthcare sector. Meanwhile, inflation rose to 2.4% reflecting, among other things, rises in rent levels, new tax regulations for the purchase of new cars, and higher motor fuel prices.

The Venezuelan economy expanded by 5.2% in the third quarter of 2012, sustained by a growth in both domestic and net foreign demand. The expansion in domestic demand was attributable to increases in both private and public spending. During the third quarter of 2012, private demand in Venezuela grew as a result of higher employment and improved purchasing power. The improvement in purchasing power was caused by higher real wages. Public demand expanded because of a rise in government spending on public works. Meanwhile, net foreign demand rose, due to a growth in export of goods and services, although it was mitigated by more imports. However, export growth was slower than in the third quarter of 2011 because of lower international oil prices and a decline in non-oil exports. Meanwhile, imports rose significantly because of the increase in domestic spending. An analysis by sector reveals that the economic growth was driven largely by increased real value added in the oil, construction, financial services, and manufacturing sectors. The significant expansion in the construction sector was related to the surge in public works and a large house building program by the Venezuelan government preceding the 2012 presidential election. Inflation dropped to 23.2% during the third quarter of 2012 as the Venezuelan government tightened price controls on 19 consumer care products. As a result of the economic expansion, the labor market in Venezuela improved, reflected by a drop in the unemployment rate to 7.3% in September 2012.

GENERAL ECONOMIC DEVELOPMENTS IN CURAÇAO

The Curaçao economy expanded by a mere 0.1% in the third quarter of 2012, a slowdown compared to the growth of 0.6% registered in the third quarter of 2011. Net foreign demand and private spending contributed positively to economic growth, mitigated by a decline in public spending. The third-quarter growth was accompanied by a lower inflation rate of 2.4%, largely the result of downward adjustments in domestic energy prices (see Table 2).

An analysis of the GDP by expenditure reveals that net foreign demand was the main driver of growth, as exports grew faster than imports. However, the contribution of net foreign demand to economic growth was less pronounced than in 2011. Export growth during the third quarter of 2012 was due mainly to increased foreign exchange revenues from the tourism, transportation, and manufacturing sectors. Imports rose as a result of, among other things, more merchandise imports by the free-zone companies. In addition, the import of construction materials increased due to more nonresidential investments.

Private spending increased due solely to more private investments, as private consumption shrank. Ongoing construction activities, particularly in commercial properties, led to the rise in private investments. The latter was reflected in the increase in business loans extended. Meanwhile, private consumption dropped, in line with the decline in merchandise imports by the retail trade sector. Similar to 2011, public spending contributed negatively to GDP growth as both public consumption and investment dropped.

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

	2011-III	2012-III
Domestic expenditure, of which:	-2.5	-1.1
Private sector	0.4	0.3
- Investment	0.6	0.7
- Consumption	-0.2	-0.4
Government sector	-2.9	-1.4
- Investment	-0.1	-0.1
- Consumption	-2.8	-1.3
Changes in inventory	0.5	0.0
Foreign net expenditure	2.5	1.2
- Export of goods and services	7.6	2.0
- Import of goods and services	5.1	0.8
GDP	0.6	0.1
Net primary income	-1.3	0.9
Gross national income	-0.8	1.0
Net current transfers from abroad	-5.2	1.0
Gross national disposable income	-6.0	2.1

CBCS estimates

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

Domestic production

From a sectoral perspective, the sluggish gain in real GDP can be attributed entirely to the private sector, as the public sector contracted. The restaurants & hotels, transport, storage & communication, and manufacturing sectors were the main contributors to GDP growth (see Table 3). However, in all these sectors, growth was less pronounced in the third quarter of 2012 than in the corresponding quarter of 2011.

The expansion in the restaurants & hotels sector was driven by increases in both stay-over and cruise tourism. Despite a decline in the number of cruise calls, the number of cruise visitors rose, indicating larger cruise ships. The growth in stay-over tourism was attributable to an increase of 42.3% in the number of visitors from South and Central America. Venezuela, which is traditionally an important tourism market for Curaçao, recorded a significant growth again due to, among other things, increased marketing efforts among the highest income groups in this country. In addition, the introduction of direct flights by COPA airlines between Panama City and Curaçao resulted in more tourists from South and Central America. In contrast, the North American market segment shrank by 3.5% because of a decline in the number of U.S. visitors. The latter drop can be ascribed largely to the discontinuation of direct flights from the east coast of the United States. The number of visitors from Europe also dropped during the July – September period of 2012, due mainly to fewer tourists from the Netherlands (-7.4%). However, the decline in the European market segment was mitigated by more visitors from Germany as a result of the weekly nonstop flights from Düsseldorf by Air Berlin combined with promotional activities. The number of tourists from the Caribbean shrank by 8.9% reflecting declines in the number of visitors from most islands, including Jamaica, the Dominican Republic, and Trinidad and Tobago (see Table 7 in the appendix). Higher stay-over tourist arrivals were accompanied by more time spent on the island. Consequently, the number of visitor nights rose by 11.9%. However, the hotel occupancy rate dropped from 74.2% in the third quarter of 2011 to 70.3% in the third quarter of 2012 as an increased number of visitors chose to stay at alternative accommodations, including apartments.

Growth in the transport, storage & communication sector was sustained by increased harbor and air transportation activities. In the harbor sector, oil storage activities rose considerably as a result of the upgrading and expansion of the oil storage facilities in the port of Bullenbaai. Furthermore, due to a rise in transshipment, container movements increased as did the number of freighters and tankers piloted into the port. By contrast, the number of cruise ships visiting the port of Willemstad dropped. Air transportation and airport-related activities expanded as a result of a growth in total passenger traffic in Curaçao, albeit the increase was less pronounced than in 2011. The increase in total passenger traffic was in line with the developments in stay-over tourism.

Table 3 GDP by sector (real percentage changes)

Sector	2011-III	2012-III
Agriculture, fishery & mining	-3.4	-5.6
Manufacturing	6.7	1.5
Electricity, gas & water	3.8	0.1
Construction	-7.4	1.6
Wholesale & retail trade	1.9	0.9
Restaurants & hotels	7.6	4.0
Transport, storage & communication	3.7	2.4
Financial intermediation	0.6	0.3
Real estate, renting & business activity	0.4	-0.4
Other community, social & personal services	-0.6	-1.6
Private households	0.9	0.1
Total private sector	1.1	0.6
Public sector	-0.5	-0.3
Taxes minus subsidies	-0.1	-0.1
GDP	0.6	0.1

CBCS estimates

Despite the increase in stay-over visitors, real value added growth in the wholesale & retail trade sector slowed to 0.9% in the third quarter of 2012. This weakening was caused by a contraction in private consumption combined with a slight decline in re-exports by the free- zone companies. The worsening of the free-zone performance was accompanied by a decline in the number of free-zone visitors, particularly from the Caribbean market.

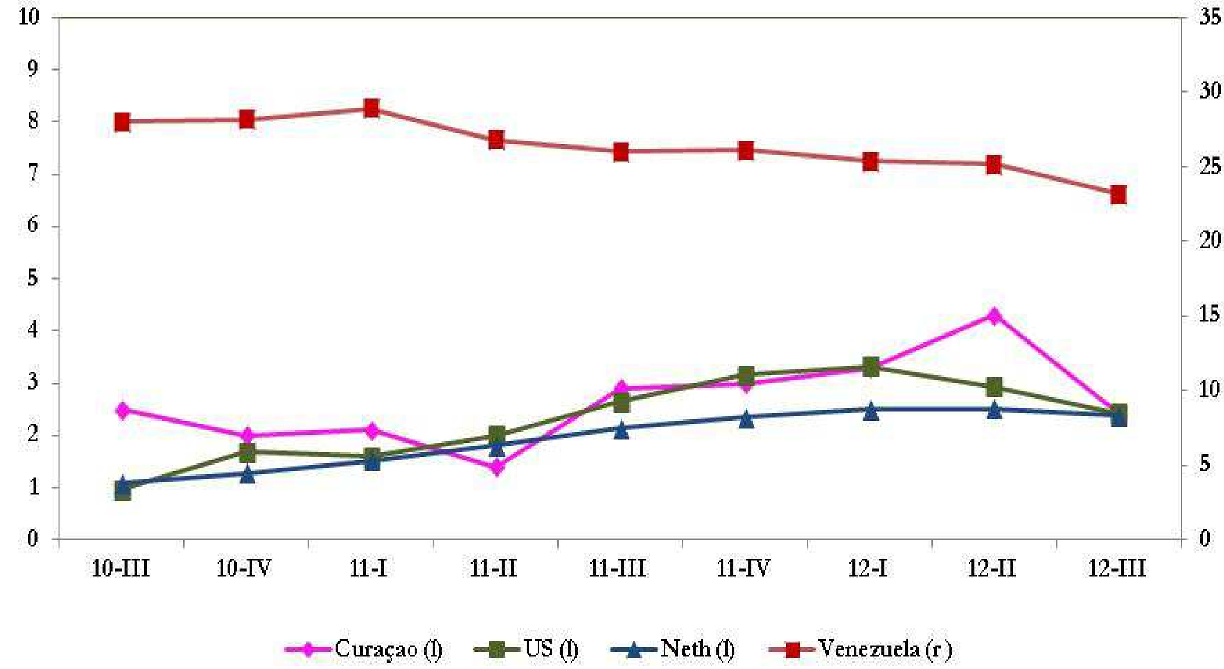
The increase in real value added in the manufacturing sector was related to a growth in activities at the "Isla" refinery related to maintenance work on the cat cracker plant. The financial services sector grew at a sluggish pace of 0.3% due exclusively to the expansion in real value added in the domestic financial services. During the third quarter of 2012, net income of the domestic commercial banks expanded as the drop in interest expenditures outpaced the decline in interest income. In contrast, real value added of the international financial services contracted because of declines in wages and salaries.

As opposed to 2011, the construction sector performed well in the three months ending September 2012 as a result of increased non-residential investments, including the construction of a new datacenter and several retail outlets. The latter is in line with the increase in business loans extended and the rise in imports of construction material.

Inflation

Inflationary pressures in Curaçao eased in the September quarter of 2012, as the inflation rate slowed to 2.4%, stemming mostly from downward adjustments in domestic energy prices. In Curaçao, energy prices are adjusted on a monthly basis in line with the international developments but with a lag of two months. Therefore, the downward adjustments in energy prices during the third quarter of 2012 reflect largely the decline in international oil prices recorded during the months April – June of 2012 (see Graph 1).

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



An analysis of the quarterly inflation rates reveals that all CPI components recorded a gain during the third quarter of 2012 compared to the third quarter of 2011. This price gain can be ascribed to the increase in the turnover tax rate (OB) from 5% to 6% in January 2012. The highest price increases were recorded in the categories "Food" (5.1%), "Beverages and tobacco" (4.4%), "Housing", (2.2%), and "Housekeeping and furniture" (2.6%). In the category "Housing," prices increased despite a reduction of 12.6% in the price of water. The increase in the category "Food" was less pronounced than in the third quarter of 2011. Food prices rose at a slower pace in the third quarter of 2012 due largely to a deceleration in the price increases of "Potatoes, fruits and vegetables" and "Meat & fish". Prices decelerated as well in the category "Transportation & communication" because of the downward adjustment in gasoline prices in July and August 2012. (See Table 8A in the appendix.)

GENERAL ECONOMIC DEVELOPMENTS IN SINT MAARTEN

Real GDP growth could not be estimated for Sint Maarten in the third quarter of 2012 because of a lack of data, notably national account and quarterly government statistics for the period 2010 – 2012. However, this section provides an analysis of the economic developments in the private sector during the third quarter of 2012. The analysis is based on collected indicators of the main sectors of the Sint Maarten economy.

The restaurants & hotels sector performed well during the months July – September 2012 as a result of a growth in both stay-over and cruise tourism. The number of cruise visitors expanded by 11.3% as both the number and the size of cruise vessels increased. Following a contraction of 7.4% in the third quarter of 2011, the number of stay-over tourists expanded by 7.5% in the third quarter of 2012. This favorable outcome in stay-over tourism was the result of growth in all tourism markets. However, the growth was more pronounced in the North American market segment (7.2%). The U.S. market, which is traditionally the main tourism market for Sint Maarten, was severely affected by the international financial crisis. Although this segment is gradually showing signs of recovery, it has not reached its pre-crisis level yet. Moreover, the airlift capacity, which dropped in 2011 as American Eagle discontinued its daily flights between Puerto Rico and Sint Maarten, increased again in 2012. This increase was the result of JetBlue starting with daily flights between these two countries, thereby filling the gap left by American Eagle (see Table 7 in the appendix for more details). In line with the increase in stay-over tourism, the hotel occupancy rate increased in the third quarter of 2012 by 17.1 percentage points to reach 36.9%.

Activities in the transport, storage & communication sector also expanded. Airport-related activities increased due to more passenger traffic in line with the growth in stay-over tourism. Activities in the harbor rose as well, reflected by more freighters, tankers, and cruise ships piloted into the port. In addition, container movements expanded in the third quarter of 2012.

The growth in the number of construction permits requested and issued, in particular residential permits, indicates some improvement in the construction sector in Sint Maarten. In addition, the public housing project in Belvedere had a positive impact on the construction sector during the third quarter of 2012. Developments in the utilities sector also were positive as the production of both water and electricity rose in the September quarter of 2012. Activities in the domestic financial services sector increased due to a growth in the interest income earned by the domestic commercial banks combined with a slight drop in their interest expenses.

Inflation

The decrease in Sint Maarten's inflation was marked by a decline in energy prices, mitigated by increased food prices. The quarterly inflation eased from 5.6% in the third quarter of 2011 to 2.8% in the third quarter of 2012. The lower third-quarter inflation was driven mainly by a price deceleration in the categories "Housing" (0.4%) and "Transport & communication" (0.8%), primarily reflecting developments in international oil prices. Prices rose at a slower pace in the housing category due mainly to a decline in electricity prices. Meanwhile, "Transport & communication" recorded a price deceleration as a result of lower gasoline and communication prices. Nevertheless, a considerable increase in food prices (10.7%) added to inflationary pressures. During the third quarter of 2012, increases in international food prices resulting from, among other things, the severe drought in the United States, resulted in higher domestic prices of grain, potatoes, vegetables & fruits, and meat & fish. (See Table 8B in the appendix.)

DEVELOPMENTS IN PUBLIC FINANCE

Public finances of Curaçao

During 2012's third quarter, the public sector of Curaçao contributed negatively to the economy, as both public consumption and investment declined compared to the third quarter of 2011. Public consumption fell as a result of lower outlays on wages & salaries, while the drop in public investment was due to reduced spending on development projects. The government's timid performance mirrored the overall state of Curaçao's public finances--ongoing budget woes. On July 13, 2012, the Kingdom Council of Ministers followed the advice of the College Financieel Toezicht (CFT) [1] and instructed the Curaçao government to balance its 2012 budget. Underlying this decision was the fact that Curaçao's annual accounts for both 2010 and 2011 exposed a budget deficit, while according to the CFT, the government of Curaçao was not making enough progress with the fiscal policy changes needed to end 2012 with a balanced budget. Running a year-end budget deficit is a violation of the Kingdom Act financial supervision Curaçao and Sint Maarten (the Kingdom Act). According to norms stipulated in the Kingdom Act, the governments of Curaçao and Sint Maarten are required to run a balanced budget on an annual basis. Consequently, the Curaçao government was given an official instruction by the Royal Council of Ministers to sort its budget woes and bring the 2012 budget back in line with the norms stipulated in the Kingdom Act. (See the Box for more details.)

In the quarter ending September 2012, the government of Curaçao ran a budget deficit of NAf.18.9 million. Expenditures rose by 1.4% compared to the third quarter of 2011, owing mostly to a growth in outlays on goods & services and the category "other expenditures". Total revenues remained flat relative to the third quarter of 2011, as the upturn in nontax and other revenues was all but offset by a drop in tax income. The decline in tax income was attributable largely to lower proceeds from profit taxes, import duties, and land tax. By contrast, sales tax revenues grew by NAf.16.4 million compared to 2011's third quarter, mainly as a result of the increase in the sales tax rate from 5% to 6% on January 1, 2012. (See Tables 9A and 9B in the appendix for an overview.)

The government of Curaçao covered its 2012 third-quarter budget deficit by increasing its outstanding obligations with nonbank creditors and drawing down its deposits with the central bank. Monetary financing was still negative, as the government replenished its accounts with the commercial banking sector, offsetting its central bank withdrawals (see Table 4A).

Table 4A Financing of the budget balance of Curaçao (in millions NAf.)

	2011-III	2012-III
Monetary financing	56.3	-6.0
Central bank	-5.9	8.7
Commercial banks	62.2	-14.7
Nonmonetary financing	-42.0	24.9
Government securities with the public	0.0	0.0
Other	-42.0	24.9
Budget balance	-14.3	-18.9

[1] The College Financieel Toezicht (CFT) is the independent board of financial supervision in charge of monitoring the public finances of Curaçao en Sint Maarten and providing counsel to the governments whenever this is considered necessary.

Public sector debt of Curaçao

Curaçao's total public debt as of the end of September 2012 could not be determined because debt statistics were not available. The largest part of Curaçao's public debt consists of NAf.1.667 billion in outstanding government bonds issued in 2010. Nonetheless, without any information regarding the government's outstanding arrears, the public debt-to-GDP ratio of Curaçao cannot be ascertained.

Public finances of Sint Maarten

In the third quarter of 2012, the focus of the Sint Maarten government remained on strengthening its public institutional framework to function better autonomously. However, the financial constraints the government faced continued to pose a challenge to the achievement of a full-fledged public administration system. In its 2012 third-quarter report, the financial supervisory board College Financieel Toezicht (CFT) warned that the government of Sint Maarten was heading towards a 2012 year-end deficit, which would be a breach of the norms stipulated in the Kingdom Act financial supervision Curaçao and Sint Maarten. Hence, the government of Sint Maarten was advised to implement several cost-reducing and revenue-boosting measures in order to balance its 2012 budget.

In the three-month period ending September 2012, Sint Maarten's government registered a NAf.20.1 million deficit. Total expenditures increased by NAf.23.3 million compared to the third quarter of 2011, while total revenues declined by NAf.9.1 million. This decline was triggered mostly by a drop in entrepreneurial & property income and less revenue from taxes on income & profits. A further analysis of Sint Maarten's tax revenues reveals that income from taxes on goods & services grew, led by a rise in room tax and turnover tax proceeds, while taxes on property increased due to more property transfer tax collected in the third quarter of 2012. (See Tables 9C and 9D in the appendix for an overview.)

In the September quarter of 2012, the government of Sint Maarten covered its deficit by drawing down its commercial bank accounts and increasing its liabilities to other creditors. As a result, both monetary and nonmonetary financing registered a rise in 2012's third quarter (see Table 4B).

Table 4B Financing of the budget balance of Sint Maarten (in millions NAf.)

	2011-III	2012-III
Monetary financing	16.7	11.7
Central bank	0.0	0.0
Commercial banks	16.7	11.7
Nonmonetary financing	-29.0	8.4
Government securities with the public	0.0	0.0
Other	-29.0	8.4
Budget balance	12.3	-20.1

Public sector debt of Sint Maarten

The public debt-to-GDP ratio of Sint Maarten as of the end of 2012's third quarter could not be established due to lacking data. The available information shows that on September 30, 2012, Sint Maarten had NAf.328.1 million in outstanding government bonds and NAf.30.3 million in other loans. However, since no information was available regarding the outstanding arrears of Sint Maarten's government, the public debt-to-GDP ratio of the country could not be calculated.

Box

Curaçao's government budget woes gave rise to an instruction from the Kingdom Council of Ministers

On July 13, 2012, the Kingdom Council of Ministers (the Council) officially instructed the government of Curaçao to amend its 2012 budget, in order to comply with the norms stipulated in article 15 of the Kingdom Act financial supervision Curaçao and Sint Maarten (the Kingdom Act). The instruction came about following the advice of the College Financieel Toezicht (CFT), the independent board of financial supervision in charge of monitoring the finances of the governments of Curaçao and Sint Maarten. Pursuant to article 13 of the Kingdom Act, the CFT may advise the Council to instruct the entities −in this case the government of Curaçao− to amend their budget, when the CFT concludes that the budgetary norms stipulated in article 15 of the Kingdom Act are not being adhered to despite several warnings and advices given to the government. These compulsory norms comprise a balanced budget requirement for the current fiscal year as well as on a multiannual basis, and compliance with an interest burden rule, which establishes a loan ceiling. The main aim of these norms is to prevent an uncontrolled accumulation of new government debt. The Netherlands and the government entities of the former Netherlands Antilles agreed on the adoption of these norms during the constitutional reform, as a prerequisite to the initiation of the debt relief program that was implemented during 2009 and 2010.

In the weeks preceding the instruction, the government of Curaçao published its 2011 annual account, revealing a second consecutive annual deficit amounting to almost NAf.155 million (approximately 3% of GDP). By then it also became apparent that the year 2012 and the next several years would be concluded with similar or even higher deficits if no measures were taken soon. Therefore, the CFT interacted intensively with the government of Curaçao in order to help bring the budget back in line with the compulsory norms. However, as the months lapsed, the CFT could not conclude otherwise than that the progress being made by the government of Curaçao was not sufficient or quick enough to balance the 2012 budget and the multiannual projections before the end of 2012. Consequently, the CFT advised the Council to give an instruction to Curaçao's government to adjust its 2012 budget. The instruction of the Council entailed the following obligations for the government of Curaçao:

1) to compensate for the budget deficits of 2010 and 2011 by generating a budget surplus in 2012 (and surpluses in 2013-2015 if needed);
2) to exclude from the 2012 budget any savings related to the planned dividend policy changes until these have been attained and to refrain from using the (legal) reserves of the social security bank, SVB, to cover the budget deficits;
3) to include the necessary reforms to be implemented in the health care sector and old-age pension in the 2012 budget and the multiannual projections, in order to avoid annually increasing deficits. The risks associated with the government's expected tax revenues, dividend income, and other revenue categories, and the expected cost of free education were also to be included in the projections;
4) to be more in command of the implementation of the planned measures, so as to make sure that the health care, old-age pension, and dividend policy reforms would start on January 1, 2013;
5) to exclude from the 2012 budget any commitments to issue public loans until the 2012 budget and the multiannual projections were balanced as stipulated in article 15 of the Kingdom Act; and
6) to exclude from the 2012 budget any commitments to hire additional personnel.

On August 10, 2012, the government of Curaçao filed an appeal with the Dutch Council of State, a constitutionally established advisory body on legislation and administrative court, in an attempt to get the instruction revoked. However, after considering the arguments of both parties, the Dutch Council of State issued a decree on November 2, 2012, upholding the instruction. Those parts of the instruction that were deemed not to be based on the CFT's original advice to the Kingdom Council of Ministers were dropped, while the other parts were either maintained or somewhat reformulated. Even so, the core of the instruction remained the same: Curaçao had to bring its 2012 budget and multiannual projections in line with article 15 of the Kingdom Act financial supervision Curaçao and Sint Maarten.

DEVELOPMENTS IN THE BALANCE OF PAYMENTS OF THE MONETARY UNION

During the third quarter of 2012, the deficit on the current account of the balance of payments of the monetary union narrowed by NAf.34.6 million compared to the third quarter of 2011. The lower deficit was caused largely by a significant improvement of the services balance, offset only partly by a deterioration in the trade and current transfers balances. Since the current account deficit dropped, the combined capital and financial account worsened at a slower pace than in the third quarter of 2011(see Table 5).

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

	2010-III	2011-III	2012-III
Current account	-462.3	-502.0	-467.4
Capital transfers	8.1	19.4	-0.9
External financing of the government	0.0	0.0	-1.6
External financing of the private sector	684.1	507.8	225.4
- Direct investment	153.3	45.9	46.6
- Loans and credits	719.2	358.0	139.1
- Portfolio investments	-188.4	103.9	39.7
Change in gross reserves of the central bank *)	-380.4	-31.4	218.2
- held at foreign central banks	-447.1	-124.9	374.9
- held at foreign commercial banks	170.6	44.8	-166.3
- other claims	-	48.7	9.6
Statistical discrepancies	46.6	54.9	35.8

*) A minus sign implies an increase.

Current account

Net exports of goods and services in the monetary union increased by NAf.42.0 million during the third quarter of 2012 compared to the third quarter of 2011, as a result of an increase in exports (NAf.94.2 million) mitigated by a growth in imports (NAf.52.2 million). Below follows an analysis of the development in net exports of goods and services in Curaçao and in Sint Maarten, respectively.[2]

Developments in the net export of goods and services in Curaçao

In Curaçao, net exports of goods and services increased during the third quarter of 2012 compared to the third quarter of 2011, as the increase in exports (NAf.48.5 million) exceeded that in imports (NAf.14.2 million). The growth in exports was related to, among other things, an increase in foreign exchange revenues from the tourism industry (NAf.32.1 million), an acceleration compared to the third quarter of 2011. Both foreign exchange earnings from cruise tourism and stay-over tourism rose during the July – September period of 2012, by 61.0% and 15.6%, respectively. The higher tourism revenues were accompanied by a growth in foreign exchange receipts from the transportation sector (NAf.24.4 million). In addition, exports expanded due to an increase in the received refining fee (NAf.18.6 million) as a result of maintenance work at the cat cracker of the Isla refinery. In contrast, exports by the free-zone companies registered a slight decline (NAf.7.6 million).

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

In comparison to the third quarter of 2011, international oil prices remained fairly stable in the third quarter of 2012. In spite of this price stabilization, foreign exchange revenues from bunkering activities dropped slightly (NAf.5.9 million). Moreover, foreign exchange revenues from ship repair activities dropped significantly (NAf.37.4 million).

The increase in the imports of goods and services was largely the result of more merchandise imports by the free-zone companies in Curaçao. As their exports dropped, stock building increased. In addition, investments in a new shopping mall and a data center, among other things, contributed to a rise in the import of construction materials (NAf.8.1 million). In contrast, merchandise imports by the retail trade sector dropped, reflecting the decline in domestic spending.

Developments in the net export of goods and services in Sint Maarten

In Sint Maarten, net foreign demand rose moderately by NAf.5.4 million during the third quarter of 2012 compared to 2011's third quarter, as the rise in exports (NAf.44.7 million) offset the increase in imports (NAf.39.3 million) The growth in exports was related mostly to increased foreign exchange revenues from the tourism sector. The latter revenues expanded by NAf.41.2 million, largely as a result of an increase in revenues from stay-over tourism (NAf.31.9 million). In addition, revenues from cruise tourism increased by NAf.9.4 million. On the other hand, the import of goods and services increased as a result of more imported oil products.

Developments in the income balance and current transfers balance

The income balance of the monetary union improved by NAf.11.2 million in the third quarter of 2012 compared to 2011's third quarter, due mainly to more interest income earned on foreign assets by resident companies. In addition, dividend payments to foreign investors decreased. In contrast, the current transfers balance deteriorated by NAf.18.9 million, reflecting an increase in current transfers paid to abroad offset only partly by a rise in current transfers received from abroad. (For a detailed overview, see Table 10 in the appendix.)

Financing of the current account balance

In line with the deficit on the current account, the net foreign wealth of the private sector dropped by NAf.225.4 million in the third quarter of 2012. This change in the external financing of the private sector was due mainly to a deterioration of the loans and credits balance. The direct investment and portfolio investment balances deteriorated also, but to a smaller extent.

Net direct investments into the monetary union expanded by NAf.46.6 million in the third quarter of 2012, almost equal to the increase of NAf.45.9 million registered in the third quarter of 2011. The expansion during the September quarter of 2012 was due mainly to increased claims of foreign direct investors on their subsidiaries in Curaçao and Sint Maarten and, to a small extent, to nonresidents' purchase of real estate in both countries.

The portfolio investment balance deteriorated by NAf.39.7 million, largely as a result of received funds from matured foreign debt securities held by institutional investors, which were not reinvested abroad. The bulk of these matured debt securities was issued in the past by the entities of the Netherlands Antilles and taken over by the Dutch government in October 2010 as part of the debt relief program.

The loans and credits balance deteriorated by NAf.139.1 million, as domestic companies withdrew funds from their foreign bank accounts to finance part of their imports. Also, the net trade credit balance worsened because of net repayments on trade credits extended combined with an increase in trade credits received on imports.

Meanwhile, capital transfers declined by NAf.20.3 million in the third quarter of 2012 compared to the third quarter of 2011 as no development aid funds were received during the third quarter of 2012. As a result of the decline in capital transfers and the smaller amount of external financing to the private sector, gross reserve assets declined by NAf.218.2 million in 2012's third quarter. (See Table 11 in the appendix for a detailed overview.)

MONETARY DEVELOPMENTS

Monetary policy

The Bank uses the reserve requirement and auctions of certificates of deposit (CDs) as its main instruments in implementing monetary policy. These instruments are directed at influencing the liquidity in the domestic money market and, hence, domestic credit extension, spending, imports, and the use of foreign exchange. As an intermediate target to maintain the fixed peg to the US dollar, the Bank aims at a level of official reserves corresponding with three months of import coverage. This target was successfully met during the third quarter of 2012.

The Bank tightened its monetary policy stance in 2012's third quarter by raising the percentage of the reserve requirement by 0.75 percentage point to reach 12.25% at the end of September 2012. The increase in the reserve requirement percentage was complemented by a temporary freeze on private credit extension for the March – August 2012 period to effectively address the high deficit on the current account of the balance of payments and the declining trend in the international reserves. These measures helped to moderate the growth in credit and the drop in the international reserves; as a result, the credit measure was eased somewhat for the September 2012 – February 2013 period by allowing a maximum credit growth of 1.00%.

The bi-weekly auctioning of CDs was deployed in a neutral manner during the third quarter of 2012, as the Bank aimed only at the refinancing of maturing CDs.

The Bank's official interest rate, the pledging rate, was left unchanged at 1.00% throughout the September quarter of 2012.

Monetary base

The monetary base,[3] M0, contracted by NAf.169.2 million (18.8%) during the September quarter of 2012, reflecting declines in both the commercials banks' current account balances with the Bank (NAf.159.5 million) and currency in circulation (NAf.9.7 million). Table 12 in the appendix shows the changes in the Bank's assets and remaining liabilities, which can be used to explain the change in the monetary base. All else being equal, an increase in the Bank's assets leads to an expansion in M0, whereas an increase in the Bank's remaining liabilities causes the monetary base to contract. The decline in M0 during the September 2012 quarter stemmed mainly from an increase in the capital and reserves of the Bank and more private sector deposits held at the Bank.

[3] A measure of the Bank's monetary liabilities. It consists of currency in circulation and the commercial banks' current account deposits with the Bank.

Money supply

Broad money (M2) contracted by NAf.140.6 million (1.8%) during June-September 2012. The near money component, which contracted by 3.2%, contributed most to the decline in M2, due entirely to a drop in time deposits (6.4%). The money component (M1) declined only marginally (0.1%), as a result of a drop in coins and notes with the public mitigated by an increase in demand deposits. The annual growth rate of M2 decelerated to 5.4% in September from 6.6% in June 2012. (See Table 13 in the appendix.)

Factors affecting the money supply

The monetary contraction in the third quarter of 2012 was caused mainly by a decline in net foreign assets of the banking system (3.1%), related to insufficient external financing to cover the current account deficit of the balance of payments. Net foreign holdings of the commercial banks declined by NAf.185.2 million while the central bank's net foreign position increased by NAf.49.9 million (1.7%).

In addition, net domestic assets dropped marginally (0.2%) in the third quarter of 2012. This drop was attributable to declines in the net claims on the government (NAf.10.3 million) and in miscellaneous balance sheet items (NAf.153.1 million). The decline in net claims on the government resulted from increases in the deposits of the government of Curaçao (NAf.5.9 million) and the former central government (NAf.16.0 million), mitigated by a drawdown of deposits by the government of Sint Maarten (NAf.11.6 million).

In contrast, net credit to the private sector expanded by NAf.158.1 million (2.5%). The loan component rose by 2.9%. This increase was accounted for almost entirely by Curaçao, where total loans to the private sector expanded by 3.9%. All loan components contributed to the expansion: mortgages by 1.2%, consumer loans by 2.8% and business loans by 8.3%. In Sint Maarten, total loans increased by 0.4%, attributable entirely to business loans (8.1%). Consumer loans and mortgages declined by 2.4% and 3.8%, respectively. (See Table 14 in the appendix for more details.)

As a result, the annual growth rate of private sector credit extended in the monetary union accelerated from 2.5% in June to 5.4% in September 2012. The annual growth in September was due entirely to the 9.0% growth in Curaçao because Sint Maarten registered a decline of 3.5%. The acceleration in credit growth, despite the credit measure that was in effect since March 2012, can be attributed mainly to the exemptions of (1) the take-up of the undisbursed part of credit commitments agreed upon before the credit measure became effective, and (2) loans for projects that will strengthen the foreign exchange reserves.

Developments in domestic interest rates

When setting the rate offered on CDs during the bi-weekly auctions, the Bank takes into account developments in the international financial markets, which affect interest rates in the domestic money market. The benchmark one-month US dollar libor rate[4] remained unchanged in the September quarter of 2012. This development was reflected also in the 1-month CD rate, which dropped only marginally from 0.11% at the end of the second quarter to 0.10% at the end of the third quarter of 2012.

[4] The London interbank offered rate, the main gauge of interbank lending.

Most commercial bank rates remained about the same during the third quarter of 2012. In lending rates, the average mortgage rate decreased to 6.8%, while the average rate on time loans remained at 8.0%. Meanwhile, with respect to the borrowing rates, the average rate offered on a 12-month time deposit increased to 1.8% in the third quarter of 2012, while the average interest rate on passbook savings remained unchanged at 1.2%.

Yields on government paper plummeted during the third quarter of 2012, in line with the developments on the Dutch capital market. The average effective yield on 5-year government bonds dropped from 1.3% at the end of the second quarter of 2012 to 0.8% at the end of the third quarter. Finally, the yield on 12-month treasury bills dropped by 0.12 percentage point to nearly zero (0.03%). (See Table 15 in the appendix for a detailed overview.)

DEVELOPMENTS IN THE COMMERCIAL BANKING SECTOR

Total assets of the domestic banking sector grew by 1.2% during the third quarter of 2012 compared to 2.6% in the second quarter. Profitability improved as net income surpassed 2011's third-quarter level. The commercial banks' capital structure and liquidity levels remained healthy, but asset quality deteriorated.

The traditional intermediation business of the commercial banks recorded an increase in lending by 2.0% during the September quarter of 2012, up from 1.1% in the June quarter. Lending accounted for 56.3% of total assets at the end of September 2012. On an annual basis, lending accelerated to 3.9%, up from 3.4% in the September quarter of 2011. Besides the growth in loans, increases in interest-bearing cash (3.4%), investments in unconsolidated subsidiaries and affiliates (47.2%), fixed assets (2.2%), and other assets (11.3%) also contributed to the expansion of the commercial banks' asset base. However, contractions in investments (7.2%) and non-interest bearing cash (2.6%) mitigated the growth in assets during the third quarter of 2012.

The growth rate in the total liabilities of the domestic commercial banking sector decelerated to 1.1% in the September quarter of 2012 from 2.8% in the June quarter. Total deposits dropped by 0.8%, while the share of interest-bearing deposits (time and savings deposits) in total deposits continued to decline from 52.5% in the second quarter of 2012 to 51.9% in the third quarter. Moreover, the domestic commercial banks' capitalization increased by 2.0% in the September quarter of 2012 compared to the June quarter. This increase was mostly the result of the net addition to general provisions. (See Table 16 in the appendix for more details.)

Contrary to a growth by 0.2% in the third quarter of 2011, total operational income of the domestic banking sector dropped by 0.4% in the third quarter of 2012 compared to a year prior. The decline in 2012's third quarter was the result of a drop in other income (12.3%) that outweighed a growth in net interest income (5.8%). Interest income increased (1.9%), complemented by a drop of 14.1% in interest expenses.

During the third quarter of 2012, total operational expenses dropped by 0.7%, as opposed to a 14.0% growth in the third quarter of 2011. The 44.6% drop in the net addition to general provisions accounted for the decline in 2012's third-quarter expenses as all other categories registered a growth. The abovementioned developments resulted in a 0.3% growth in net operating income in the third quarter of 2012. Combined with the receipt of net extraordinary income, net income after taxes more than doubled to NAf.58.3 million in the third quarter of 2012, compared to NAf.27.0 million in the third quarter of 2011. (See Table 17 in the appendix for more details.)

Financial soundness indicators

The Bank uses aggregates of microprudential indicators to monitor the health and soundness of the financial sector. The key financial soundness indicators (FSI) for the commercial banking system suggest that the commercial banks remained adequately capitalized and strengthened their earnings in the third quarter of 2012. This microprudential approach, which is based on microeconomic variables and takes only the exposure of individual banking institutions into account, is complemented by a more comprehensive analysis that considers macroeconomic factors through stress tests. These stress tests together with the FSI constitute a macroprudential approach aimed at better assessing the vulnerability of the banking system to shocks and the extent of systemic risk.

The ability of financial institutions to withstand shocks to their balance sheets is determined by their capital adequacy. Capital provides a buffer that allows for the orderly disposal of assets and shields creditors from losses. Moreover, capital requirements act as a disincentive to excessive risk-taking by banks. The commercial banks' total capital-to-total assets ratio reached 11.3% at the end of the September quarter of 2012, about the same as at the end of the previous three quarters (see Table 6). This value indicates that the capital stock of the domestic commercial banks remained relatively strong. In addition, the core (Tier 1) capital adequacy ratio remained stable at 9.2%, consistently above the internationally acknowledged regulatory requirement of 4.0% under the Basel I and Basel II agreements.

The quality of the commercial banks' assets portfolio deteriorated due to a surge of 6.9% in the amount of outstanding nonperforming loans in the September quarter of 2012. As total loans grew only marginally (0.7%), the increase in nonperforming loans caused the ratio of nonperforming loans-to-total loans to reach 7.5%, up from 7.1% in the June quarter of 2012. Related to the growth in nonperforming loans, provisioning increased (2.7%) but not enough to prevent a decline in the ratio of provisions for loan losses-to-nonperforming loans from 44.7% at the end of June 2012 to 42.9% at the end of September.

The profitability of the domestic banking sector improved in the third quarter of 2012 as all earnings ratios increased. Banks continued, in line with their traditional intermediation role, to rely on customer deposits to fund their loans. Customers' deposits represented 94.1% of the banks' total liabilities at the end of the third quarter of 2012. The deposit-to-loan ratio remained high at 148.0%, enabling the banking sector to finance credit entirely from this primary source of funding. The growth in interest income remained rather flat at 0.5%, but the drop in interest expenses by 4.0% ultimately caused the net interest margin to improve to 4.6% in the September quarter of 2012 compared to the third quarter of 2011 (4.4%). The increase in interest income together with a rise in average earning assets caused the gross earning assets yield to remain stable at 5.6%. The return-on-assets ratio increased from 1.3% in 2011's third quarter to 2.1% in 2012's third quarter, as net income before dividends and taxes more than doubled (57.6%), outweighing the growth in average outstanding assets (5.0%).

Finally, the ratio of total loans-to-total deposits, a measure of liquidity in the domestic banking sector, increased from 66.5% in the June quarter of 2012 to 68.0% in the September quarter. The increase in this ratio reveals a drop in liquidity during 2012's third quarter, as total loans increased while total deposits declined.

Table 6 Financial stability indicators (in %, end of period)

	2011-III	2011-IV	2012-I	2012-II	2012-III
Capital adequacy					
Total capital/total assets	10.8	11.3	11.4	11.2	11.3
Tier 1 capital/total assets	8.9	9.4	9.5	9.2	9.2
Asset quality					
Nonperforming loans/total loans	7.4	6.8	6.7	7.1	7.5
Provisions for loan losses/non-performing loans	41.4	45.9	46.3	44.7	42.9
Earnings					
Gross earning assets yield	5.5	5.6	5.6	5.5	5.6
Net interest margin	4.4	4.5	4.5	4.5	4.6
Return on assets	1.3	1.9	1.9	1.9	2.1
Liquidity					
Total loans/total deposits	67.6	68.7	67.4	66.5	68.0

APPENDIX

Table 7 Developments in stay-over tourism (% change)[1)]

	Curaçao				Sint Maarten			
	2011-III		2012-III		2011-III		2012-III	
North America, of which:	28.0	(5.0)	-3.5	(-0.6)	-9.1	(-4.8)	7.2	(3.8)
-U.S.A.	30.1	(5.1)	-4.0	(-0.6)	-9.1	(-4.4)	5.6	(2.6)
Europe, of which:	6.2	(2.8)	-2.0	(-0.8)	-0.1	(0.0)	6.0	(1.6)
-The Netherlands	4.5	(1.7)	-7.4	(-2.5)	-6.5	(-0.3)	10.6	(0.4)
South & Central America, of which:	38.4	(8.6)	42.3	(12.4)	-3.6	(-0.1)	13.7	(0.5)
-Venezuela	45.4	(7.7)	44.3	(10.1)	-6.6	(0.0)	23.3	(0.2)
-Colombia	29.2	(0.6)	37.1	(1.0)	--	--	--	--
Caribbean, of which:	3.6	(0.4)	-8.9	(-0.9)	-4.1	(-0.3)	3.7	(0.2)
-Dominican Republic	74.0	(0.9)	-16.7	(-0.2)	14.7	(0.2)	18.8	(0.2)
Total	15.9	--	8.3	--	-7.4	--	7.5	--

Source: Curacao Tourist Board (CTB) and St. Maarten Tourist Bureau

1) Weighted growth rates between brackets.

Table 8A Curaçao consumer prices (annual quarterly percentage change)

	2011-III	2011-IV	2012-I	2012-II	2012-III
Food	8.4	8.5	8.2	6.8	5.1
Beverages & tobacco	3.1	3.6	5.8	6.0	4.4
Clothing & footwear	0.5	0.6	1.6	1.1	0.7
Housing	0.8	0.7	0.6	2.7	2.2
Housekeeping & furnishings	1.1	1.5	2.0	2.7	2.6
Health	1.1	0.3	0.6	0.6	1.4
Transport & communication	4.5	4.4	5.3	7.5	1.4
Recreation & education	0.1	0.5	1.3	1.7	1.4
Other	1.5	1.7	2.0	2.2	1.8
General inflation rate	2.9	3.0	3.3	4.3	2.4

Source: Central Bureau of Statistics of Curaçao

Table 8B Sint Maarten consumer prices (annual quarterly percentage change)

	2011-III	2011-IV	2012-I	2012-II	2012-III
Food	10.4	15.9	15.5	13.2	10.7
Beverages & tobacco	11.1	14.4	11.1	10.0	6.8
Clothing & footwear	2.2	4.5	6.8	8.2	6.0
Housing	5.7	3.6	4.7	1.4	0.4
Housekeeping & furnishings	5.1	6.7	7.4	7.2	4.9
Health	2.1	2.8	2.7	2.4	0.8
Transport & communication	5.6	4.4	2.3	1.3	0.8
Recreation & education	2.0	2.5	4.9	4.3	3.5
Other	3.4	3.6	3.8	2.9	2.0
General inflation rate	5.6	5.5	5.8	4.0	2.8

Source: Department of Statistics, Sint Maarten

Table 9A Budgetary overview of Curaçao (in millions NAf.)

	2011-III	2012-III
Revenues	377.0	378.0
Tax revenues, of which:	341.1	324.2
Taxes on income and profits	166.7	147.2
Taxes on goods and services	112.6	125.4
Taxes on property	16.1	10.6
Taxes on international trade and transactions	44.1	39.2
Nontax and other revenues	35.9	53.7
Expenditures, of which:	391.3	396.9
Wages and salaries	189.6	167.8
Goods and services	81.6	87.2
Transfers and subsidies	119.9	115.2
Interest payments	0.1	0.9
Other expenditures	0.1	25.8
Budget balance	-14.3	-18.9

Table 9B Overview of selected tax revenues of Curaçao (in millions NAf.)

	2010-III	2011-III	2012-III
Taxes on income and profits, of which:	159.1	166.7	147.2
Profit tax	38.0	41.1	21.8
Wage tax	123.0	127.7	126.0
Taxes on property, of which:	16.5	16.1	10.6
Land tax	11.0	9.8	6.5
Property transfer tax	5.2	4.8	4.0
Taxes on goods and services, of which:	---	112.6	125.4
Sales tax	71.3	76.9	93.3
Excises, of which:	21.9	23.6	21.1
Excise on gasoline	11.6	15.2	11.9
Motor vehicle tax	5.4	5.1	5.3
Taxes on international trade and transactions, of which:	---	44.1	39.2
Import duties	43.0	43.8	38.8

--- Value is unknown as Curaçao's share in certain central government tax revenues is not known.

Table 9C Budgetary overview of Sint Maarten (in millions NAf.)

	2011-III	2012-III
Revenues	108.7	99.6
Tax revenues, of which:	74.2	76.2
Taxes on income and profits	35.4	31.0
Taxes on property	2.9	4.4
Taxes on goods and services	35.9	40.8
Social contributions	4.8	5.0
Nontax and other revenues	29.8	18.4
Expenditures	96.4	119.7
Budget balance	12.3	-20.1

Table 9D Overview of selected tax revenues of Sint Maarten (in millions NAf.)

	2010-III	2011-III	2012-III
Taxes on income and profits, of which:	30.1	35.4	31.0
Profit tax	1.3	2.2	-1.5
Wage tax	28.7	33.5	33.1
Taxes on property, of which:	6.6	2.9	4.4
Land tax	1.1	0.9	0.8
Property transfer tax	5.5	2.0	3.6
Taxes on goods and services, of which:	---	35.9	40.8
Turnover tax	17.0	26.7	28.8
Vehicle tax	0.2	0.2	0.2
Excise on gasoline	1.1	2.2	2.6

--- Value is unknown as Sint Maarten's share in certain central government tax revenues is not known.

Table 10 Detailed overview of the balance of payments (in millions NAf.)

	2010-III	2011-III	2012-III
Trade balance	-894.2	-769.1	-832.2
-Exports	353.9	514.3	480.1
-Imports	1,248.1	1,283.4	1,312.3
Services balance	364.8	343.2	448.7
Receipts, of which:	782.0	819.8	948.2
-Travel	455.3	417.9	491.2
-Transportation	83.1	77.9	102.8
-Other services, of which:	243.6	324.0	354.2
-Int. fin & bus. services sector	58.1	42.6	36.7
Expenses, of which:	417.2	476.6	499.9
-Travel	136.9	168.6	169.9
-Transportation	83.8	80.5	91.4
-Other services, of which:	196.5	227.5	238.6
-Int. fin & bus. services sector	29.9	21.9	19.4
Income balance[1)]	-17.3	-29.5	-18.3
Current transfers balance[2)]	84.4	-46.6	-65.5
Current account balance	**-462.3**	**-502.0**	**-467.4**
Capital & financial account balance	**415.7**	**447.1**	**431.5**
Capital account balance	8.1	19.4	-0.9
Financial account balance	407.6	427.7	432.5
Net errors & omissions	**46.6**	**54.9**	**35.8**

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

Table 11 Breakdown of net changes in the financial account[1)](in millions NAf.)

	2010-III	2011-III	2012-III
Direct investment	153.3	45.9	46.6
- Abroad [2)]	-5.8	1.2	-6.8
- In Curaçao and Sint Maarten [3)]	159.1	44.7	53.4
Portfolio investment [3)]	-188.4	103.9	39.7
Other investment, of which:	586.6	446.3	261.2
- Assets [3)]	525.6	444.7	249.6
- Liabilities [3)]	61.0	1.6	11.6
Net lending/borrowing, of which:	132.6	-88.3	-123.8
- Assets [2)]	3.5	-49.6	-85.9
- Liabilities [3)]	129.1	-38.7	-37.9
Reserves [4)]	-380.4	-31.4	218.2
Total assets [2)]	-45.5	468.8	414.8
Total liabilities [3)]	349.1	7.6	27.1
Balance	407.7	476.4	441.8

1) Transaction basis
2) A minus sign means an increase in assets
3) A minus sign means a decrease in liabilities
4) A minus sign means an increase in reserves

Table 12 The monetary base and its sources (in millions NAf.)

	2012-II	2012-III	Change Amount	Change Percentage
Banknotes issued	377.6	367.9	-9.7	-2.6%
Banks' demand deposits (current account)	523.5	364.0	-159.5	-30.5%
Monetary base (M0)	901.1	731.9	-169.2	-18.8%
Central bank assets				
Foreign assets (including gold)	3,325.1	3,329.8	4.7	0.1%
Claims on deposit money banks	-	-	-	-
Claims on the government	0.2	0.2	0.0	-18.8%
Claims on government agencies and institutions	525.6	524.0	-1.6	-0.3%
Fixed and other assets	99.9	117.8	17.9	18.0%
less:				
Central bank remaining liabilities				
Private sector deposits	992.8	1,069.8	77.0	7.8%
Government deposits	199.6	207.8	8.2	4.1%
Foreign liabilities	662.7	615.4	-47.3	-7.1%
Other liabilities	93.2	96.2	3.0	3.2%
Capital and reserves	1,101.3	1,250.7	149.4	13.6%

Table 13 Monetary aggregates (quarterly changes, in millions NAf.)

	2012-I		2012-II		2012-III	
	Amount	**%**	**Amount**	**%**	**Amount**	**%**
Money supply (M2)	101.2	1.4%	360.7	4.9%	-140.6	-1.8%
Money (M1)	145.1	4.6%	229.4	7.0%	-4.8	-0.1%
Coins & notes with the public	-5.8	-1.9%	8.8	3.0%	-12.0	-4.1%
Total demand deposits, of which:	150.9	5.3%	220.5	7.4%	7.2	0.2%
- Netherlands Antillean guilders	59.8	2.7%	247.9	11.1%	-14.2	-0.6%
- Foreign currency	91.1	13.5%	-27.3	-3.6%	21.4	2.8%
Near money	-44.0	-1.1%	131.3	3.2%	-135.7	-3.3%
Time deposits	-67.3	-3.0%	111.2	5.1%	-138.4	-6.4%
Savings	23.3	1.2%	20.1	1.0%	2.7	0.1%

Table 14 Monetary survey (in millions NAf.)

	2011-III	2011-IV	2012-I	2012-II	2012-III
Money supply (M2)	7,237.7	7,308.1	7,409.3	7,770.0	7,629.4
Money (M1)	3,129.0	3,148.8	3,293.9	3,523.3	3,518.5
Coins & notes with the public	291.2	301.3	295.6	304.4	292.4
Total demand deposits, of which:	2,837.8	2,847.5	2,998.4	3,218.9	3,226.1
- Netherlands Antillean guilders	2,224.5	2,174.7	2,234.5	2,482.3	2,468.1
- Foreign currency	613.3	672.8	763.9	736.6	758.0
Near money	4,108.7	4,159.3	4,115.3	4,246.7	4,110.9
Time deposits	2,179.1	2,266.4	2,199.0	2,310.3	2,171.9
Savings	1,929.6	1,893.0	1,916.3	1,936.4	1,939.1
Factors affecting the money supply	7,237.7	7,308.1	7,409.3	7,770.0	7,629.4
Net domestic assets	2,751.8	3,230.6	3,257.3	3,462.1	3,456.9
Government sector	-732.2	-621.6	-657.0	-524.8	-535.1
- Former central government	-117.5	-106.4	-106.2	-98.0	-114.0
- Curacao	-406.3	-333.6	-369.1	-265.9	-271.8
- Sint Maarten	-208.4	-181.6	-181.8	-160.9	-149.2
Private sector	5,861.3	6,158.8	6,279.5	6,315.1	6,473.2
Memorandum items	-2,377.3	-2,306.6	-2,365.2	-2,328.1	-2,481.3
Net foreign assets	4,485.9	4,077.6	4,152.0	4,307.9	4,172.5
Central bank	2,966.4	2,886.4	2,909.4	2,850.6	2,900.5
Commercial banks	1,519.5	1,191.2	1,242.6	1,457.2	1,272.0
Government loans by commercial banks	0.1	0.1	0.1	0.1	0.1
Government of Curaçao	0.0	0.0	0.0	0.0	0.0
Government of Sint Maarten	0.1	0.1	0.1	0.1	0.1
Private sector loans Curacao	3,759.0	3,839.3	3,901.7	3,944.7	4,098.8
- Mortgages	1,533.9	1,628.2	1,690.4	1,732.7	1,753.0
- Consumer loans	963.6	954.9	921.9	922.2	948.4
- Business loans	1,261.5	1,256.3	1,289.4	1,289.9	1,397.4
Private sector loans Sint Maarten	1,553.3	1,544.0	1,501.3	1,493.1	1,498.5
- Mortgages	647.2	648.2	630.1	646.5	622.1
- Consumer loans	382.1	379.4	382.4	370.4	361.5
- Business loans	524.0	516.4	488.8	476.1	514.9

Table 15 Developments in domestic interest rates (in %)

	2011-III	2011-IV	2012-I	2012-II	2012-III
Central bank					
- Pledging rate	1.0	1.0	1.0	1.0	1.0
- Maximum CD rate (1-month)	0.09	0.17	0.12	0.11	0.10
Commercial bank borrowing rates					
- Passbook savings	1.1	1.1	1.1	1.2	1.2
- Time deposits (12-month)	2.0	2.1	1.8	1.7	1.8
Commercial bank lending rates					
- Mortgages	7.3	7.3	7.1	7.0	6.8
- Time loans	8.4	8.3	8.1	8.0	8.0
Government securities					
- Government bonds (5-year effective yield)	1.6	1.4	1.4	1.3	0.8
- Treasury bills (12-month)	0.5	0.15	0.18	0.15	0.03

Table 16 Aggregate balance sheet of domestic commercial banks (in millions NAf.)

	2011-III	2011-IV	2012-I	2012-II	2012-III
Assets					
Non-interest-bearing cash	1,315.9	1,506.3	1,544.3	1,585.0	1,544.4
Interest-bearing cash	2,883.0	2,426.9	2,651.8	2,703.3	2,795.7
Investments	1,345.5	1,540.1	1,478.1	1,666.8	1,547.4
Loans	8,347.5	8,451.4	8,412.4	8,503.4	8,670.6
Investments in unconsolidated subsidiaries and affiliates	53.4	69.7	80.9	66.5	97.9
Fixed assets	345.4	355.5	360.6	362.9	371.0
Other assets	313.0	307.8	309.6	335.2	373.2
Total assets	14,603.7	14,657.8	14,837.6	15,223.2	15,400.1
Liabilities					
Demand deposits	5,637.4	5,673.1	5,877.8	6,144.7	6,177.6
Savings deposits	4,078.3	4,016.1	4,034.2	4,057.2	4,020.3
Time deposits	2,745.2	2,724.1	2,694.1	2,729.4	2,636.2
Total deposits	12,460.9	12,413.3	12,606.1	12,931.4	12,834.2
Borrowings	28.4	31.1	28.0	28.3	210.4
Other liabilities	513.7	531.6	484.6	530.9	588.3
Total liabilities	13,003.0	12,976.1	13,118.7	13,490.6	13,633.0
Minority interest	10.8	10.2	10.0	10.8	11.5
General provisions	274.4	282.1	288.7	299.8	316.7
Capital & reserves	1,315.5	1,389.3	1,420.2	1,422.1	1,439.0
Total capital	1,600.7	1,681.7	1,718.9	1,732.6	1,767.2
Total liabilities and capital	14,603.7	14,657.8	14,837.6	15,223.2	15,400.1

Table 17 Aggregate income statement of domestic commercial banks (quarterly changes, in millions NAf.)

	2011-III	2011-IV	2012-I	2012-II	2012-III
Interest income	188.2	141.6	195.6	186.2	191.7
Interest expenses	37.2	25.3	35.6	32.6	32.0
Net interest income	**150.9**	**116.3**	**160.0**	**153.7**	**159.7**
Other income	79.8	71.2	78.3	74.5	70.0
Total operational income	**230.7**	**187.5**	**238.3**	**228.2**	**229.7**
Salaries & other employee expenses	84.1	80.6	89.1	86.5	86.4
Occupancy expenses	26.0	22.0	26.8	26.1	27.3
Other operating expenses	41.6	20.6	39.6	39.1	44.7
Net addition to general provisions	17.9	-0.7	9.1	29.9	9.9
Total operational expenses	**169.6**	**122.5**	**164.5**	**181.6**	**168.4**
Net operating income	61.1	65.0	73.8	46.6	61.3
Net extraordinary items	-21.5	57.7	0.0	6.3	8.1
Applicable profit taxes	12.7	7.9	14.1	8.3	11.2
Net income after taxes	**27.0**	**114.8**	**59.7**	**44.6**	**58.3**