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LAPSE OF TIME

SM/20/58
Correction 1

March 26, 2020

To: Members of the Executive Board

From: The Secretary

Subject: **Kingdom of the Netherlands—Curaçao and Sint Maarten—Staff Report for the 2019 Article IV Consultation Discussions**

Board Action:	The attached corrections to SM/20/58 (3/3/20) have been provided by the staff:
Evident Ambiguity	**Pages 1 and 74**
Factual Errors Not Affecting the Presentation of Staff's Analysis or Views	**Pages 8 and 20**
Typographical Errors	**Pages 13, 18, 55**
Questions:	Mr. Kovtun, WHD (ext. 39785)

INTERNATIONAL MONETARY FUND

KINGDOM OF THE NETHERLANDS—CURAÇAO AND SINT MAARTEN

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION DISCUSSIONS

March 3, 2020

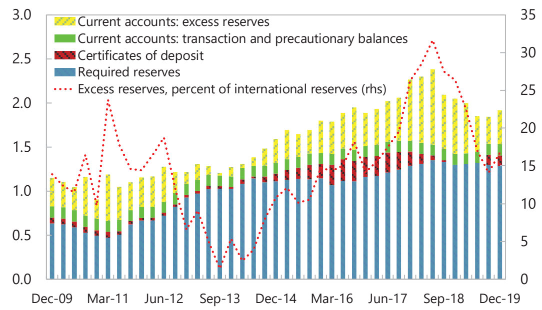
~~COVID-19~~. The staff report was prepared by a staff team of the IMF for the Executive Board's consideration on March 18, 2020. The staff report reflects discussions with the Kingdom of the Netherlands—Curaçao and Sint Maarten authorities in November 2019 and is based on the information available as of March 3, 2020. It focuses on Curaçao and Sint Maarten's near and medium-term challenges and policy priorities and was prepared before COVID-19 became a global pandemic and resulted in unprecedented strains in global trade, commodity and financial markets. It, therefore, does not reflect the implications of these developments and related policy priorities. The outbreak has significantly worsened the outlook and greatly amplified uncertainty and downside risks around it. Staff is closely monitoring the situation and will continue to work on assessing its impact and the related policy response in Curaçao and Sint Maarten and globally.

Context. The monetary union of Curaçao and Sint Maarten (Union) has been grappling with negative shocks. Curaçao experienced four years of recession mainly due to significant spillovers from the Venezuela crisis and has fragilities in the financial system. Sint Maarten's recovery after the devastating 2017 hurricanes has been uneven, demonstrating small island constraints and structural impediments. The external position of the Union worsened in the past two years, putting some pressure on international reserves. These shocks have exposed long-standing rigidities and highlighted the need for wide-ranging reforms. Governance concerns remain at the forefront in both countries.

Outlook and risks. The Union's growth outlook is improving but remains fragile. Curaçao's outlook is vulnerable to setbacks with reviving the oil refinery and to possible spillovers from financial sector fragilities. The ongoing recovery of Sint Maarten is vulnerable to delays in key projects such as reconstruction of the airport.

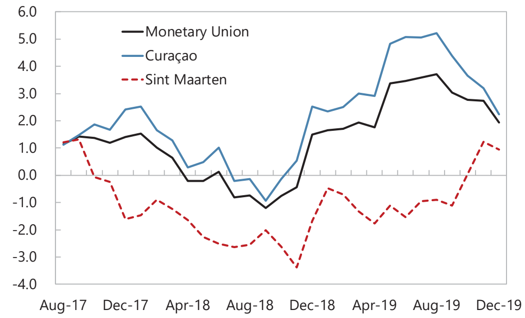
Policy recommendations. Improving the functioning of the Union requires better policy frameworks, stronger buffers, and a strong macro framework based on better data. Both countries need steady implementation of structural reforms in conjunction with gradual fiscal adjustment to raise potential growth and maintain fiscal sustainability. Sint Maarten should step up efforts in post-hurricane reconstruction and requirement ratio from 18 to 19 percent in mid-February 2020. It also introduced ~~foreign exchange-~~ U.S. dollar- denominated CDs to increase international reserves.

Central Bank Liabilities to Banks
(Billions of NA*f* unless otherwise indicated)



Source: The CBCS and IMF staff estimations.

Bank Loans to Non-Government Sectors
(y/y change)



Source: The CBCS.

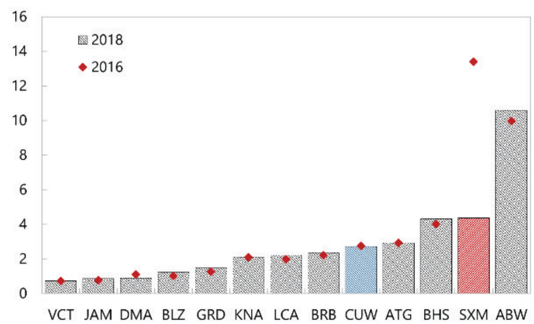
9. The negative shocks have heightened vulnerabilities in the banking system, particularly in Curaçao. As of June 2019, the union-wide capital adequacy ratio (CAR) was close to the regulatory minimum of 10 percent (Table 10), but it varied across banks. Nonperforming loans (NPLs) in Curaçao and Sint Maarten reached 12.7 and 8.3 percent of gross loans. Provisioning is low (32.1 and 39.1 percent in Curaçao and Sint Maarten, respectively), suggesting that bank capital may be overstated. In 2018, the CBCS placed Ennia, a large insurance company, under special administration. In September 2019, the CBCS also intervened in Banco del Orinoco NV, an international (off-shore) bank, which was subsequently declared bankrupt by the court.[11] In December 2019, the CBCS froze large deposits of Girobank, a medium-size bank in Curaçao which had been under special CBCS' administration since 2013; the Curaçao authorities have since announced that a Deposit Guarantee System (to be established in 2020) will take over CBCS' claims related to the payout of small deposits in Girobank.[12] These cases emphasize the urgent need to improve financial sector supervision and regulation, governance, and the resolution framework. The potential loss of correspondent banking relationships (CBRs) also remains a significant risk. In 2017–18, the banking system lost 17 CBRs, which was partially offset by 10 new CBRs, and Deutsche Bank recently terminated its relationship with Curaçao. In 2018, the CBCS established the De-Risking Taskforce, which developed an action plan to address CBR risks.

[11] In Curaçao, the term "international bank" denotes institutions licensed to conduct business only with non-residents. International banks have limited linkages with the local economy.

[12] The deposit freeze was precipitated by a bank run. The CBCS announced that deposits up to NA*f* 10,000 will be paid out, and the government subsequently announced that it intends to protect all depositors. The CBCS has a significant exposure (close to 5 percent of GDP) to Girobank. The authorities are working on a strategy towards Girobank resolution.

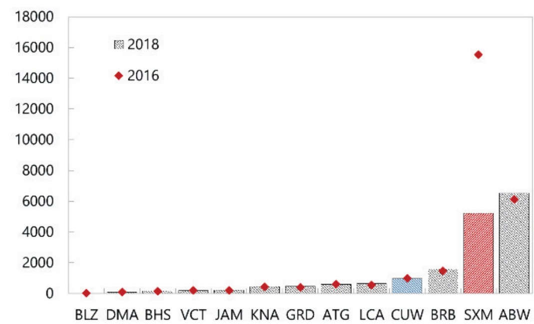
impact and safeguarding tourism quality in light of high tourism density. In Curaçao, the increasing importance of the tourism sector stresses the need to update the tourism master plan defining the appropriate business model.

Stay-Over Visitors Per Capita



Sources: Caribbean Tourism Organization and IMF staff estimates.

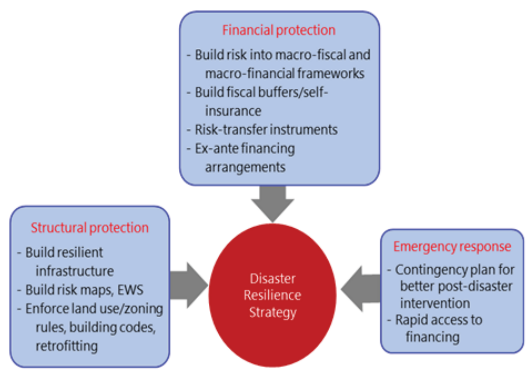
Stay-Over Visitors Per km²



Sources: Caribbean Tourism Organization and IMF staff estimates.

- ***Building resilience to natural disasters.*** The Sint Maarten authorities could benefit from a comprehensive three-pronged Disaster Resilience Strategy (DRS). Sint Maarten's National Recovery and Resilience Plan contains some of the elements covered in a DRS, such as the "build back better" principle, and Trust Fund resources have been used for Sint Maarten's membership in the Caribbean Catastrophe Risk Insurance Facility (CCRIF), increasing the financial resilience through risk transfer. However, attention should also be given to measures such as early warning systems, building codes, post-disaster decision-making process and ensuring adequate capacity of the emergency services. When fiscal space allows, the authorities should build a fiscal buffer.

National Disaster Resilience Strategy



Authorities' Views

17. In both countries, the authorities acknowledged the need for broad-based structural reforms. The Curaçao authorities noted that structural reforms—including improving the business climate, strengthening public financial management and administration—are part of their policy priorities as evidenced by the Growth Accord and their Growth Strategy. They are working on legislation to cut red tape. They pointed out that people on social assistance are offered retraining for work within the hospitality sector but noted that this is not likely to be enough to address the lack of supply of human capital in the hospitality sector. In Sint Maarten, the authorities, business sector, and the unions have developed a Tripartite consensus document covering desired labor market reforms (promoting flexibility and security), although the reform has been put on hold. In needs to be done in a way that avoids long-term fiscal risks. To improve transparency, the authorities should improve the timeliness of preparation and publication of fiscal financial reports.

27. Strong implementation of these reforms and additional measures are needed to reduce debt and build resilience to natural disasters. A fiscal path reducing debt to 40 percent of GDP by 2030 would be more consistent with the objectives of fiscal sustainability and resilience. This would require achieving a primary surplus excluding grants of about 0.3 percent of GDP by 2025, implying additional fiscal adjustment of about 1.2 percent of GDP relative to the staff's baseline projections. On the revenue side, the authorities could consider the feasibility of introducing excises on alcohol and tobacco (while maintaining competitiveness with the French part of the island) and rationalizing existing tax expenditures. On the expenditure side, a functional review of the civil service and rationalizing subsidies could find scope for some savings. Strong structural reform is needed to boost potential GDP and debt sustainability. In staff's illustrative active scenario, real GDP growth would be slightly lower in 2021−22 due to the additional fiscal consolidation but slightly higher afterward due to assumed higher capital expenditure and the implementation of growth-increasing structural measures.[19] These measures would also allow building a fiscal buffer to improve resilience to natural disasters (staff's projections include savings of 0.5 percent of GDP from 2022).

Sint Maarten: Selected Fiscal Indicators, 2019 - 30

(Percent of GDP, unless otherwise indicated)

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
						Baseline Projections						
Revenue	25.3	30.8	34.3	29.8	29.8	29.8	29.6	24.5	24.6	24.6	24.6	24.6
Expenditure	27.0	29.5	29.4	29.3	30.1	30.7	30.6	29.6	28.7	27.7	26.8	26.0
of which : Capital expenditure	0.3	3.1	2.8	2.3	2.3	2.2	2.1	2.1	2.2	2.2	2.3	2.3
of which: Accumulation of fiscal buffer	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Primary balance	-0.9	2.0	5.5	1.0	0.2	-0.4	-0.6	-4.7	-3.7	-2.7	-1.7	-0.9
Excl. Trust Fund grants and spending	-0.8	-3.1	-2.3	-1.5	-1.4	-1.1	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9
Gross central government debt	51.3	52.6	55.3	55.0	54.8	54.4	53.2	52.2	51.2	50.4	49.6	48.9
of which : EIB loan 1/		1.2	4.5	4.3	4.1	3.9	3.5	3.1	2.8	2.5	2.1	1.9
Real GDP growth (annual percent change)	5.0	2.9	2.5	2.7	2.3	2.1	2.0	2.0	2.0	2.0	2.0	2.0
						Illustrative Active Scenario						
Revenue	25.3	30.8	34.7	30.7	30.7	30.7	30.5	25.4	25.5	25.5	25.5	25.5
Expenditure	27.0	29.3	29.2	29.6	30.2	30.6	30.3	29.2	28.3	27.3	26.4	25.5
of which : Capital expenditure	0.3	3.1	2.8	2.3	2.3	2.2	2.2	2.2	2.2	2.3	2.3	2.4
of which: Accumulation of fiscal buffer	0.0	0.0	0.0	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Primary balance	-0.9	2.2	6.0	1.6	1.0	0.6	0.6	-3.4	-2.4	-1.4	-0.5	0.3
Excl. Trust Fund grants and spending	-0.8	-3.0	-1.8	-0.9	-0.6	-0.1	0.3	0.3	0.3	0.3	0.3	0.3
Gross central government debt	51.3	52.4	54.7	54.1	53.0	51.6	49.2	46.9	44.6	42.6	40.7	38.8
of which : EIB loan 1/		1.2	4.5	4.3	4.1	3.9	3.5	3.1	2.8	2.4	2.1	1.8
Real GDP growth (annual percent change)	5.0	2.9	2.3	2.3	2.3	2.3	2.3	2.5	2.5	2.4	2.4	2.4

Source: IMF staff projections.

1/ EIB loan is on-lent to the airport.

[19] Given the small economic size and high trade openness of Sint Maarten, fiscal multipliers are likely to be small (0.4−0.6 upon impact), implying that the impact of fiscal adjustment on GDP could be limited. This is supported by empirical work on other small states (of which many in the Caribbean) that show that fiscal multipliers are close to zero over the medium term but somewhat larger on impact, see "Fiscal Policy Multipliers in Small States," IMF Working Paper No. 19/72. An exception is the multiplier for capital expenditure which tends to be larger.

Maarten should consider operationalizing the Treasury Single Accounts in the CBCS. Over the longer term, the authorities should consider revising the current standing subscription framework to enable the orderly development of the domestic debt market and therefore new monetary policy tools.

31. **Significant risks in the financial system need to be addressed promptly, including by strengthening financial sector oversight and reforming the bank resolution framework**. The protracted recession and incidents of mismanagement have increased financial system fragilities in Curaçao, which could spill over to the rest of the system and the broader economy, if not properly handled. The authorities should develop a plan to resolve Girobank in a way that preserves financial stability while minimizing the fiscal cost. They should also conduct a thorough diagnostic to assess the strength of other deposit takers and develop a strategy to deal with any issue that may be identified. This will require legal amendments to strengthen supervision, including the development of a prompt corrective action regime, and bring the bank resolution framework in line with international standards. Given elevated NPLs (especially in Curaçao), the authorities should also develop a strategy to facilitate their resolution. To strengthen the insurance sector, the authorities should design a strategy for Ennia's successful exit from the CBCS's special administration regime. The authorities have requested technical assistance from the Fund to help bring their banking and insurance supervision and resolution frameworks in line with international good practice. In the short term, the authorities should prioritize efforts to bolster financial system stability over diverting resources to the fintech area. Staff recommended that a Deposit Guarantee System be established only after financial sector vulnerabilities have been addressed.

Authorities' Views

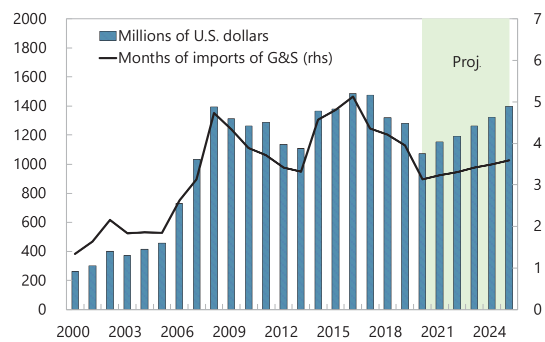
32. **The CBCS broadly agreed with staff's analysis.** The CBCS agreed that monetary policy should support the peg more actively, but noted that absorbing more liquidity would entail costs for the CBCS. The Monetary Policy Committee will consider recommendations from the recent Fund technical assistance on monetary policy instruments. Moreover, the CBCS agreed that financial sector fragilities should be addressed as a matter of priority. The CBCS is planning to strengthen its supervision and resolution functions through hiring additional supervision staff and requesting technical assistance to advise on options for strengthening the bank resolution framework. The authorities expressed their intent to amend the legal framework and are considering introducing a deposit insurance scheme.

D. Improving Governance

33. **Governance concerns remain at the forefront in both countries.** The CBCS needs to complete its governance structure by appointing a President. A significant strengthening of supervision and an overhaul of the bank resolution framework are needed to improve governance in the financial sector. The Curaçao and Sint Maarten authorities should be prepared to recapitalize the CBCS if its capital buffer fell below the required norm due to addressing pockets of vulnerability in the financial sector or costs related to monetary policy. Both countries have taken steps to establish

~~4.~~ months of imports of G&S) in 2016 to $1.3 billion (4 months of imports) in 2019. In 2019, international reserves were slightly above traditional measures of reserve adequacy (3 months of imports of goods and services, 100 percent cover of short-term debt, 20 percent cover of broad money), but below the IMF's risk-weighted measure.[1] They are projected to decline to around 3.1 months of imports in 2020 and increase slightly thereafter.

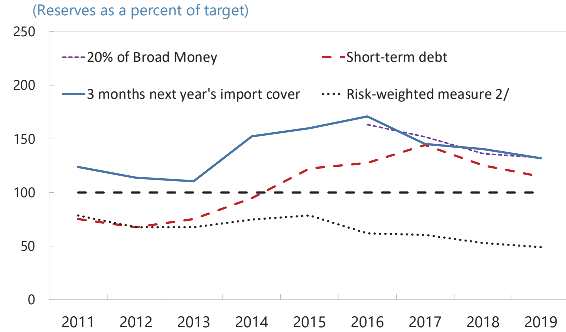
The Union: Gross International Reserves



Sources: The CBCS and IMF staff estimations.

Reserve Adequacy 1/

(Reserves as a percent of target)

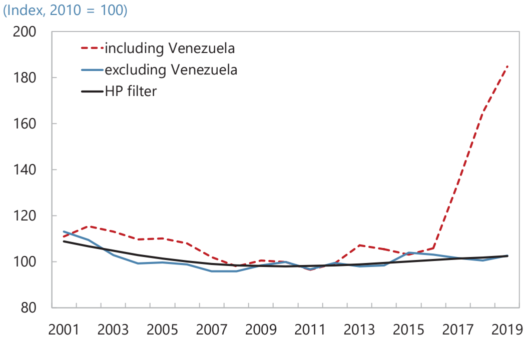


Sources: IMF staff estimates.
1/ Values >100 indicate reserves in excess of the metric recommended level.
2/ Based on IMF policy paper *Assessing Reserve Adequacy*, 2011.

~~5.~~ 4. **The real effective exchange rate (REER) indexes and the "Week at the beach" (W@TB) index do not suggest a price competitiveness issue.**[2] In Curaçao, the REER estimated using trading partner weights over the past 10 years suggests a sharp appreciation due to Venezuela. The REER excluding Venezuela—which is more appropriate given that the trade with Venezuela shrank significantly in recent years—is flat, and the W@TB index suggests that Curaçao remains a relatively low-cost destination. In Sint Maarten, REER has appreciated by 12 percent since 2008. However, the W@TB index for Sint Maarten is still lower than the regional average.

Curaçao: Real Effective Exchange Rate

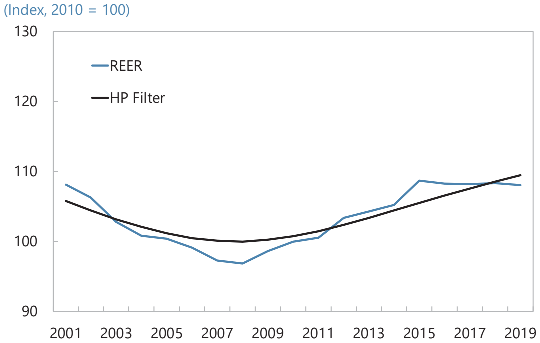
(Index, 2010 = 100)



Source: IMF staff estimations.

Sint Maarten: Real Effective Exchange Rate

(Index, 2010 = 100)



Source: IMF staff estimations.

[1] IMF, 2011, Assessing Reserve Adequacy, available from https://www.imf.org/external/np/pp/eng/2011/021411b.pdf

[2] The W@TB index is based on Laframboise, Mwase, Park, and Zhou (2014), IMF Working Paper No. 14/229.

INTERNATIONAL MONETARY FUND

COM COMMUNICATIONS DEPARTMENT

Appendix I. Draft Press Release

Press Release No. 20/X
FOR IMMEDIATE RELEASE
March XX, 2020

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2019 Article IV Consultation Discussions with the Kingdom of the Netherlands—Curaçao and Sint Maarten

On March [18], 2020, the Executive Board of the International Monetary Fund (IMF) concluded the 2019 Article IV consultation discussions[1] with Curaçao and Sint Maarten, two autonomous constituent countries within the Kingdom of the Netherlands, and considered and endorsed the staff appraisal without a meeting.[2] These consultation discussions form part of the Article IV consultation with the Kingdom of the Netherlands.

The analysis below reflects discussions with the Kingdom of the Netherlands—Curaçao and Sint Maarten authorities in November 2019 and is based on the information available as of March 3, 2020. It focuses on Curaçao and Sint Maarten's near and medium-term challenges and policy priorities and was prepared before COVID-19 became a global pandemic and resulted in unprecedented strains in global trade, commodity and financial markets. It, therefore, does not reflect the implications of these developments and related policy priorities. The outbreak has significantly worsened the outlook and greatly amplified uncertainty and downside risks around it. Staff is closely monitoring the situation and will continue to work on assessing its impact and the related policy response in Curaçao and Sint Maarten and globally.

Over the last few years, Curaçao and Sint Maarten have faced significant challenges. Curaçao has been in a recession since 2016 mainly due to continued spillovers from the Venezuela crisis, and real GDP contracted by an estimated 2 percent in 2019. The unemployment rate increased to 21.2 percent in April 2019, among the highest in the region. The economy of Sint Maarten was severely damaged by Hurricanes Irma and Maria in 2017 and despite €550 million pledged by The Netherlands to support reconstruction, rebuilding has been slow. Real GDP is estimated to have

[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. The IMF can also hold consultation discussions with parts of IMF members; these discussions form part of the Article IV consultation with the member.

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