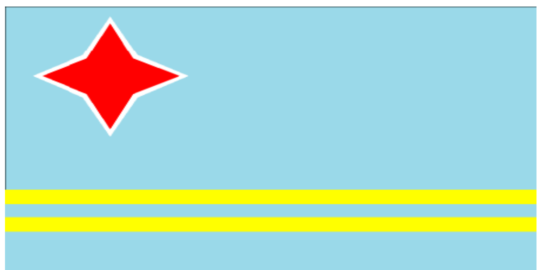
COUNTRY REVIEW

Aruba



12 November 2009

ANALYST: David Atkinson

<u>EULER HERMES COUNTRY RISK GRADE: B</u>

Country Risk Grades are on a scale of AA, A, BB, B, C, D

where AA is the lowest and D the highest risk.

Strengths

- Sound political institutions within a parliamentary framework
- Constitutionally within the umbrella of the Netherlands and strong links provide some financial support
- High levels of real income
- Market-oriented policy framework
- Low external debt levels

Weaknesses

- Over-dependence on tourism based on arrivals from US and Venezuela
- Rising public debt ratios
- Volatile current account balance and FDI flows
- Pegged exchange rate
- Patchy data

Country Risk Assessment

Ratings	Aruba		Median	Peers		
	Latest	Previous	Grade B	Uruguay	Peru	Costa Rica
Systemic Political Risk:	**P2+**	**P2+**	**P2-**	**P2+**	**P3+**	**P2+**
Systemic Economic Risk:	**E4**	**E4**	**E4**	**E4**	**E4**	**E4**
ME rating:	ME4	ME4	ME4	ME4	ME4	ME4
Structure	*5.0*	*5.0*	*5.0*	*4.0*	*5.0*	*2.3*
Policy	*4.8*	*2.8*	*4.0*	*5.6*	*3.8*	*5.8*
Solvency	*1.9*	*2.9*	*2.5*	*3.8*	*2.8*	*1.3*
External Liquidity	*4.5*	*5.2*	*3.7*	*3.2*	*2.8*	*5.5*
SBE rating:	SBE3	SBE3	SBE3	SBE3	SBE3	SBE3
COUNTRY GRADE:	**B**	**B**	**B**	**B**	**B**	**B**

Nomenclature:
Political Risk Ratings are on a scale of P1 (lowest risk), P2+, P2-, P3+, P3-, P4 (highest risk).
Economic Risk Ratings are on a scale of E1 (lowest risk), E2, E3, E4, E5, E6 (highest risk).
ME (Macro-Economic) ratings are on a scale of ME1 (lowest risk), ME2, ME3, ME4, ME5, ME6 (highest risk).
The constituent parts of the ME rating are on a scale of 1.0 (best) to 6.0 (worst).
SBE (Structural Business Environment) ratings are on a scale of SBE1 (best), SBE2, SBE3, SBE4, SBE5, SBE6 (worst).
Country Grades are on a scale of AA, A, BB, B, C, D where AA is the lowest and D the highest country risk.

Source: Euler Hermes Country Risk Unit

ECONOMIC STRUCTURE

Country Profile	
Capital city:	Oranjestad
Population:	0.11 mn (2008)
GDP:	USD 2724 mn (2008)
Currency:	Aruban guilder/florin (AWG)
Form of state:	Parliamentary democracy
Head of government:	PM Eman
Next elections:	2010

Major Industries (% of GDP at market prices)
Not available

Global Assumptions	2009	2010
Real GDP grth (% yr/yr) *	-3.9	0.9
Inflation (%, av) *	-0.1	1.3
Dated brent (USD/b)	61	72

* Major economies

Main Exports (% of total, 2008)	
General merchandise	2.3%
Free zone	2.0%
Other sectors	0.3%
Goods for processing	95.2%
Other	2.6%

Main Imports (% of total, 2008)	
General merchandise	31.8%
Oil sector	10.1%
Free zone	1.7%
Other sectors	19.9%
Goods for processing	68.2%

Lead Export Markets (% of total exports, 2007)	
Panama	29.7%
Colombia	17.0%
US	11.3%
Venezuela	10.9%

Lead Import Markets (% of total imports, 2007)	
US	54.6%
Netherlands	12.0%
UK	4.7%
Colombia	3.0%

Basic indicators

Selected economic indicators	2006	2007	2008	2009f	2010f
Nominal GDP (USD mn)	2,421	2,563	2,724	2,847	2,989
Population (mn)	0.10	0.10	0.11	0.11	0.11
GDP per capita (USD)	24,210	25,630	24,764	25,878	27,172
Real GDP growth (% yr/yr)	0.6	-0.1	-1.6	-2.5	1.0
Inflation (%, eop)	2.5	9.9	-1.9	6.5	4.0
Fiscal balance (% of GDP)	-2.8	-1.6	1.1	-4.5	-3.5
Current account balance (% of GDP)	-1.6	7.4	-5.7	1.9	0.0
External debt/GDP (%)	53	54	53	53	52
External debt/Exports of goods & services (%)	25	33	27	45	38
Interest payments/Exports of goods & services (%)	2	2	2	3	3
Foreign exchange reserves (USD mn)	338	372	605	600	610
Import cover (months)	0.8	1.2	1.4	2.2	1.9
Exchange rate assumption, AWG:USD (av)	1.79	1.79	1.79	1.79	1.79
f: CRU central forecast					

Sources: National, IMF, World Bank, Euler Hermes Country Risk Unit

Political Stability

Aruba has been autonomous within the Kingdom of the Netherlands since separating formally from the Netherlands Antilles in 1986. The island authorities have full control over internal affairs, while the Netherlands has responsibility for defence and foreign affairs. There are no deep ethnic or religious divisions, living standards are high and the transfer of power is orderly within the framework of a parliamentary democracy. Institutions are robust and income inequality is relatively low. The World Bank Institute's latest Worldwide Governance Indicators put political stability and government effectiveness above average for both high income economies and the Caribbean region. In the event of crisis the Netherlands may provide financial support. The Dutch government has also announced an enquiry into corruption on the island.

Elections in September 2009 were won by the opposition Aruban People's Party (AVP) by a comfortable margin giving the party an absolute majority (12 seats in parliament out of 21). The AVP is led by Mike Eman becomes the new PM, ending eight years of rule by Nelson Obuder of the People's Electoral Movement (MEP). A generally market-oriented policy agenda can be expected to be maintained.

Economic Stability

Per capita GDP is relatively high at around USD25,000. Tourism, mainly from the US (around 70% of arrivals) dominates the economy, accounting for more than 50% of GDP. Oil refining (a single refinery) is also important. The narrow base leaves the economy highly exposed to the US economic cycle and the oil market.

Real GDP contracted in 2007 and 2008 and probably will decline further in 2009 by 2-3%, as tourism has been hit by the US recession, exacerbated by oil demand weakening in 2009 affecting throughput of the refinery. With both tourism and oil demand recovering the economy should return to growth of around 1% in 2010.

The fiscal balance was in surplus in 2008 (1.1% of GDP) but largely as a result of transfers from the Netherlands government relating to the sale of hotels. Nonetheless, this allowed the authorities to reduce government debt, in the process lowering the government debt-GDP ratio to 42% from 47% at end-2007. However, in 2009 revenues have fallen while spending as continued to increase to cushion the impact of the recession. Overall, the deficit could rise to 4.5% of GDP and will only narrow slightly in 2010. As a result the government debt-GDP ratio will return to 45-50%. In the medium-term there is a need to reduce the costs of the public health and pension schemes.

Monetary policy is geared to the US dollar exchange rate peg, the credibility of which is retained by the maintenance of adequate net foreign assets of the monetary sector, which covered more than eight months of merchandise goods imports excluding the oil sector (which are imports destined for the oil refinery for re-export) in at end-Q1 and 6.2 months of total import payments. Bank lending growth has not been excessive in recent years. As a result of the exchange rate peg inflation is generally low, tracking that of the US, though it accelerated to 10.2% yr/yr at end-2007 as result of one-off shocks, but deflation had set in by end-2008 and has persisted so far in 2009, though a return to inflation should be evident by year-end with a return to the low trend rate through 2010.

The current account balance is volatile, swinging from deficit of 8.7% of GDP in 2005 to surplus of 7.4% in 2007 before returning to deficit of 5.7% in 2008. In 2009 a surplus should re-emerge as both exports and imports have fallen sharply and should remain in rough balance in 20100. FDI is also lumpy. The pegged exchange rate has credibility and a long track record, which offsets the low level of import cover on traditional measures, which in any event at just over 2 months currently stands above the long-term average of 1.1. External debt-GDP is a relatively high 53% of GDP, but a relatively modest 45% of exports of goods and services. Interest payments as a proportion of exports of goods and services are estimated to be low (2-3%). Moreover, at end-2008 Aruba was a net public sector creditor.

Structural Business Environment

The Structural Business Environment is generally sound, ranking above average our assessment, but falling short of the strongest ratings overall.

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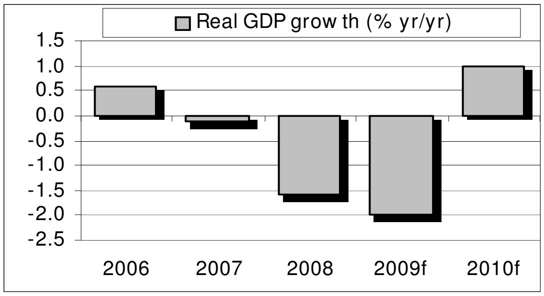
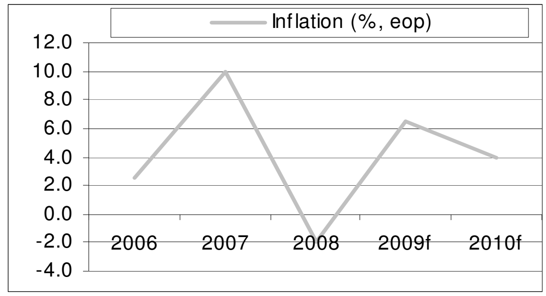
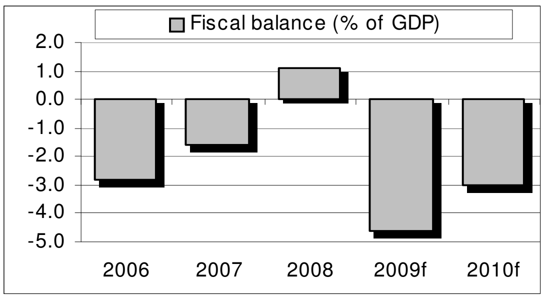
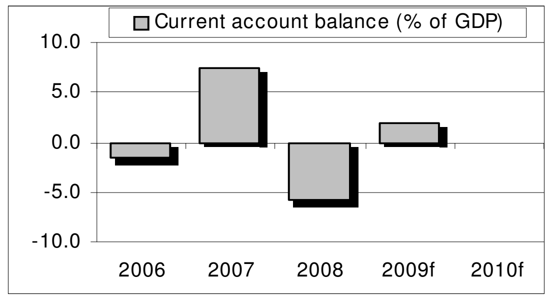
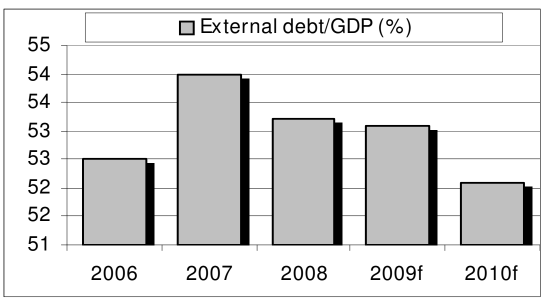
Charts

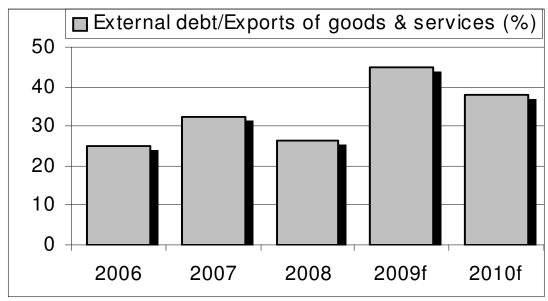

Real GDP grow th (% yr/yr)
1.5
1.0
0.5
0.0
-0.5
-1.0
-1.5
-2.0
-2.5
2006
2007
2008
2009f
2010f

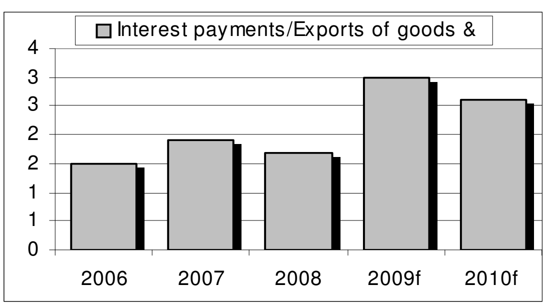

Inflation (%, eop)
12.0
10.0
8.0
6.0
4.0
2.0
0.0
-2.0
-4.0
2006
2007
2008
2009f
2010f

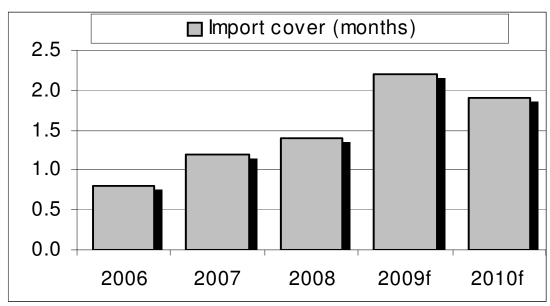

Fiscal balance (% of GDP)
2.0
1.0
0.0
-1.0
-2.0
-3.0
-4.0
-5.0
2006
2007
2008
2009f
2010f


Current account balance (% of GDP)
10.0
5.0
0.0
-5.0
-10.0
2006
2007
2008
2009f
2010f


External debt/GDP (%)
55
54
54
53
53
52
52
51
2006
2007
2008
2009f
2010f


External debt/Exports of goods & services (%)
50
40
30
20
10
0
2006
2007
2008
2009f
2010f


Interest payments/Exports of goods &
4
3
3
2
2
1
1
0
2006
2007
2008
2009f
2010f


Import cover (months)
2.5
2.0
1.5
1.0
0.5
0.0
2006
2007
2008
2009f
2010f