



Achieving a higher and more inclusive growth path for Curaçao

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Presentation for Rotary Luncheon
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President a.i. CBCS
November 1, 2018

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Good afternoon Rotarians, ladies and gentlemen,

First allow me to thank Rotary Club of Curaçao for the invitation to give a presentation today on a very important topic, “Achieving a higher and more inclusive growth path for Curaçao”.

For some years already, the economic performance of Curaçao has been disappointing. It is therefore necessary that we change this negative trend and realize a higher pace of growth. Today I would like to discuss with you some challenges that may pose a downside risk to our growth prospects. Furthermore, I will provide some policy recommendations to achieve a higher and more inclusive growth path.

Let me emphasize in this context that inclusiveness is crucial. Evidence suggests that when the benefits of growth are shared more broadly, growth is stronger, more durable, and more resilient.

Our economic performance



Let me start by giving you a brief overview of our recent economic performance and prospects.

Expected developments in Curaçao in 2018 and 2019

	2016	2017	2018**	2019**
Current account balance (in mln Naf.)	-1,080.8	-1,120.3	-1,302.7	-1,632.6
Change in gross foreign reserves of the central bank (in mln Naf.)*	-187.5	17.6	-28.7	-67.0
Real GDP growth (%)	-1.0	-1.7	-1.6	0.4
Inflation (%)	0.0	1.6	2.2	2.1
Unemployment rate (%)	13.3	14.1	14.5	13.4

*- sign means an increase

** projection CBCS

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As you can see in this table, the current account of the balance of payments of the monetary union will worsen in both 2018 and 2019 due mainly to a decline in exports combined with an increase in imports. Meanwhile, gross foreign reserves of the central bank are projected to increase as foreign financing will be more than sufficient to cover the current account deficit.

In 2018, real GDP is projected to contract by -1.6% in Curaçao. Domestic demand will decrease because of a decline in private consumption, public investment and consumption. **Private consumption will decline because of lower disposable income due to higher inflationary pressures and the worsened situation in the labor market. Public investment will decline because the construction of the new hospital is reaching its final stages, and consumption because of less spending on goods & services and on wages & salaries.** Imports will increase because of more imports by the manufacturing and wholesale & retail trade sector, while exports will rise because of more tourism activities and more bunkering activities.

For 2019, a slight real GDP expansion of 0.4% is projected supported mainly by private investment growth in the hotels & restaurants, transportation, and utilities sectors. Also, exports will increase because of more air transportation, tourism, and ship repair activities. Imports will also increase thanks to the private investment growth.

Changes in international oil and food prices have a considerable impact on our local prices. Consequently, the inflation rate is projected to increase to 2.2% in 2018 on the back of higher international oil and food prices. In 2019, inflation will ease slightly due to a projected decline in international oil prices.

Meanwhile, the 14.1% (in 2017) unemployment rate in Curaçao is among the highest in the Caribbean region and is expected to remain around 13/14% in the coming years. Important to mention is that the positive development in 2019 is only possible under the assumption that the expected private investments indeed take place and the investments that are currently ongoing indeed finalize.



Risks and challenges that impede growth

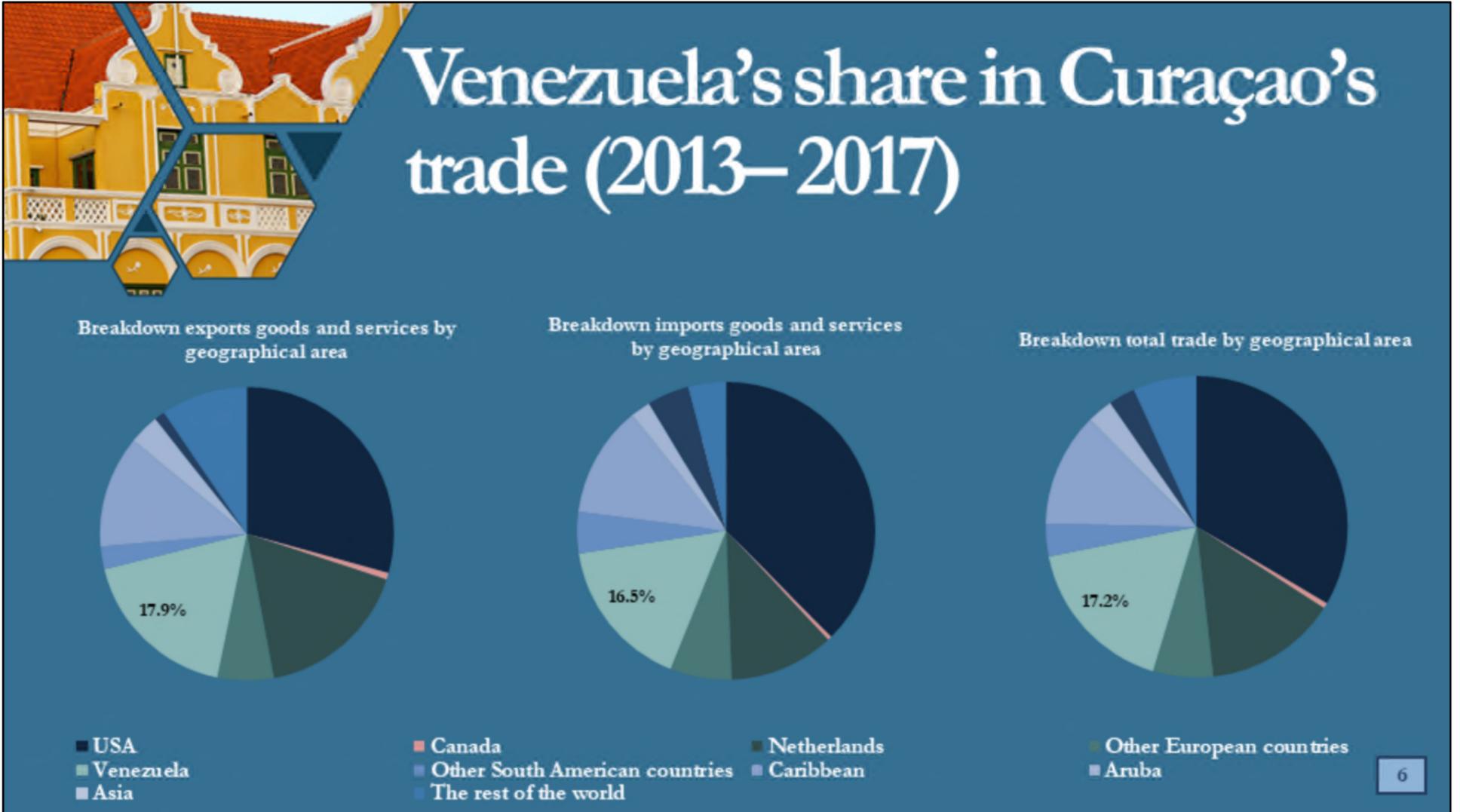
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As I have already shown on the previous slide, we expect a slight economic growth for 2019. However, there are some risks and challenges that could put a drag on our growth prospects for 2019 and beyond.

I would like to focus on three of them. First, our exposure to Venezuela. Second, the developments in the international financial services sector, which is one of the pillars of our economy. And third, our public finances with a special focus on the Hospital Nobo Otrobanda.



Because of our geographic proximity, Venezuela has always been one of our main trading partners. Consequently, activities in key economic sectors of our economy were affected by the deep recession and unstable situation in Venezuela of the past years.



The pie charts on this slide show Curaçao's exports, imports, and total trade by geographical area.

As shown in the first pie chart, Venezuela is Curaçao's second most important export market with a share of 17.9% of the total exports of goods and services. It is important to note that the bulk of foreign exchange income from Venezuela is generated from the refining activities of the Isla refinery.

In the second pie chart, it is shown that Venezuela's share in Curaçao's import of goods and services is 16.5%, thereby making it the second highest after the United States. Curaçao imports primarily merchandise from Venezuela, of which oil (89%) is the most important product.

A breakdown of total trade, i.e., the sum of export and import of goods and services, as shown in the third pie chart, reveals that Venezuela is Curaçao's second most important trading partner with a share of 17.2% of total trade.



Macro-economic effects of removing all trade transactions with Venezuela (%)

2019**	Baseline	Simulation	Difference
Real GDP	0.4	-5.2	-5.6
<i>Effect of removing Isla only</i>	<i>0.4</i>	<i>-2.5</i>	<i>-2.9</i>
Inflation	2.1	2.3	0.2
Unemployment rate	13.4	13.9	0.5

** projection CBCS

To assess the effect of trade with Venezuela on the real GDP of Curaçao, we calculated a scenario in which all trade transactions between Curaçao and Venezuela were removed and a scenario in which all transactions with only the Isla Refinery were removed.

As Venezuela is one of Curaçao's main trading partners, a discontinuation of all trade will have a negative effect on real GDP, causing a contraction of 5.2% in Curaçao whilst the effect of the closing of only the Isla refinery would mean that the real GDP of Curaçao would contract by 2.5%.

Private consumption will drop because of lay-offs, which is a result of a decline in activities in other important export sectors, namely tourism, wholesale & retail trade, and transportation. Meanwhile private investment will drop since no investments will be taking place at the Isla refinery. Public consumption will contract as the government will receive less tax income.

Exports will drop and will result in lower foreign exchange revenues due to the decline in the refining fee, transportation activities, tourism activities and re-exports by the free-zone companies. Imports will decline as well, due to a decline in domestic spending, less tourism spending, less free-zone re-exports and no import of goods and services by the Isla refinery.

The inflation rate will increase as the non-oil merchandise imports from Venezuela will be replaced by imports from other countries at a higher price.

The unemployment rate will rise with 0.5%.



Challenges & opportunities for the International Financial Services (IFS) sector

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The international financial services sector has been an important pillar of the economy of Curacao since the 1930.

However, over the past twenty years, the sector has experienced a gradual decline due to among other things, the termination of the Tax Treaty with the United States and the abolishment of the US Foreign Withholding Tax. Also, increased competition from tax-exempt jurisdictions has affected our international financial services sector.

One of the main tax measures that had an impact on the sector, was the enactment of a New Fiscal Regime in 2001 to be in full compliance with the policies of the OECD for fair tax practices. The NFR ended the distinction between onshore and offshore entities. However, institutions that already existed in 1999 have been given a transitional phase of 20 years to be able to adapt to the new offshore regime. After the exemption period, offshore companies will be subject to the onshore tax regime. This grandfather clause will end in 2019.



These pie charts depict the total foreign exchange income from the export of goods and services by economic sector.

Although its contribution has declined over the past 20 years (6% compared to 18%), the international financial services sector still remains an important economic pillar of Curaçao. Overall, the sector represents approximately 6% of the total GDP of Curaçao.

The sector provides labor intensive high-skilled employment to more than 1,000 persons and contributes indirectly to the economy through spillover effects to other related industries including the business, telecommunication, transportation and hospitality sectors.

Comparing the year 2017 with 2000 reveals that, in terms of foreign exchange income, the Curaçao economy has become significantly more dependent on the tourism industry. Although the growth of the tourism sector is a welcome development, losing a key economic pillar such as the international financial services sector can be considered a weakness as the economy will become less diversified.

Future of the sector

- CBCS expects limited impact on the economy of Curaçao when the transition period ends in 2019.
- The sector can grow if the right steps are taken, independent of the developments in the local economy.
 - Implementation of BEPS recommendations
 - Becoming a MMOU signatory member of the International Organization of Securities Commissions (IOSCO).
 - Compliance with the latest standards of worldwide regulators
 - Embrace innovation and capitalize on Fintech products and services.

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As I mentioned earlier, the grandfather clause will expire in 2019. As most of the offshore companies have already changed or adjusted their products, clients and the way they are doing business, the CBCS expects limited impact of the expiration of the exemption period on the sector and, hence, the economy.

Nevertheless, this sector needs to be strengthened to provide a higher contribution to our economy. The sector can grow if the right steps are taken. These steps include:

- The implementation of the Base Erosion and Profit Shifting (BEPS) Multilateral Instrument (MLI) recommendations. The International Organization of Securities Commissions (IOSCO) launched the BEPS in 2017 to ensure a “stronger and fairer international tax system” for governments and taxpayers equally. Hence, by implementing these standards, Curaçao is taking the steps in the right direction to strengthen the sector.
- Becoming a Multilateral Memorandum of Understanding signatory member of IOSCO. The CBCS is working on becoming a signatory member of IOSCO as the global standard setter for the securities sector.
- Compliance with the latest standards of worldwide regulators. As an example CBCS has recently been entrusted with the supervision of Securities Intermediaries and Asset Managers.
- Embrace innovation and capitalize on Fintech products and services. In this respect CBCS has installed an Innovation platform in which different CBCS experts are represented that functions as sparring partner for different investors in this respect.

With these steps, we can transform Curaçao into a modern and transparent jurisdiction that can attract bona fide customers.

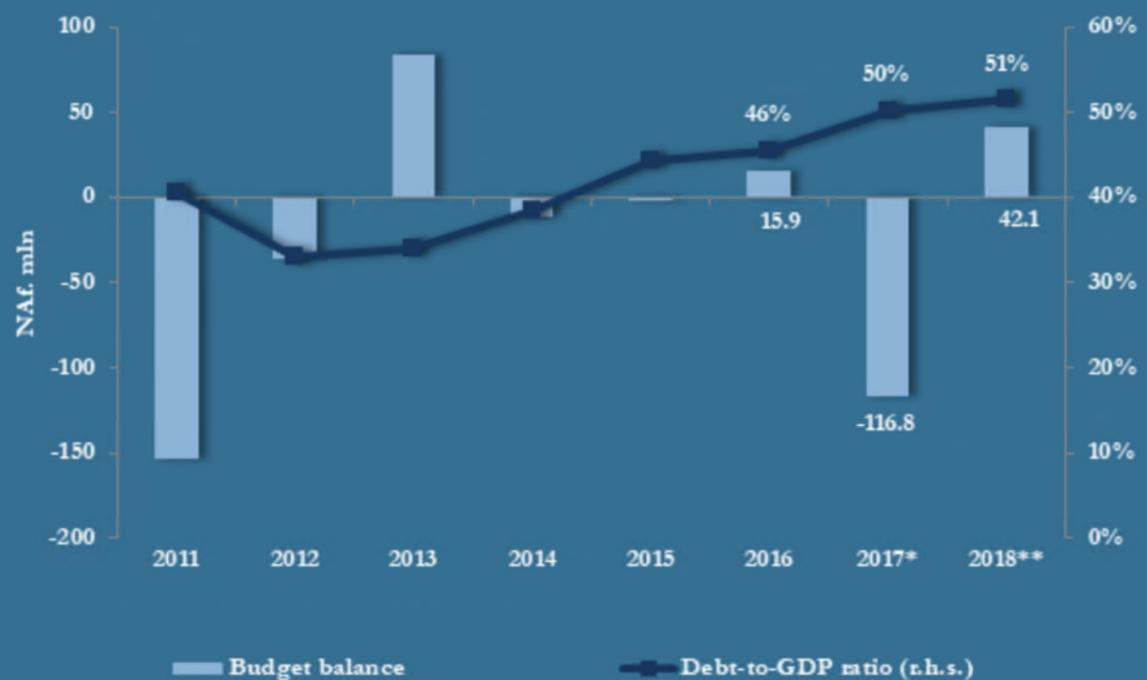


Public finance and debt sustainability

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Sound public finances and debt sustainability are important preconditions for macroeconomic stability. Evidence shows that macroeconomic stability has a positive effect on economic growth.

Budget development and debt-to-GDP ratio: Curaçao



This graph shows the development on the current budget of the government of Curaçao since becoming an autonomous country in the Dutch Kingdom in 2010. Sound public finances are critical for macroeconomic stability, since 2010, it seems that adherence to strict budgetary norms has been the main focus of the government while other important policy areas have not gotten the attention they deserve. In fact, the economy has been trapped in a downward spiral of low economic growth, worsening public finances, and social decline.

In 2017 the government recorded a current budget deficit of NAf.116.8 million. For 2018, however, the government expects a surplus of NAf.42 million on its budget, even though tax income has been lower than initially projected.

Meanwhile, Curaçao's debt-to-GDP ratio has been increasing since 2012. Curaçao entered its status of autonomous country with a debt-to-GDP ratio of 34,6% in 2010. As you can see, today, the debt-to-GDP ratio exceeds 50%.



The Hospital Nobo Otrobanda case

- The government issued two bonds to finance the construction. An additional NAf.200.0 million is still needed to finalize the project.
- The additional NAf.200.0 million can be obtained from:
 - Government loans;
 - Local and international institutional investors.
- However, the loan will not be risk-free for the government.

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The government of Curaçao started to borrow in 2014 for the construction of the new hospital, Hospital Nobo Otrobanda (HNO). Therefore, the government issued two bonds, totaling NAf.492.5 million. Currently, the financing of the construction of the hospital represents 17.5% of the total outstanding public debt and 8.8% of our GDP.

Nevertheless, an additional NAf.200.0 million is still needed to finalize this project. There are two possible options to obtain these additional funds. First, the government can issue a NAf.200.0 million bond loan resulting in a higher debt-to-GDP ratio. The second option is that HNO directly borrows the required funds from local and international institutional investors, in this case the public debt to GDP ratio will not increase. It seems that this last option is being considered as the most viable one at this moment.

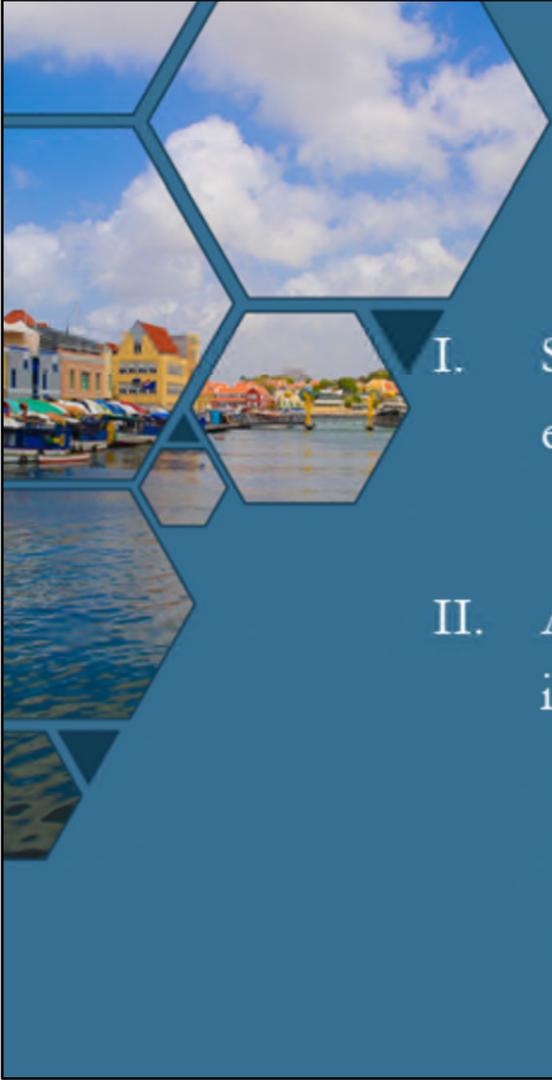
However, there will be still risks involved for the government. Assuming that the social security bank, SVB, will have to guarantee the loan to the private institutional investors, in case of a default by the hospital, the SVB will have to repay these debts. Hence, this could affect the sustainability of the social insurances and, indirectly, the public finances. It will be crucial that the hospital is able to comply with the financial obligations towards its lenders in the future. Therefore, continuous supervision on the hospital's operations will be very important.

Policies to achieve a higher and more inclusive growth path



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Finally, I would like to present some policy recommendations to address these risks and achieve a higher and more inclusive growth path.



Policy considerations

- I. Strengthen resilience to mitigate the risks associated with external shocks
 - Economic diversification.
- II. Address structural weaknesses to achieve a higher and more inclusive growth path
 - Simplify administrative procedures.
 - Improve access to risk capital and long-term financing.
 - Reduce the high cost of doing business.

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The considerable negative effects that external shocks, such as the situation in Venezuela, have on our economies underscore the importance of strengthening our resilience. One of the strategies to strengthen our resilience is economic diversification. First, the public and private sectors should act together to strengthen the current economic pillars and develop new sectors. Second, Curaçao should also diversify its tourism source market and implement the Tourism Master Plan.

Curaçao also has to address the structural weaknesses in its macroeconomic environment that are impeding growth. These weaknesses include complex and lengthy administrative procedures that can delay the execution of investment projects or even discourage investors from starting a new venture.

Another barrier to growth is the limited access to risk capital and long-term financing, particularly for small and medium enterprises (SMEs) that are the backbone of our economies. In Curacao, the fragmentation in the market for high-risk financing should be addressed. The current public entities should consider working more closely together and eventually merging in the future.

Furthermore, the high cost of doing business is another impediment to growth in Curaçao that needs to be addressed. Recent technological advancements provide opportunities to reduce the cost of doing business through diversification towards alternative sources of energy such as wind, sun, and cold seawater.



Policy considerations (cont'd)

III. Develop a growth strategy aimed at transforming the economy

- Structural reforms to improve the investment climate and, hence, unleash private investments.
- Public sector investments to improve the public infrastructure and strengthen human resources.
- Allow temporary deviations from the budgetary norms

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Curaçao should develop a strategy aimed at transforming its economy to achieve a higher and more inclusive growth path. Structural reforms to improve the investment climate are therefore crucial. After all, a more enabling investment climate will unleash private investment, which is ultimately the driver of sustainable growth.

However, private sector investments frequently also demand public investments in key infrastructure and human resources. Therefore, the growth strategy for the future should include public sector investments for improving the public infrastructure and strengthening our human resources.

In times of external shock-inflicted economic crises, the strict budgetary norms can act counterproductive and dampen prospects of economic recovery. Therefore, more flexibility should be introduced into the budgetary norms in periods of prolonged economic downturn.

However, the growth strategy should not be considered a plea to increase public sector debt to unsustainable levels. If temporary deviations are allowed, then an important condition should be that the government must implement a realistic plan, including structural reforms, to comply again with the norms within an agreed time frame.



Thank You

Given the current economic situation and the many challenges facing Curacao, only a comprehensive and well-balanced growth strategy that includes structural reform measures will help us reach a sustainable higher and more inclusive economic growth path.

Thank you for your attention.