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Research Update:

Cook Islands 'B+/B' Ratings Affirmed On Sound Tourism Prospects And Donor Support; Outlook Remains Stable

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Overview

- The Cook Islands' developing policymaking and institutional settings, narrow economic base with infrastructure shortcomings, absent monetary policy flexibility, and information deficiencies, particularly in the external accounts, weaken the country's credit quality.
- These weaknesses are balanced against the Cook Islands' strongly supportive relationship with New Zealand and donor agencies, the sound performance and outlook for the key tourism sector, and its low government debt burden.
- We are affirming the 'B+/B' sovereign credit ratings on Cook Islands. The outlook on the ratings remains stable.

Rating Action

On Feb. 3, 2017, S&P Global Ratings affirmed its 'B+/B' sovereign issuer credit ratings on the Cook Islands. The outlook remains stable. The Transfer & Convertibility assessment remains 'AAA'.

Rationale

The ratings on the Cook Islands reflects the vulnerabilities associated with its weak institutional settings, limited monetary policy flexibility, a narrow economic base that suffers from heavy emigration, and limited external data. These factors are partly offset by the government's supportive relationship and high labor mobility with the highly rated New Zealand sovereign, the use of the New Zealand dollar, the sound outlook for its key tourism sector, low borrowings, financial and technical assistance from donor agencies, and the country's insulated financial system.

The vulnerabilities associated with the country's weak policymaking culture and institutional settings are a key ratings constraint. The political framework has historically been fragmented and susceptible to policy shifts driven by populist sentiments that have hampered previous development and reform efforts. Limits to funding and skilled labor weigh on institutional capacity. The policymaking settings are supported by a vigorous free press, an outspoken business community, and efforts by major aid donors to promote sound financial and economic public-policy development and administration. There appears to be no significant off-budget transactions, and governance and transparency is adequate.

The Cook Islands also benefits from a close and comprehensive political, economic, defense, and foreign policy relationship with New Zealand. A large Cook Islands diaspora resident in New Zealand and Australia supports close ties with those countries. The security environment is good and the judicial system is robust.

The country's monetary policy flexibility is diminished because of its use of the New Zealand dollar and absence of a central bank. This arrangement means it forfeits monetary independence which is an important lever for promoting economic and financial stability. That said, its use of the New Zealand dollar has enabled the Cook Islands to benefit from lower inflation than its peers.

In addition, there is a lack of transparency in the activities of statutory authorities and other government-owned or government-controlled entities contributing to the Cook Islands' off-balance-sheet liabilities.

Inadequate coverage and timeliness of statistical releases is a key factor that restricts a robust analysis of its economic, external, and financial system performance. The Cook Islands is not a member of the United Nations or International Monetary Fund, and is not included in major international economic and social surveys such as the United Nations Development Index, and this also limits opportunities for comparison with the Cook Islands' peers.

The Cook Islands' moderate per capita income level and relatively low government debt burden support the rating. Income is high compared with that of its peers, with GDP per capita estimated at US$24,800 in 2017. During the past year, the government reinstated GDP over a number of historical years, significantly increasing both nominal and real GDP. We project Cook Islands' real per capita GDP growth will average 1.7% during 2017 to 2019, partly reflecting further expected declines in its population. High emigration has seen the residential population falling substantially during the past two decades, reflecting Cook Islanders' access to the New Zealand labor market, education, and healthcare systems.

The narrow-based economy is vulnerable to cyclones and changing tourism preferences on its major revenue earner, the tourism industry. We expect moderate further increases in tourist arrivals to support economic growth, with tourism remaining the country's primary economic activity. The weaker New Zealand dollar from previous highs, combined with new international flights and a major cyclone hitting a major competitor for tourists--Fiji--has benefited the Cook Islands' tourism. The Cook Islands still faces competition from other Pacific islands, though, particularly for Australian tourists.

We expect net debt to average 6.4% of GDP during the next few years, helped by upward GDP data revisions. The government's fiscal position is supported by a large one-off increase in grants during 2017, and weaker-than-expected execution of the government's large infrastructure program, including water, sanitation, and road infrastructure. We forecast the government's fiscal balances will remain broadly in balance between 2017 and 2019. We expect revenues to be volatile during the next few years, reflecting a large increase in 2017 of official grants, which are forecast to fall in 2018. These infrastructure projects are funded by official lending and could support the tourism sector prospects and the economy.

The concessional and long-term nature of current government borrowings, as well as the government's low debt, mean that the ratio of the general government interest expenditure to revenues is low, estimated to average 0.9% of revenues during2017 and 2019. A depreciation of the New Zealand dollar would adversely affect its debt-servicing costs because about 60% of this debt is exposed to foreign-currency movements.

We equalize the local currency rating with the foreign currency rating, reflecting the Cook Islands' absence of monetary policy flexibility and a domestic capital market, and its use of the New Zealand dollar. The transfer and convertibility assessment for the Cook Islands is 'AAA', which also reflects its use of the New Zealand dollar.

Outlook

The stable outlook balances the Cook Islands' tourism sector prospects and supportive relationship with New Zealand and donor agencies with the challenges it faces in overcoming weak political and institutional settings and infrastructure shortcomings to raise the prospects of the population

The rating could come under pressure over the next 12 months if there were a weakening in the government's commitment to uphold past fiscal gains through changes to economic or fiscal policies, resulting in weaker fiscal balances, and its debt burden rising by significantly more than we currently expect. Further, we could lower the ratings if weakening in global economic conditions reduces tourism sector receipts and, in turn, worsens the government's finances.

There is little prospect for improvements in creditworthiness over the next 12 months without sustained gains in policymaking stability and effectiveness, evidenced by the closing of sizable data deficiencies, a strengthening of the government's fiscal position, and progress in opening up the economy to create opportunities for residents to stem the population decline.

Key Statistics

Table 1

Cook Islands - Selected Indicators										
	--Year ended June 30--									
Mil. NZ$	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017e**	**2018f**	**2019f**	**2020f**
ECONOMIC INDICATORS (%)										
Nominal GDP (bil. LC)	0.4	0.4	0.4	0.4	0.4	0.4	0.5	0.5	0.5	0.5
Nominal GDP (bil. $)	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
GDP per capita (000s $)	18.2	20.7	21.6	23.2	23.7	23.5	25.5	25.3	25.9	25.8
Real GDP growth	(2.6)	4.0	0.5	4.5	4.8	5.5	3.5	1.1	0.5	3.8
Real GDP per capita growth	(21.1)	6.9	1.9	8.3	9.6	9.8	3.5	1.1	0.5	3.8
Real investment growth	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Investment/GDP	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Savings/GDP	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Exports/GDP	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Real exports growth	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Unemployment rate	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
EXTERNAL INDICATORS (%)										
Current account balance/GDP	12.4	20.5	23.9	38.2	22.7	41.0	36.8	39.0	39.8	40.6
Current account balance/CARs	11.9	21.5	25.6	36.1	27.2	40.7	43.2	44.7	46.1	45.9
CARs/GDP	103.8	95.3	93.4	105.9	83.5	100.8	85.3	87.2	86.3	88.5
Trade balance/GDP	(41.6)	(34.9)	(32.8)	(31.3)	(30.4)	(27.5)	(24.0)	(23.8)	(23.5)	(23.4)
Net FDI/GDP	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net portfolio equity inflow/GDP	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross external financing needs/CARs plus usable reserves	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Narrow net external debt/CARs	21.3	1.5	19.1	10.9	4.0	(1.6)	(1.8)	(1.8)	(1.7)	(1.7)
Net external liabilities/CARs	21.3	1.5	19.1	10.9	4.0	(1.6)	(1.8)	(1.8)	(1.7)	(1.7)
Short-term external debt by remaining maturity/CARs	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Reserves/CAPs (months)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Reserves (mil. $)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
FISCAL INDICATORS (%, General government)										
Balance/GDP	1.1	(2.2)	(2.1)	(4.3)	(4.6)	(1.7)	2.4	(3.4)	1.3	2.1
Change in debt/GDP	(1.8)	(0.6)	3.6	(1.7)	0.3	1.2	(2.4)	3.4	(1.3)	(2.1)
Primary balance/GDP	1.4	(1.9)	(1.9)	(3.9)	(4.0)	(1.2)	2.8	(3.1)	1.7	2.5
Revenue/GDP	29.7	41.7	42.8	39.8	40.5	38.8	47.2	39.4	37.7	36.8
Expenditures/GDP	28.6	43.9	44.9	44.1	45.0	40.5	44.8	42.8	36.4	34.6
Interest /revenues	1.0	0.7	0.6	0.9	1.3	1.5	0.8	0.9	0.9	0.9
Debt/GDP	24.0	22.5	25.9	23.5	22.8	21.8	17.9	20.8	18.9	16.8
Debt/Revenue	80.8	53.8	60.5	59.0	56.3	56.1	38.0	52.8	50.1	45.7
Net debt/GDP	6.6	6.2	15.7	13.7	12.7	7.4	4.6	7.8	6.3	4.2
Liquid assets/GDP	17.4	16.3	10.2	9.8	10.1	14.3	13.4	12.9	12.6	12.6
MONETARY INDICATORS (%)										
CPI growth	2.8	0.8	2.6	1.5	5.3	(0.1)	1.7	1.5	1.7	1.7

Table 1

Cook Islands - Selected Indicators (cont.)										
	--Year ended June 30--									
Mil. NZ$	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017e**	**2018f**	**2019f**	**2020f**
GDP deflator growth	3.9	(0.1)	0.2	(1.9)	(0.3)	4.9	3.3	2.5	2.2	(3.7)
Exchange rate, year-end (LC/$)	1.2	1.3	1.3	1.1	1.5	1.4	1.5	1.5	1.6	1.6
Banks' claims on resident non-gov't sector growth	(2.3)	(5.8)	(0.2)	(7.4)	(0.1)	(6.2)	(2.0)	(2.0)	(2.0)	(2.0)
Banks' claims on resident non-gov't sector/GDP	79.5	72.1	71.4	64.5	61.7	52.3	47.9	45.4	43.3	42.4
Foreign currency share of claims by banks on residents	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Foreign currency share of residents' bank deposits	0.0	0.0	0.0	0.0	0.0	0.0	N/A	N/A	N/A	N/A
Real effective exchange rate growth	N/A	N/A	N/A	N/A	N/A	N/A	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. e--estimate. f--forecast. N/A--Not applicable.

Ratings Score Snapshot

Table 2

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

S&P Global Ratings' analysis of sovereign creditworthiness rests on its score 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 (v) monetary assessment. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). The fiscal score is the average of the fiscal performance and flexibility score and the sovereign debt burden score. Section V.B of S&P Global Ratings' "Sovereign Government Rating Methodology And Assumptions" (Dec. 23, 2015) summarizes how the various factors are combined to derive the foreign currency rating, while section V.C details how the scores are derived. The rating 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, lower rated sovereigns more weaknesses. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in score 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 scores.

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Related Criteria

- Criteria - Governments - Sovereigns: Sovereign Rating Methodology, Dec. 23, 2014
- General Criteria: Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 07, 2013
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Related Research

- Sovereign Rating And Country T&C Assessment Histories, Dec. 15, 2015
- Banking Industry Country Risk Assessment Update: October 2015, Oct. 7, 2015
- Sovereign Ratings Score Snapshot, Oct. 5, 2015
- Sovereign Defaults And Rating Transition Data, 2013 Update, Sept. 17, 2014

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 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

Cook Islands	
Sovereign Credit Rating	B+/Stable/B
Transfer & Convertibility Assessment	
Local Currency	AAA