IMMEDIATE ATTENTION

SM/11/292
Supplement 2

November 15, 2011

To: Members of the Executive Board

From: The Secretary

Subject: **Kingdom of the Netherlands—Curaçao and Sint Maarten—2011 Article IV Consultation Discussions—Draft Public Information Notice**

Attached for consideration by the Executive Directors is the draft Public Information Notice (PIN) relating to the staff report for the 2011 Article IV consultation discussions with the Kingdom of the Netherlands—Curaçao and Sint Maarten (SM/11/292, 11/4/11), which is being considered on a lapse of time basis. In the absence of a request for a Board discussion by **noon on Wednesday, November 16, 2011**, the Executive Board Assessment section of the PIN will be based on the staff appraisal, as attached.

Unless an objection from the authorities of the Kingdom of the Netherlands—Curaçao and Sint Maarten is received prior to the conclusion of the Board's consideration, the PIN will be published.

Questions may be referred to Mr. Kanda (ext. 35414) and Mr. Weber (ext. 37846) in EUR.

Unless the Documents Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the European Commission, following its consideration by the Executive Board.

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

Att: (1)

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Department Heads

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 11/xx
FOR IMMEDIATE RELEASE
[November 18, 2011]

International Monetary Fund
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Washington, D. C. 20431 USA

IMF Executive Board Concludes 2011 Article IV Consultation Discussions with the Kingdom of the Netherlands—Curaçao and Sint Maarten

On November 18, 2011 the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Kingdom of the Netherlands—Curaçao and Sint Maarten,[1] on a lapse-of-time basis.[2]

Background

Following the dissolution of the Netherlands Antilles on October 10, 2010 Curaçao and Sint Maarten became autonomous countries within the Kingdom of the Netherlands, with a currency union and a peg to the U.S. dollar. Alongside, the Dutch government gave substantial debt relief to both countries, and new fiscal frameworks were installed to help sustain sound fiscal positions.

Macroeconomic challenges are substantial. In addition to low growth, high unemployment, and aging, the current account deficit for the currency union has widened rapidly to 25¾ percent of Gross Domestic Product (GDP) in 2010, increasing the vulnerability of the currency peg. However, a strong increase in international reserves in recent years, to about five months of imports in 2010, has provided some

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

[2] The Executive Board takes decisions under its lapse-of-time procedure when the Board agrees that a proposal can be considered without convening formal discussions.

cushion, and there is no indication currently of pressures against the guilder. In 2011, international reserves have been broadly stable thus far. A number of indicators suggest weak competitiveness and moderate real exchange rate overvaluation, particularly in Curaçao.

The global crisis caused relatively modest contractions in both countries in 2009, and activity remained anemic in 2010. Curaçao's GDP is estimated to have contracted by 1¼ percent in 2009, and grown by ½ percent in 2010, while Sint Maarten's GDP contracted by 2 percent in 2009, and was flat in 2010. With weaker growth, unemployment stayed around 10 percent in Curaçao over 2009 and 2010, after steady declines since 2007, while, in Sint Maarten, it stayed around 12 percent after steadily declining since 2003. As demand pressure fell in the crisis and commodity prices declined temporarily, inflation decelerated in 2009 to 1¾ percent in Curaçao and ¾ percent in Sint Maarten. However, driven by renewed oil and food price increases, inflation started picking up again in 2010 and reached 2¾ and 3¼ percent on average in Curaçao and Sint Maarten, respectively.

Bank capital and liquidity buffers appear robust, though credit quality has declined. The risk weighted capital adequacy ratio stood at 18¼ percent in 2010, well above the regulatory minimum. Bank liquidity buffers also appear sound, with a loan to deposit ratio of 75 percent and reserves well above regulatory requirements. But the nonperforming loan (NPL) ratio has increased by 2 percentage points over 2008 and 2010 to 8½ percent. However, loan-loss provisions are also sizeable at close to 70 percent of NPLs, and they rose further in 2010. Banks remain profitable, with a return on assets above the Caribbean average.

Excluding the impact of debt relief, both island governments run modest fiscal deficits over 2009–10. Excluding grants received as part of debt relief, Curaçao would have had fiscal deficits of ¾ percent of GDP in both 2009 and 2010. Fiscal expenditure data for 2009–10 for Sint Maarten are still unavailable, but fiscal deficits of about one percent of GDP in both 2009 and 2010 are estimated, excluding debt relief grants. As of end-2010 public debt stood at 34½ percent of GDP and 28¼ percent of GDP in Curaçao and Sint Maarten, respectively. In 2011, both countries are on track with respect to the fiscal rules, and Curaçao is expected to have an overall balanced budget outturn, while Sint Maarten is expected to an overall deficit outcome of ½ percent of GDP.

Executive Board Assessment

In concluding the 2011 Article IV consultation discussions with the Kingdom of Netherlands—Curaçao and Sint Maarten, Executive Directors endorsed the staff's appraisal, as follows:

Both countries face substantial challenges, requiring sustained adjustment efforts over the near and medium terms. In addition to low growth, high unemployment, and aging pressures, the current account deficit for the currency union has risen to worrisome levels. The real exchange rate also appears moderately overvalued, particularly in Curaçao. Anemic competitiveness, rapid credit growth, and inadequate pass-through of recent increases in international oil and food prices particularly in 2010, appear to be the main drivers of the external deficit. While international reserves have risen in recent years, vulnerabilities are substantial, and strong efforts are needed to reduce the current account deficit to sustainable levels. If efforts lag, international reserves could come under pressure over the medium term, requiring a devaluation. Moreover, devaluation would only yield temporary adjustment unless it is buttressed with policy tightening and structural measures to improve competitiveness.

A substantial adjustment is needed to bring the underlying current account deficit to historically sustainable levels over the medium term. This could be facilitated by measures to restrain credit growth, supported by fiscal consolidation. In addition, structural reforms to generate wage and price flexibility and improve the business environment will be needed to realize durable gains in competitiveness. In several areas policy responses are being prepared, but prompt implementation will be key.

Clarity is needed on dollarization and the future of the currency union to avoid undermining confidence in the economy and the guilder. The current peg has delivered credible exchange rate stability and relatively low inflation for a prolonged period. Given anemic competitiveness, dollarizing without first enhancing wage and price flexibility risks locking-in protracted low growth, with adverse effects on fiscal sustainability and employment. Also, dissolving the currency union would fracture the domestic banking system and raise both banking and supervisory costs, and the credibility of the Central Bank of Curaçao and Sint Maarten may not carry over to the successor central banks. Continued public discussion of these issues and the divergent views of the different authorities could undermine investor confidence and adversely impact the growth outlook, and should be avoided.

Monetary and macroprudential tools should be used firmly to aid adjustment by reducing credit growth below that of nominal GDP. The recent increase in the rate of required reserves is welcome, but more increases are needed, together with a gradual relaxation of the limits on foreign investment by domestic nonbank financial institutions and the use of other macroprudential instruments. Supervisory vigilance should also be intensified as the tightening, together with the frail near term outlook, could increase strains in the banking system.

Financial crisis resolution mechanisms should be further strengthened. The authorities should press ahead with plans to set up a funded deposit guarantee scheme, and develop clear understandings on the roles of the two governments in the event that public bailout of a bank is ever contemplated.

The new fiscal frameworks appear to be entrenching fiscal soundness. The 2011 fiscal outturns in both countries are on track with respect to the fiscal rules, and incentives to address spending pressures related to aging and institutional buildup have been strengthened. The College Financieel Toezicht (CFT) appears to be providing effective guidance on fiscal policy, and its assessments are a major input in the setting of budget parameters and both short and longer term fiscal efforts.

However, significant fiscal tightening is needed over the near to medium term to support the efforts to reduce the current account deficit. Given the relative size of Curaçao and data suggesting that it is primarily responsible for the widening of the current account deficit, the bulk of the adjustment will need to come from Curaçao. The significant tightening already expected in Curaçao for 2011 is therefore a step in the right direction. In addition to efforts to contain aging and institutional buildup-related pressures, areas that could be targeted in this effort include social benefits, goods and services, and wages. In Sint Maarten, scope for reducing expenditures appears limited, given the need to fill institutional gaps. However, tax reforms as well as compliance increasing measures being developed will likely need to be moderately revenue enhancing.

Planned tax reforms will help improve the business environment and competitiveness by reducing rates on labor and profits and raising indirect taxes. Rebalancing from direct to indirect taxes would also support productive activity and moderate consumption, thus contributing to a reduction of the underlying current account deficit. The new legislation in Curaçao is a commendable start, and the authorities' plans to go further along the lines proposed by the IMF's Fiscal Affairs Department Technical Assistance mission are in the right direction. For Sint Maarten, the timing of implementation of tax reforms should be brought forward as much as possible. Given the shared border with the French side, synchronization of tax policy on both sides would be critical to avoid arbitrage across borders.

Deep structural reforms are needed to enhance price and wage flexibility and improve the business environment. With a currency peg, domestic price and wage flexibility is the primary channel by which the economy adjusts to shocks and sustains competitiveness. However, structural rigidities are pervasive in both countries hampering adjustment and limiting growth potentials. Wide-ranging reforms are needed to substantially enhance labor market flexibility, liberalize the administered price regime, and sharply reduce administrative red tape.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Curaçao and Sint Maarten: Selected Economic Indicators

	2006	2007	2008	2009	2010	2011 1/
Real economy (change in percent)						
Curaçao						
Real GDP	1.9	2.7	2.6	-1.3	0.4	0.1
Domestic demand	3.8	7.1	4.7	-1.6	5.9	0.2
CPI	1.3	3.0	6.9	1.8	2.8	2.8
Unemployment rate (percent)	14.6	12.4	10.3	9.7	10.1	10.5
Sint Maarten						
Real GDP	5.3	4.3	2.3	-2.0	-0.1	-0.1
Domestic demand	14.9	13.2	9.7	-4.7	-7.6	0.7
CPI	2.3	2.3	4.6	0.7	3.2	3.7
Unemployment rate (percent)	11.9	10.6	11.4	12.2	12.0	12.0
Public finance (percent of GDP) 2/						
Curaçao						
General government balance	-2.3	-1.8	-1.7	7.6	5.4	0.0
General government debt	53.6	56.3	52.6	47.3	34.6	33.6
Sint Maarten						
General government balance	-2.2	-6.5	-2.4	-0.9	3.6	-0.5
General government debt	17.6	30.7	29.0	31.8	28.3	27.6
Balance of payments (in percent of GDP, unless otherwise indicated) 3/						
Trade balance	…	-54.1	-52.7	-45.6	-48.2	-48.0
Current account	…	-19.0	-25.4	-16.6	-25.7	-24.3
Exports of goods and services	…	76.0	80.7	71.9	68.2	71.0
Imports of goods and services	…	95.9	105.4	92.0	93.9	96.1
Net foreign direct investment	…	5.4	6.0	2.4	2.7	2.3
Net official reserves (U.S.$ mill.)	…	905	1123	1223	1263	1330
Exchange rate						
Guilder per US$	1.79	1.79	1.79	1.79	1.79	1.79
Real effective rate (2007=100) 4/						
Curaçao	…	100.0	96.2	93.8	100.1	...
Sint Maarten	…	100.0	99.7	101.4	103.0	…

Sources: National authorities; and IMF staff estimates.

1/ Staff projections.

2/ Data from 2006–2010 reflects the fiscal operations of the local island government. Data from 2011 onwards refers to the new island government that has integrated the fiscal operations of the previous central government of the Netherlands Antilles.

3/ Refers to the sum of the BOP of the two island economies.

4/ Based on CPI.