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Research Update:

Aruba Outlook Revised To Positive On Better Economic Expectations; 'BBB+/A-2' Ratings Affirmed

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Overview

- The agreement between CITGO and Aruba to reopen its refinery could improve Aruba's growth. However, uncertainty remains about the investment timeframe.
- The ratings on Aruba reflect the strong ties with the Kingdom of the Netherlands, strengthened by a fiscal agreement.
- We are revising our outlook on Aruba to positive and affirming our 'BBB+/A-2' sovereign credit ratings.
- The positive outlook reflects our view that the reopening of the refinery could result in higher economic growth and a stronger external position. Coupled with the fiscal consolidation agreement, we could also expect a faster improvement in fiscal indicators.

Rating Action

On June 6, 2016, S&P Global Ratings revised its outlook on Aruba to positive from stable. We also affirmed our 'BBB+/A-2' long- and short-term sovereign credit ratings on Aruba. In addition, we affirmed our transfer and convertibility assessment of 'BBB+'.

Rationale

Our outlook revision reflects the agreement between Aruba and CITGO to reopen Aruba's refinery. Uncertainty about CITGO's capacity to have the refinery working in the planned timeframe weighs on our analysis, but if implemented, we would expect to see stronger foreign direct investment (FDI) inflows bolstering GDP growth, as well as a stronger external position. Faster growth, coupled with Aruba's fiscal agreement with the Netherlands, could result in fiscal consolidation and debt decreasing faster than we expect in our base-case scenario.

That said, the ratings on Aruba reflect its stable political system based on parliamentary democracy, its status as a member of the Kingdom of the Netherlands, and its relatively high $25,000 per capita GDP. They also reflect its narrow, open economy, which is highly dependent on tourism, and its limited monetary flexibility due to its fixed exchange rate.

On May 13, 2016, CITGO reached an agreement to reopen Aruba's refinery. CITGO will run the refinery under a 15-year lease agreement (with a 10-year extension option), and we expect it to invest around $1 billion on upgrading works and blend around 235,000 barrels per day of heavy Venezuelan oil. According to the plan, the refinery will be operating in 2018. The agreement also involved the refinery's former operator Valero Energy Group, a U.S. oil company, which transferred the facility and gasoline stations assets to the Aruban government in exchange for a relief in its contractual obligations regarding environmental contingencies and the dismantling of the refinery.

The sizable investment, which is equivalent to 40% of the country's GDP, and the subsequent refining operations should bolster GDP growth, expand Aruba's export base, gradually improve its external position, and potentially strengthen fiscal revenues (a new fiscal framework will be discussed in parliament). However, there is uncertainty about the timely execution of the agreement. We believe the possibility of CITGO being drawn into a potential Petróleos de Venezuela S.A. (PDVSA; Venezuela's state-owned oil company) bankruptcy is low, but the company's highly leveraged profile might limit its capital expenditure capacity. Moreover, we cannot rule out the possibility of PDVSA selling assets abroad, which could include CITGO, to generate additional foreign currency funding to make timely payments on its external debt. This could result in a significant delay of the planned reopening, and it's the main reason we don't include this operation in our base-case forecast.

Therefore, our base case incorporates GDP growth of below 2% during 2016-2018, driven by somewhat higher tourism arrivals, a relatively stable tourist expenditure average, and faster execution of government public works. We expect GDP per capita of around $25,000 in 2016. GDP growth in 2015 was only 0.1%, below our expectation, because of low private confidence, lower available income given the recent pension and health care reforms (which reduced available income), delays on the main government infrastructure projects, and the postponement of the Bahía Principe Hotel (the largest private infrastructure project in the pipeline).

Following pension and health care reforms (approved in 2014), the fiscal agreement with the Netherlands in May 2015, the establishment of the CAFT (College Aruba Financieel Toezicht, an independent council in charge of fiscal oversight), and expenditure containment and a more active revenue collection strategy, Aruba's general government deficit declined to 3.3% of GDP in 2015 from 6.3% in 2014. (The general government deficit incorporates the results of the pension funds and various social welfare funds.) The fiscal agreement contemplates a 2% general government deficit in 2016, 0.5% deficit in 2017, and a surplus in 2018. Our base case estimates that Aruba will be able to broadly comply with the goals, and we expect general government deficits of around 2% of GDP on average during 2016-2018. In our opinion, successful execution of the government's budget targets relies on both the CAFT being able to promote measures (if necessary) to achieve a surplus by 2018 and the timely reopening of the refinery, which is not considered in our base-case projections.

In line with the 2015 results and our fiscal projections, we expect net general government debt (which includes APFA [the public-sector pension system] assets other than its holdings of central government debt) to stabilize during the next three years at around 23% of GDP. The low net general government debt is explained by the significant assets held by APFA, at around 40% of GDP. But considering the high gross central government debt (which we estimate at around 83% of GDP during 2016-2018), the interest burden will also continue to be high at 10% of general government revenues. That said, Aruba has enjoyed access to international debt markets, and as of year-end 2015, 50% of its debt was denominated in foreign currency.

We believe that contingent liabilities are limited. The banking sector is profitable and has adequate capital. The nonfinancial public sector is generally run on commercial lines and, in our view, poses limited contingent liabilities to the sovereign. We estimate its total debt to be less than 7% of GDP (owed by the power and water utility).

Under our base case, relatively low oil prices, moderate growth in tourism receipts, and lower government deficits will result in low current account deficits (CAD) of around 1% of GDP on average during 2016-2018. Some FDI inflows (mostly related to tourism activities) and government external debt should support stable international reserves during the same period. We expect narrow net external debt around 20% of current account receipts (CAR) during 2016-2018 and gross external financial needs to remain around 110% of CAR plus usable reserves during the same period. The gap between Aruba's net external liabilities and its narrow net external debt (both measured as a percentage of CAR), which will remain about 100% of CAR, and the volatility on Aruba's terms of trade highlight Aruba's external vulnerability.

A fixed exchange rate and a midsize financial system constrain the central bank's ability to conduct monetary policy. Also, the central bank's monetary policy instruments are limited mainly to reserve requirement on bank deposits.

Outlook

The positive outlook reflects our view that within the next two years, there is greater than one in three likelihood that timely reopening of the refinery, in terms of investment and production, could lead to faster GDP growth than in our base case. The new refinery would likely expand Aruba's export base and improve its external indicators. Coupled with the ongoing fiscal consolidation program, this should also help to reduce Aruba's fiscal deficits and debt level. An improvement in Aruba's economic profile and resilience could result in an upgrade within the next two years.

In contrast, we could revise the outlook to stable within the next 12 months if there are significant delays in the refinery project, resulting in continued low GDP growth. Delays on the refinery, coupled with significant deviations from the fiscal consolidation agreement, could lead to a downgrade within the next 24 months.

Key Statistics

Table 1

Selected Indicators	2009	2010	2011	2012	2013	2014	2015	2016f	2017f	2018f
ECONOMIC INDICATORS (%)										
Nominal GDP (bil. LC)	4.47	4.28	4.56	4.54	4.62	4.74	4.84	4.94	5.09	5.27
Nominal GDP (bil. $)	2.50	2.39	2.55	2.53	2.58	2.65	2.70	2.76	2.84	2.94
GDP per capita (000s $)	24.6	23.5	24.8	24.3	24.3	24.6	24.7	25.0	25.5	26.1
Real GDP growth	(11.3)	(3.4)	3.5	(1.4)	4.2	0.8	0.1	1.1	1.5	2.0
Real GDP per capita growth	(11.9)	(3.7)	2.7	(2.9)	2.2	(0.5)	(1.2)	0.0	0.4	0.9
Real investment growth	(16.6)	(10.8)	4.5	(8.4)	(12.1)	14.2	0.1	1.1	1.5	2.0
Investment/GDP	30.3	28.9	28.5	26.6	24.0	22.9	22.1	22.1	22.1	22.1
Savings/GDP	37.2	9.7	19.0	30.1	11.2	17.8	26.2	22.4	21.5	19.0
Exports/GDP	63.8	61.0	67.8	65.2	68.6	69.9	70.5	70.5	70.5	70.5
Real exports growth	(12.5)	(10.5)	4.6	(5.8)	5.9	3.4	0.1	1.1	1.5	2.0
Unemployment rate	10.3	10.6	8.9	9.6	7.6	7.5	7.5	7.5	7.5	7.5
EXTERNAL INDICATORS (%)										
Current account balance/GDP	6.9	(19.2)	(9.5)	3.5	(12.8)	(5.2)	4.1	0.3	(0.6)	(3.1)
Current account balance/CARs	4.8	(23.7)	(3.5)	2.7	(14.4)	(5.6)	4.3	0.3	(0.7)	(3.3)
Trade balance/GDP	(20.0)	(47.3)	(27.9)	(26.0)	(42.5)	(41.2)	(34.0)	(37.5)	(38.3)	(41.2)
Net FDI/GDP	(0.5)	7.6	19.1	(12.6)	8.6	9.0	(1.2)	0.8	0.8	1.7
Net portfolio equity inflow/GDP	(0.1)	0.3	0.5	5.8	2.8	4.1	2.3	1.4	1.4	1.3
Gross external financing needs/CARs plus usable reserves	99.0	132.2	106.2	99.9	122.4	116.7	107.5	109.2	111.1	114.7
Narrow net external debt/CARs	(0.8)	(1.3)	(1.3)	4.9	25.9	29.6	24.4	22.1	20.9	20.8
Net external liabilities/CARs	90.5	177.6	54.1	76.1	127.2	130.0	119.8	121.0	118.4	117.0
Short-term external debt by remaining maturity/CARs	9.8	17.3	4.2	10.3	16.8	16.2	16.1	15.7	16.3	16.2
Reserves/CAPs (months)	0.8	0.6	0.2	1.0	0.8	0.5	0.5	0.7	0.6	0.5
FISCAL INDICATORS (%, General government)										
Balance/GDP	2.4	(0.1)	(1.4)	(7.3)	(5.1)	(6.3)	(3.3)	(2.7)	(2.4)	(1.4)
Change in debt/GDP	2.9	2.7	6.6	6.3	5.4	3.8	3.6	2.7	2.4	1.4
Primary balance/GDP	5.0	2.8	1.6	(4.0)	(1.5)	(2.4)	0.8	1.5	1.8	2.8
Revenue/GDP	43.5	44.7	41.9	37.7	39.6	38.9	40.3	41.2	41.4	41.7
Expenditures/GDP	41.1	44.8	43.3	45.0	44.7	45.2	43.6	43.9	43.8	43.1
Interest /revenues	6.0	6.6	7.2	8.8	9.0	10.2	10.4	10.2	10.2	10.0
Debt/GDP	38.1	42.5	46.5	53.0	57.4	59.7	62.2	63.6	64.1	63.3
Debt/Revenue	87.5	95.1	110.9	140.7	144.9	153.5	154.3	154.2	154.9	151.6
Net debt/GDP	0.8	(0.4)	7.2	13.3	16.6	22.0	24.0	23.9	23.2	21.3
Liquid assets/GDP	37.2	42.9	39.2	39.7	40.8	37.7	38.2	39.7	40.9	41.9
MONETARY INDICATORS (%)										

Table 1

Selected Indicators (cont.)	2009	2010	2011	2012	2013	2014	2015	2016f	2017f	2018f
CPI growth	(2.2)	2.1	4.4	0.6	(2.4)	0.4	0.5	1.0	1.5	1.5
GDP deflator growth	2.7	(1.0)	3.0	0.8	(2.3)	1.8	1.9	1.0	1.5	1.5
Exchange rate, year-end (LC/$)	1.79	1.79	1.79	1.79	1.79	1.79	1.79	1.79	1.79	1.79
Banks' claims on resident non-gov't sector growth	(0.9)	1.1	2.8	3.4	5.4	3.9	(0.2)	2.1	3.0	3.5
Banks' claims on resident non-gov't sector/GDP	57.1	60.4	58.2	60.6	62.7	63.4	62.1	62.1	62.1	62.1
Real effective exchange rate growth	(2.8)	(0.5)	2.5	(2.1)	(5.2)	(5.8)	N/A	N/A	N/A	N/A

Savings is defined as investment plus the current account surplus (deficit). Investment is defined as expenditure on capital goods, including plant, equipment, and housing, plus the change in inventories. Banks are other depository corporations other than the central bank, whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private-sector borrowings from nonresidents minus official reserves minus public-sector liquid assets held by nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. LC--Local currency. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. The data and ratios above result from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. f--forecast.

Ratings Score Snapshot

Table 2

Ratings Score Snapshot	
Key rating factors	
Institutional assessment	Strength
Economic assessment	Neutral
External assessment	Weakness
Fiscal assessment: flexibility and performance	Strength
Fiscal assessment: debt burden	Strength
Monetary assessment	Neutral

S&P Global Ratings' analysis of sovereign creditworthiness rests on its assessment and scoring of five key rating factors: (i) institutional assessment; (ii) economic assessment; (iii) external assessment; (iv) the average of fiscal flexibility and performance, and debt burden; and (v) monetary assessment. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). Section V.B of S&P Global Ratings' "Sovereign Rating Methodology," published on Dec. 23, 2014 , summarizes how the various factors are combined to derive the sovereign foreign currency rating, while section V.C details how the scores are derived. The ratings score snapshot summarizes whether we consider that the individual rating factors listed in our methodology constitute a strength or a weakness to the sovereign credit profile, or whether we consider them to be neutral. The concepts of "strength," "neutral," or "weakness" are absolute, rather than in relation to sovereigns in a given rating category. Therefore, highly rated sovereigns will typically display more strengths, and lower rated sovereigns more weaknesses. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in assessment of the aforementioned factors does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the assessments.

Related Criteria And Research

Related Criteria

- Sovereign Rating Methodology, Dec. 23, 2014
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013

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- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee agreed that "external assessment" had deteriorated and that the "fiscal assessment" had improved. All other key rating factors were unchanged.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

Ratings Affirmed; Outlook To Positive

	To	From
Aruba		
Sovereign Credit Rating	BBB+/Positive/A-2	BBB+/Stable/A-2

Ratings Affirmed

Aruba	
Senior Unsecured	BBB+
Transfer & Convertibility Assessment	BBB+

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings public website at www.standardandpoors.com. Use the Ratings search box located in the left column.