COOK ISLANDS GOVERNMENT

2014/15 Half-year Economic and Fiscal Update

Hon. Mark Brown

Minister of Finance

December 2014

Table of Contents

MINISTER OF FINANCE

GOVERNMENT OF THE COOK ISLANDS
PO Box 3246, Rarotonga, Cook Islands
Telephone + 682 24875 ♦ Facsimile + 682 24178

24 December 2014

STATEMENT OF RESPONSIBILITY

I have read the Financial Secretary's Statement of Responsibility and concur with him regarding the preparation of the 2014/15 Half Year Economic and Fiscal Update.

To enable the Ministry of Finance and Economic Management to prepare this Half Year Economic and Fiscal Update, I have ensured that the Financial Secretary has been advised of all Government decisions and other circumstances as at December 2014 of which I was aware that had material economic and fiscal implications.

The 2014/15 Half Year Economic and Fiscal Update has been produced in accordance with the *Ministry of Finance and Economic Management Act 1995/96.*

I accept the overall responsibility for the integrity of the disclosures contained in this document, and the consistency and completeness of the information in compliance with the requirements of the *Ministry of Finance and Economic Management Act 1995/96*.

Kia Manuia,

Honourable Mark Brown
Minister of Finance

MINISTRY OF FINANCE AND ECONOMIC MANAGEMENT

GOVERNMENT OF THE COOK ISLANDS

Office of the Financial Secretary
PO Box 120, Rarotonga, Cook Islands
Telephone + 682 22878 Facsimile + 682 23877
Email: richard.neves@cookislands.gov.ck
Web: http://www.mfem.gov.ck

24 December 2014

STATEMENT OF RESPONSIBILITY

This Half Year Economic and Fiscal Update 2014/15 is prepared in accordance with Section 11 and 16 of the *Ministry of Finance and Economic Management Act 1995-96.* Section 16 further states that the Minister shall no earlier than the 1st day of December, nor later than the 31st day of December in each financial year, cause to be published a report containing an economic and fiscal update prepared by the Ministry.

Therefore in accordance with Section 30(2) of the *Ministry of Finance and Economic Management Act 1995/96*, the Minister of Finance and the Financial Secretary shall prepare and sign a Statement of Responsibility for the financial statements.

The integrity of the disclosures and consistency with the requirements of the *Ministry of Finance and Economic Management Act 1995/96* are warranted in relation to the financial statements included within this Half Year Economic and Fiscal Update 2014/15.

The update incorporates the fiscal and economic implications both of Government decisions and circumstances as at December 2014 that were communicated to me, and of other economic and fiscal information available to the Ministry in accordance with the provisions of the *Ministry of Finance and Economic Management Act 1995/96*.

As Financial Secretary, I accept full responsibility for the integrity of the information provided.

Kia Manuia,

Richard Neves
Financial Secretary

PREFACE

Half Year Economic and Fiscal Update

Section 16 of the *Ministry of Finance and Economic Management Act 1995/96* requires the Minister of Finance to publish a Half Year Economic and Fiscal Update (HYEFU) no earlier than 1 December and no later than 31 December in each year.

The 2014/15 HYEFU provides an update of the economic and fiscal forecasts made at the time of the 2014/15 Budget in October 2014, and provides analysis of the changes in key economic variables and their impact on the fiscal status of Government.

Given the publishing of the 2014/15 Budget in October 2014, there is only limited data and information to update. While the information presented here will present a complete update, many areas will remain largely unchanged from those presented in the 2014/15 Budget.

1 ECONOMIC UPDATE

1.1 Introduction

The Cook Islands is a small open economy largely dependent on tourism, where its natural comparative advantage lies. Consumer preferences and economic growth in the major tourist source market of New Zealand (and to a lesser extent, Australia) has a major impact on domestic economic performance. Any international developments affecting New Zealand will eventually impact on the Cook Islands. Not only is New Zealand the Cook Islands largest trading partner and source of tourism, but changes in the New Zealand dollar will also impact on domestic markets and inflation. Increasingly, large capital works have also become a driver for economic growth. The completion of these projects will present challenges for maintaining the economic stimulus of construction activity in future years.

Despite being one of the remotest countries in the world, and one of the smallest (even by Pacific standards), the Cook Islands is one of the most prosperous countries per capita in the Pacific, behind New Zealand and Australia. The Cook Islands has enjoyed a sustained period of economic prosperity following the rapid growth of the tourism industry and a series of public sector reforms following the economic crisis of the mid-nineteen nineties. The economic dependency on tourism has benefitted the Cook Islands greatly. Despite this success, the lack of economic diversity or economies of scale make any progress fragile and reversible. Labour market constraints across various areas of the economy also present major limitations on economic growth; an issue that is worsened by continued depopulation.

The reliance on imports to support local consumption makes the Cook Islands extremely vulnerable to external price shocks – particularly in regards to fuel, as transport and energy costs affect the price of almost all goods. Despite the large imbalance in goods trade, the Cook Islands enjoys a large current account surplus, owing to the significant contribution of estimated tourism receipts (which are counted as a service export).

Global economic growth remains modest, with growth diverging across the major economies. The US economic recovery continues on the back of higher domestic and export demand, and China's growth remains solid but will slow as the economy transitions to a more sustainable growth model. In contrast, the Eurozone economies are confronting persistently weak growth and the threat of deflation, while Japan has slipped into recession.

Notably, the price of oil has fallen almost 50 per cent since June 2014. While this will frustrate oil exporting nations, it will ultimately lead to lower prices for fuel globally (including in the Cook Islands). The conflicts in the Ukraine and the Middle-East, and Ebola in Africa, continue to have little impact on global commodity markets, although these events have been devastating for the economies directly involved (which most recently includes Russia, whose currency has all but collapsed).

In October 2014, the International Monetary Fund (IMF) revised its forecast for global economic growth in 2014 to 3.3 per cent, a slight downward revision, with the World Bank forecasting 2.8 per cent (a downward revision from the 3.7 per cent growth estimated earlier this year). For 2015, the IMF is forecasting that global growth will improve to 3.8 per cent, and the World Bank estimates 3.4 per cent. The ten-year average for world economic growth is 3.4 per cent growth a year.

Australia and New Zealand have updated their official growth estimates for 2014/15 to 2½ per cent and 3¼ per cent respectively. Both Governments revised down their economic and revenue forecasts, with Australia having to significantly adjust to the reductions in commodity prices. Australian arrival figures into the Cook Islands have been weaker than anticipated, likely due to below trend economic growth in Australia, a depreciating Australian dollar, and a small rise in unemployment. There has also been much stronger competition for outbound tourism to other Pacific destinations such as Fiji, Hawaii, and Bali.

Since the 2014/15 Budget, total tourism arrivals for September through to November performed as expected but the composition was not in line with forecasts. Notably, Australian arrivals have not performed as well as expected and have been revised accordingly. This has led to a small downward revision of the 2014/15 arrival forecasts.

There has also been a revision to the estimated GDP for 2013/14 due to the inclusion of quarterly data for the March and June quarter of 2014. While this does not affect revenue estimates (the 2014/15 tax receipts were forecast using the 2013/14 estimated revenue), the revision will have implications for GDP ratios.

Nominal GDP (which includes inflation) is now estimated to have fallen by 2.0 per cent in 2013/14, a downwards revision from the forecast of 2.6 per cent growth forecast at the time of the 2014/15 Budget. Nominal growth is expected to be an estimated 4.8 per cent in 2014/15, due largely to increased public sector capital investment. Estimated growth falls to 1.3 per cent growth in 2015/16 due to completion of some capital projects, before declining 2.8 per cent in 2016/17 due to a large reduction in the capital profile (a combination of completed capital projects and no new projects being scheduled). These forecasts are largely unchanged from the 2014/15 Budget due to very little new data being available.

New economic data became available after the finalisation of the forecasts presented here, but before publication. Due to time constraints, this new data will be included in future Budget estimates.

Tourist growth has been revised down from the forecasts at the 2014/15 Budget due to lower than anticipated Australian arrivals. This takes further pressure off the capacity constraints that were expected to significantly reduce growth from 2017 onwards. Growth in visitor arrivals is expected to slow from 1.6 per cent in 2013/14 to a 1.0 per cent reduction in arrivals in 2014/15, due mainly to a slower growth out of New Zealand and Australia. The forecast for 2015/16 has been relatively unchanged, at 0.8 per cent growth.

Inflation as measured by the Cook Islands Consumer Price Index (CPI) was 1.6 per cent in 2013/14. With the exception of the one-off increase in the VAT, inflation is expected to adjust towards its long-term trend. The year average CPI is forecast to increase 3.8 per cent in 2014/15 due to the change in VAT, before increasing by 2.6 per cent in 2015/16.

Table 1.1 Summary of Economic Indicators

	2012/2013 *Actual*	2013/2014 *Est*	2014/2015 *Proj*	2015/2016 ***Proj***	2016/2017 ***Proj***	2017/2018 ***Proj***
Economic Activity						
Nominal GDP ($'000)	369,131	361,568	378,778	383,729	372,867	379,794
Percentage change (YOY)	-1.0	-2.0	4.8	1.3	-2.8	1.9
Real GDP (at Constant 2006 Prices, $'000)	278,953	275,733	281,601	280,812	266,709	265,020
Percentage change (YOY)	-1.7	-1.2	2.1	-0.3	-5.0	-0.6
Inflation						
Consumer Price Index (base Dec. 2006 = 100)	124.9	126.8	131.6	135.0	139.2	143.6
Percentage change (YOY)	2.6	1.6	3.8	2.6	3.1	3.1
Construction/Capital Investment						
Commercial Building Approvals ($'000)	2,975	1,859	1,859	1,859	1,859	1,859
Residential Building Approvals ($'000)	5,887	6,161	5,732	5,611	5,494	5,378
Public Works ($'000) (includes Dev Partners)	31,295	49,455	65,311	58,365	25,185	21,002
Productive Sector Indicators						
Visitor Arrivals	120,909	122,900	121,700	122,700	123,700	124,600
Percentage change (YOY)	3.5	1.6	-1.0	0.8	0.8	0.7
Estimated Visitor Expenditures ($'000)	222,127	229,100	235,500	244,300	253,900	263,700
Pearl Exports ($'000)	291	252	150	150	150	150
Fish Exports ($'000)	8,059	20,816	20,820	20,820	20,820	20,820
External Sector						
Merchandise Trade Balance ($'000)	(126,170)	(119,611)	(117,369)	(118,196)	(119,179)	(120,045)
Services Trade Balance ($'000)	222,127	229,100	235,500	244,300	253,900	263,700
Exchange Rate (USD/NZD Average, April 2014)	0.822	0.830	0.818	0.843	0.843	0.843
Financial Sector (at end of financial year)						
Government Net Debt Position ($'000)	90,741	78,901	81,371	85,756	81,285	76,692
Private and Public Enterprise Deposits ($'000)*	170,273	175,338	186,574	-	-	-
Private and Public Enterprise Loans ($'000)*	266,325	246,141	242,286	-	-	-

* No attempt has been made to estimate public or private deposits or loans due to breaks in the data series

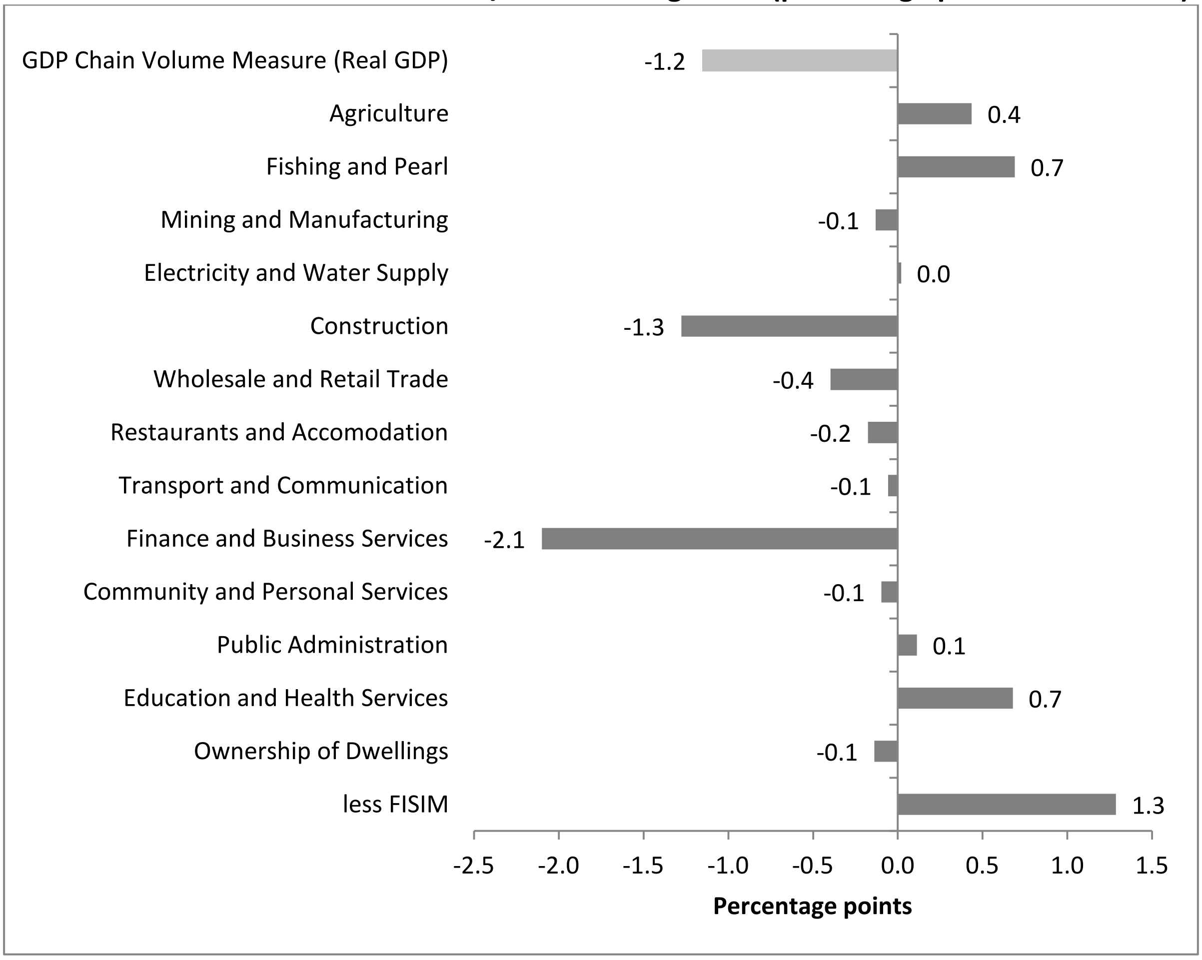
1.2 Gross Domestic Product (GDP)

With the arrival of new quarterly GDP data for the 2013/14 year, baseline estimates of economic activity were able to be updated to as recently as the June quarter 2014.

Real GDP (removing the impact of inflation) for the Cook Islands declined 1.2 per cent for 2013/14, reversing gains as achieved in 2012. Major contributors to this decline were falls in finance and business services (contributing -2.1 percentage points) and construction (-1.3 percentage points). Partially offsetting the declines were gains in financial intermediation (1.3 percentage points), education and health services (0.7 percentage points), and fishing and pearls (0.7 percentage points).

Recent GDP estimates highlight the sensitivity of the Cook Islands economy to relatively small changes in single industries or the implementation schedules of public capital projects. This is particularly important in the coming years, where the level of public capital investment will be the highest on record.

Chart 1.1 Contribution to 2013/14 real GDP growth (percentage point contribution)



Nominal GDP is now estimated to have fallen 2.0 per cent in 2013/14, as compared to an estimate of 2.6 per cent growth made at the time of the 2014/15 Budget. Similar to real GDP, this fall was due to a large reduction in the provision of financial services, a shifting of capital projects into 2014/15, and slower tourism growth.

Nominal GDP growth is estimated to increase to 4.8 per cent in 2014/15 due to the slippage of some capital investment activity from 2013/14 into 2014/15, and the bring forward of some activity into 2014/15 (notably, renewable energy for the Southern Group). However, this estimate may be revised significantly if implementation schedules are not met or are adjusted.

By 2015/16, slow growth in tourism and the completion of some capital projects are expected to lead to a slowing of nominal GDP growth to an estimated 1.3 per cent.

Table 1.2 GDP growth revisions

	2013/14		2014/15		2015/16	
	2014/15 Budget	2014/15 HYEFU	2014/15 Budget	2014/15 HYEFU	2014/15 Budget	2014/15 HYEFU
Nominal GDP growth (per cent)	2.6	-2.0	4.5	4.8	1.1	1.3
Real GDP growth (per cent)	2.0	-1.2	2.9	2.1	-0.3	-0.3
Implicit GDP deflator (percentage change)	0.6	-0.9	1.6	2.6	1.4	1.6

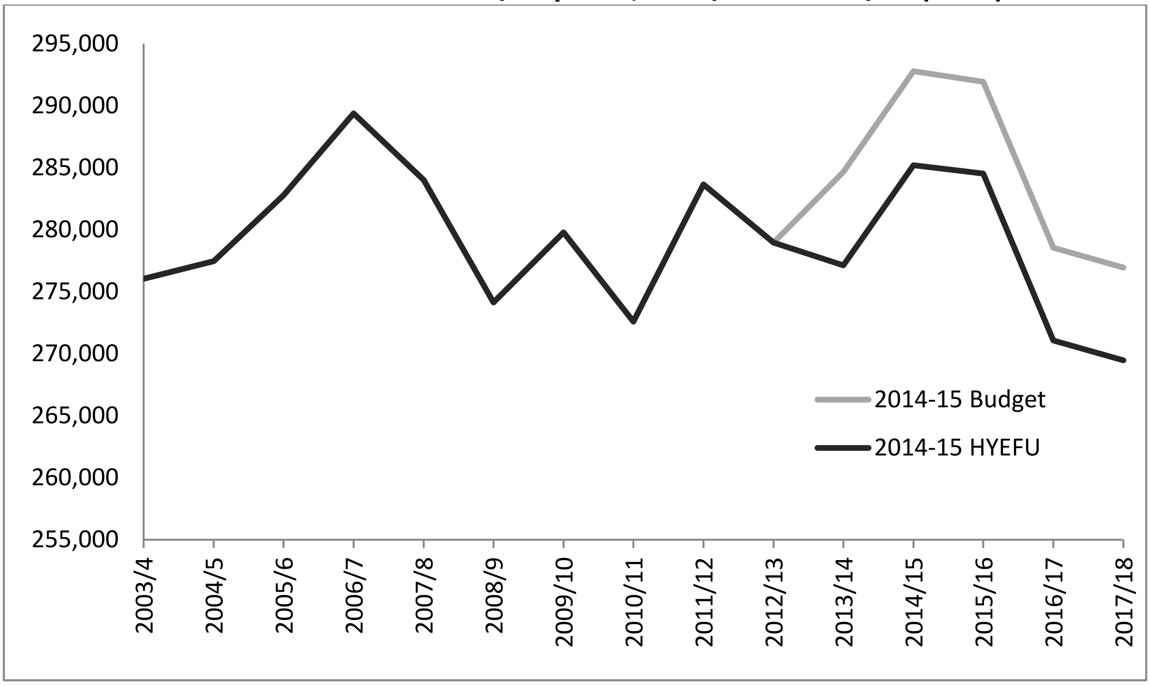
Real GDP is forecast to follow a similar pattern to nominal growth but is lower as it removes the impact of inflation. The 2014/15 Budget is the first time where attempts have been made to forecast a GDP deflator (previously this was assumed to equal inflation). Similar to the large reduction in nominal GDP growth, real GDP growth for 2013/14 was revised to a 1.2 per cent reduction.

These forecasts remain dependent on a number of recent trends continuing. The key risks to GDP growth are:

- poor budget execution of the public sector capital investment planned across the Cook Islands – in particular, any delays in the implementation of the renewable energy or water projects;
- the preferences of New Zealand and Australian tourists moving towards other competing tourism markets in the Pacific or Asia, or choosing to tourist within their respective countries;
- an economic slowdown in New Zealand and/or Australia;
- the domestic labour market failing to increase through a decline in migrant labour entering the Cook Islands to fill job vacancies, or Cook Islanders continuing to leave the local market;
- external price shocks to our major import categories (fuel or food supplied by New Zealand);
- dramatic changes in consumption patterns due to VAT or import levy changes (above and beyond those already forecast); and
- any reductions in projected assistance from development partners.

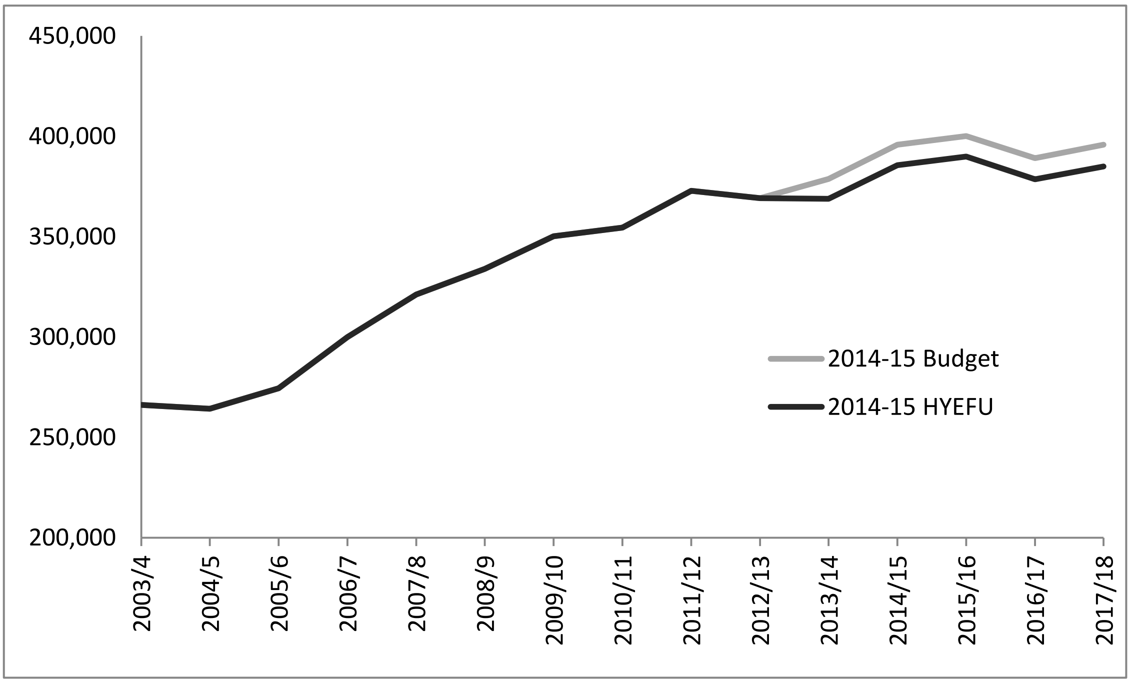
On the upside, a return to trend levels of inflation may not occur, as current inflation levels appear to be below what was expected in previous forecasts. Particularly the GDP deflator (the difference between nominal and real GDP) may be lower than expected due to recent falls in the global oil price, although it is difficult to predict when/if the price changes are fed through to the local economy.

Chart 1.2 Real GDP at 2006/07 prices, 2003/04 to 2017/18 ($000)



Note: the shift in the Real (and nominal) GDP graph is due to the inclusion of the March and June quarters of 2014.

Chart 1.3 Nominal GDP at current prices, 2003/04 to 2017/18 ($000)



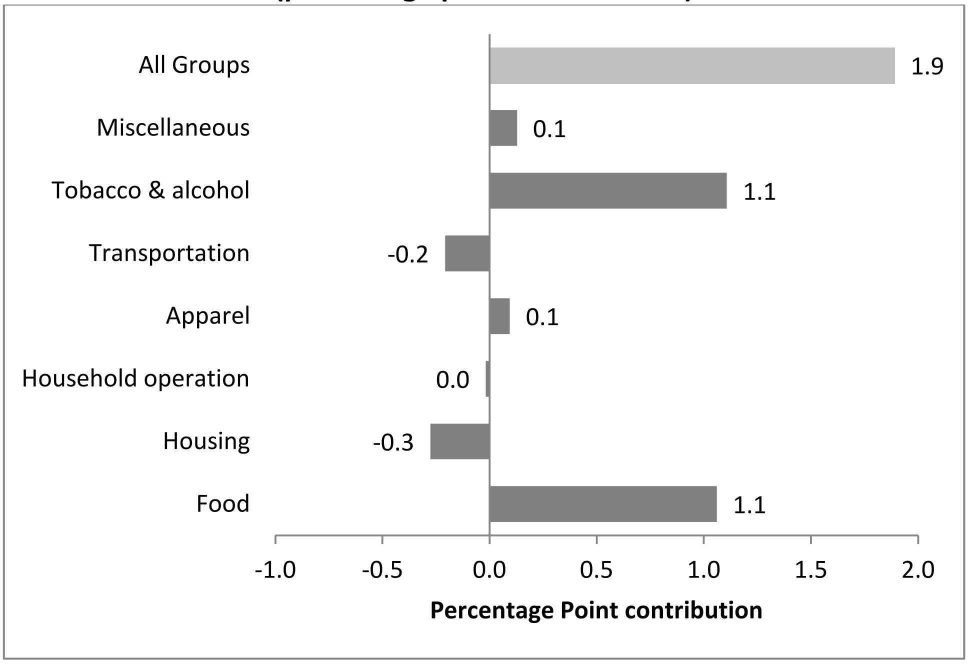
1.3 Consumer Price Index (CPI)

Inflation in the Cook Islands is measured by the Consumer Price Index (CPI) which is reported on a quarterly basis. Over the last ten years, the Cook Islands has enjoyed low and relatively stable inflation due to the use of the New Zealand dollar as the national currency (with the exception of the dramatic increase in global fuel prices which drove inflation to 10.2 per cent in 2008/09).

At the time of publication, the most recent CPI data available was for the September quarter 2014, which showed inflation of 2.7 per cent compared to the September quarter 2013, and average annual inflation of 1.9 per cent for the 12 months to September.

Average annual inflation up to the September quarter 2014 was driven by a 28.4 per cent increase in tobacco prices (contributing 1.1 percentage points to overall inflation, see Chart 1.4) and a 3.5 per cent increase in food prices (contributing 1.1 percentage points) being partially offset by 2.1 per cent decrease in the cost of housing (subtracting 0.3 percentage points).

Chart 1.4 Contribution to September quarter 2014 year average inflation (percentage point contribution)



As shown in Chart 1.5, year average inflation is estimated to increase from an average annual rate of 1.6 per cent in 2013/14 to the historical average of 3.1 per cent in the outer years; slightly higher than the New Zealand target rate.

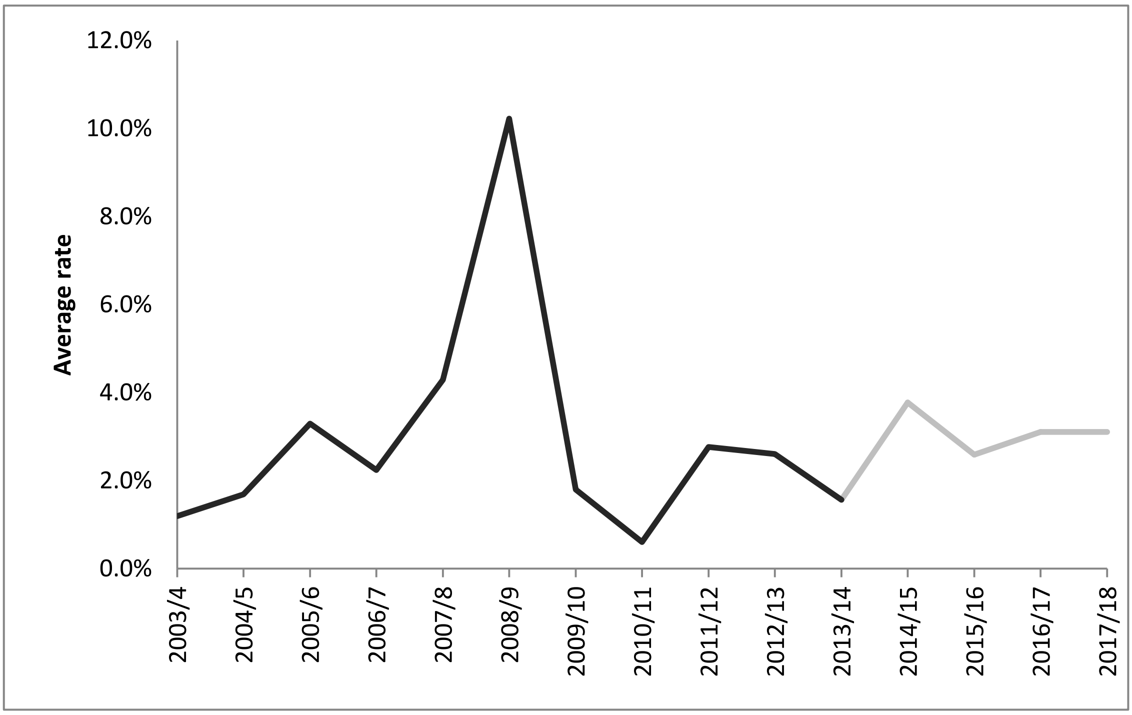
The exception to this is 2014/15, which will bear the full inflationary effect of the Tax Review increase to the VAT from 1 April 2014, with an estimated average annual inflation of 3.8 per cent. This is a significant downward revision from previous estimates of 4.6 per cent. While food, tobacco and alcohol appear to be following the expected price changes stemming from the VAT increase on 1 April, price changes in other areas have been relatively flat. Notably, the prices in key areas such as household operation, housing and transportation have fallen, providing relief to household budgets. Indeed, the price increases in tobacco have been the major driver behind CPI increases since 2013, when the duty on wholesale tobacco was increased by 33 per cent in consecutive years.

There are substantial risks surrounding these forecasts. A decline in the New Zealand dollar from its historic highs would be expected to have an inflationary impact on the Cook Island economy through higher import prices. Issues surrounding retailers using the increase of the VAT to price gouge also presents a risk, although this has been partially factored into the forecasts for 2014/15 and does not appear to be widespread.

Recent quarterly inflation figures have been less than expected both in the Cook Islands and New Zealand. If this were to continue, inflationary pressure on the economy may be much less than anticipated over 2014/15.

A notable factor which may affect CPI forecasts is the recent fall in global fuel prices. While undoubtedly this will be beneficial to CPI (and the GDP deflator), it is unclear how much of the benefit will be passed through the supply chain, or when the impact would be felt. It is likely that CPI forecasts will be adjusted once the December quarter CPI estimates become available in early 2015.

Chart 1.5 Consumer Price Index (CPI), year average, 2003/04 – 2017/18



1.4 Tourism

Tourism remains the largest industry in the Cook Islands, accounting for around 60 per cent of the economy. The Cook Islands has experienced record tourism arrival numbers almost every year since 2001 and 2013/14 was no exception, with another record year for the level of arrivals (although growth was slower).

However, as predicted at the time of the 2014 PEFU, growth in tourism arrivals continued to slow from 3.2 per cent growth in 2012/13 to 1.6 per cent growth in 2013/14 (2013/14 was forecast to grow at 1.7 per cent). The strong growth experienced from New Zealand and Australian markets likely peaked over 2010 to 2012 and a return to double digit growth in the near term is unlikely. Subsequently, tourist arrival forecasts have been further revised downwards.

New Zealand remains by far the largest market at 65 per cent of total arrivals in 2013/14, with Australia having a smaller, but increasing share (18 per cent, up 2.9 percentage points in the last four years).

Reflecting ongoing softness in Australian and New Zealand arrivals, tourist arrivals are forecast to contract 1.0 per cent in 2014/15, the first annual fall in arrivals since 2007/08. Current year-to-date arrivals (Jan-Nov) are just 0.2 per cent higher than the similar period in 2013, but the last five months (Jul-Nov) are 2.4 per cent lower than the same period last year.

Subdued growth of 0.8 per cent is predicted for 2015/16, but this is dependent on a recovery in Australian arrivals.

The average stay is estimated at around eight days, with this average weighting heavily influenced by the level of New Zealand and Australian arrivals. The average daily spend (including accommodation) is estimated to be around $200-230 per visitor (including children), but varies by time of year and by tourist source market.

Chart 1.6 Total monthly visitor arrivals (12 month moving average) 2005-2017

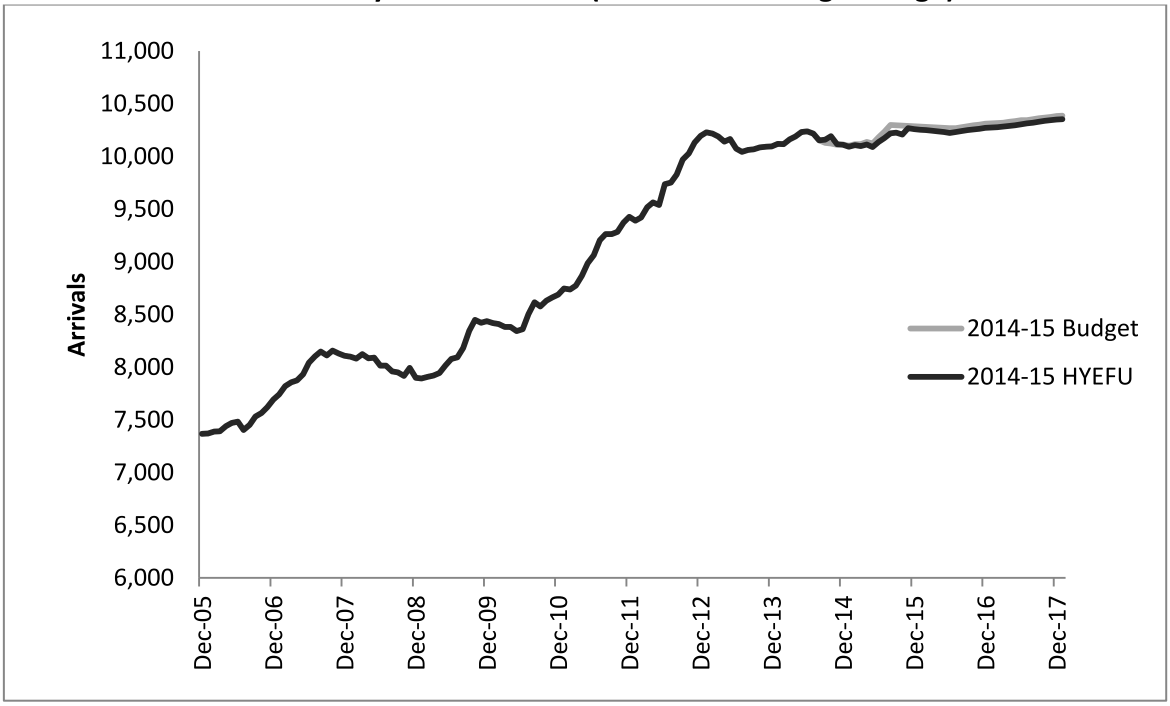


Table 1.3 Actual and forecast total tourism numbers by quarter 2012/13 to 2017/18

	Qtr 1	Qtr 2	Qtr 3	Qtr 4	Total
2012/13	39,113	31,571	20,493	29,732	120,909
2013/14	39,031	31,902	21,294	30,627	122,854
2014/15	38,102	31,320	21,100	31,100	121,700
2015/16	39,200	31,700	21,000	30,800	122,700
2016/17	39,500	32,000	21,100	31,100	123,700
2017/18	39,800	32,200	21,200	31,400	124,600

It was evident in the lead up to the Pacific Island Leaders Forum in July/August 2012, which led to a record number of arrivals, that capacity constraints are an issue in Rarotonga. July 2012 continues to be the benchmark for the maximum number of arrivals that Rarotonga can be expected to reasonably handle until new capacity comes online for the busy July 2015 period.

Table 1.4 Capacity utilisation of Cook Islands tourism sector, 2012/13 – 2017/18

Year	Average capacity	Months with arrivals of between...				Estimated lost arrivals
		80-90 per cent	90-94 per cent	95-98 per cent	99-100 per cent	
2012/13	73.0 per cent	2	2	0	1	
2013/14	74.1 per cent	2	2	1	0	
2014/15	73.4 per cent	3	1	1	0	0
2015/16	74.0 per cent	2	2	1	0	0
2016/17	74.6 per cent	2	2	1	0	0
2017/18	75.2 per cent	2	2	0	1	11

Due to the downward revision in the arrival forecasts, and an increase in some types of accommodation, capacity constraints are not expected to be as dramatic as they once were over the forecast period. In particular, a slower than anticipated July in 2014 has lowered expectations of future July arrivals. Increasingly, arrivals are being loaded onto the latter half of the calendar year. No significant growth in arrivals during the peak season will provide more space for new investments to come online in a timely manner.

While growth has been relatively muted in 2013/14, and has been revised downwards overall, the capacity of the tourism sector (be it management capacity or additional capital investment) needs to expand if growth in arrivals are expected to continue. The overall Tourism Corporation strategy of increasing arrivals in non-peak times may be able to increase the capital returns of the industry in the short term, thereby encouraging more investment, but increases in value offerings or capacity will be needed to sustain growth in the longer term.

1.4.1 New Zealand

New Zealand continues to be the Cook Islands leading market for visitors, accounting for an estimated 65 per cent of the total market (or 80,251) in 2013/14.

Over the past ten years, New Zealand arrivals have grown an average of 9.5 per cent a year – a phenomenal level of growth with New Zealand arrivals more than doubling over that period (increasing by 140 per cent). Outbound tourism from New Zealand only grew 37.3 per cent over the same period, an average of 4.6 per cent a year. This represents a large shift in New Zealand tourist preferences towards the Cook Islands over other destinations. This is supported by the results of the recent visitor survey which estimates that 47 per cent of visitors from New Zealand are return visitors – an impressive achievement for the tourism industry.

However, in 2012/13 outbound tourist growth from New Zealand fell to 1.4 per cent, the lowest growth since 2000 (the earliest data publically available). New Zealand arrivals into the Cook Islands followed a similar trend, with growth in New Zealand arrivals falling to 2.9 per cent for 2012/13, the third lowest growth outcome in 12 years, and well below the 8.1 per cent growth experienced in 2011/12.

Similarly, growth in arrivals slowed further in 2013/14, with arrivals from New Zealand only increasing 0.5 per cent, the slowest growth in New Zealand arrivals since 1997/98.

Going forward, New Zealand arrivals are expected to decline by 0.5 per cent in 2014/15, due largely to poor performance in July to November 2014 (when compared to the stellar performance in previous years); the first decline in New Zealand arrivals since 1997/98. The long term trend is also projected to be much lower than historical performance would suggest, at around 0.5 per cent. These forecasts are based on recent performance, greater anticipated competition for New Zealand tourists from other Pacific destinations, and a relatively strong New Zealand dollar (compared to other Pacific currencies) reducing relative price competitiveness.

Chart 1.7 New Zealand monthly visitor arrivals (12 month moving average) 2005-2017

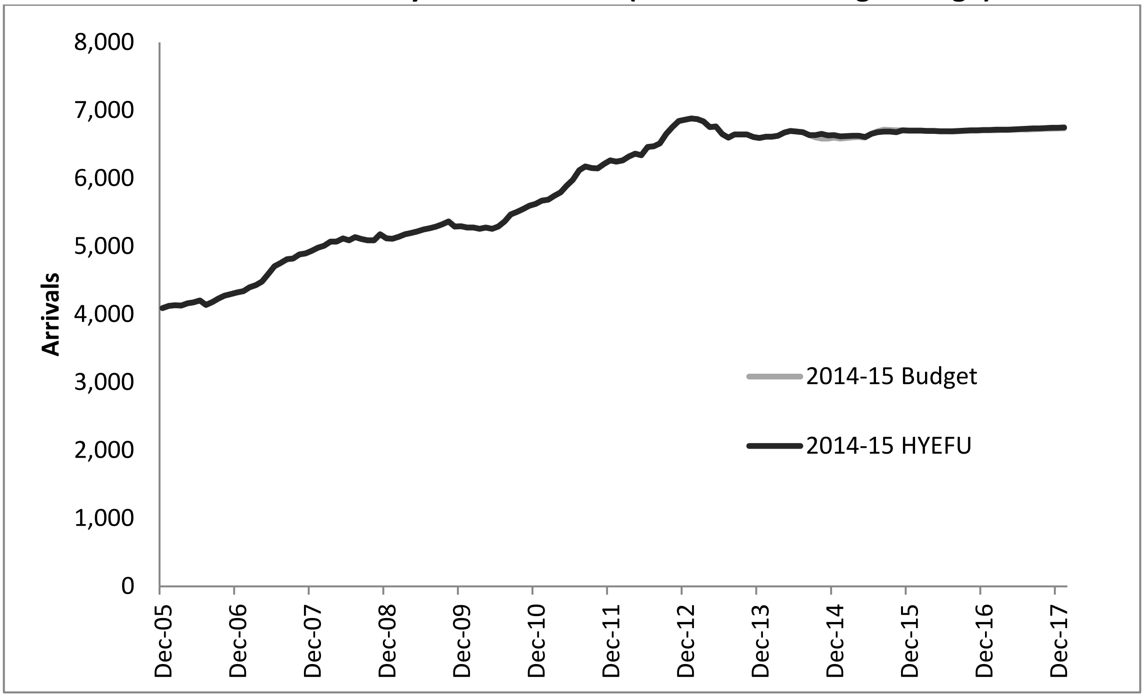


Table 1.5 Actual and forecast New Zealand tourism numbers by quarter 2012/13 to 2017/18

	Qtr 1	Qtr 2	Qtr 3	Qtr 4	Total
2012/13	28,482	19,933	11,272	20,148	79,835
2013/14	28,382	19,323	11,666	20,880	80,251
2014/15	27,788	19,326	11,500	21,200	79,900
2015/16	28,200	19,500	11,500	21,100	80,300
2016/17	28,300	19,600	11,500	21,200	80,700
2017/18	28,500	19,700	11,600	21,300	81,100

1.4.2 Australia

The Australian market is the second largest tourism market to the Cook Islands, accounting for approximately 18 per cent of the total market share.

Australia has been experiencing a boom in outbound tourism growth. In the last ten years Australian outbound tourism has grown by 112 per cent, an average of 9.3 per cent a year. To compare, Australian arrivals to the Cook Islands have increased 97 per cent, or an annual average of 7.5 per cent. While the growth in tourist arrivals from Australia has been impressive, the main driver of this appears to be the overall growth in Australian tourists, rather than the Cook Islands increasing its market share. Indeed, with the exception of the last two years, the Cook Islands' share of Australian outbound tourism fell across the period.

After growing an impressive 7.0 per cent in 2012/13, Australian arrivals slowed significantly in the last half of 2013, a trend that was expected to continue into early 2014 – historically, Australian growth in arrivals has been concentrated in the latter half of the year. Unfortunately, Australian arrivals have continued to perform poorly, falling 4.7 per cent in the first five months of 2014/15 (Jul-Nov) when compared to the same period last financial year. For the calendar year, Australian arrivals are 3.0 per cent lower compared to 2013.

For 2014/15, Australian arrivals are expected to fall by 1.0 per cent, the first fall in Australian arrivals since 2007/08. Growth is then assumed to follow the outbound tourist numbers coming out of Australia. Using Australian-based industry forecasts as a proxy for Australian arrivals into the Cook Islands, we estimate that Australian arrivals will grow by 2.9 per cent in 2015/16, 2016/17 and 2017/18.[1]

The expected change from a Boeing 767 to a Boeing 787 on the underwritten Sydney route presents an opportunity to improve fare competitiveness with other destinations in the region (notably Fiji), but also presents a financial sustainability risk of the current strategy if arrival numbers are unable to meet expected targets.

[1] These forecasts that assume that the Cook Islands' market share of Australian tourists does not change dramatically over the forecast period. Historically, evidence has been mixed, with 2013/14 showing a falling share of the outbound market, but 2011/12 and 2012/13 showing an increasing share.

Chart 1.8 Australia monthly visitor arrivals (12 month moving average) 2005-2017

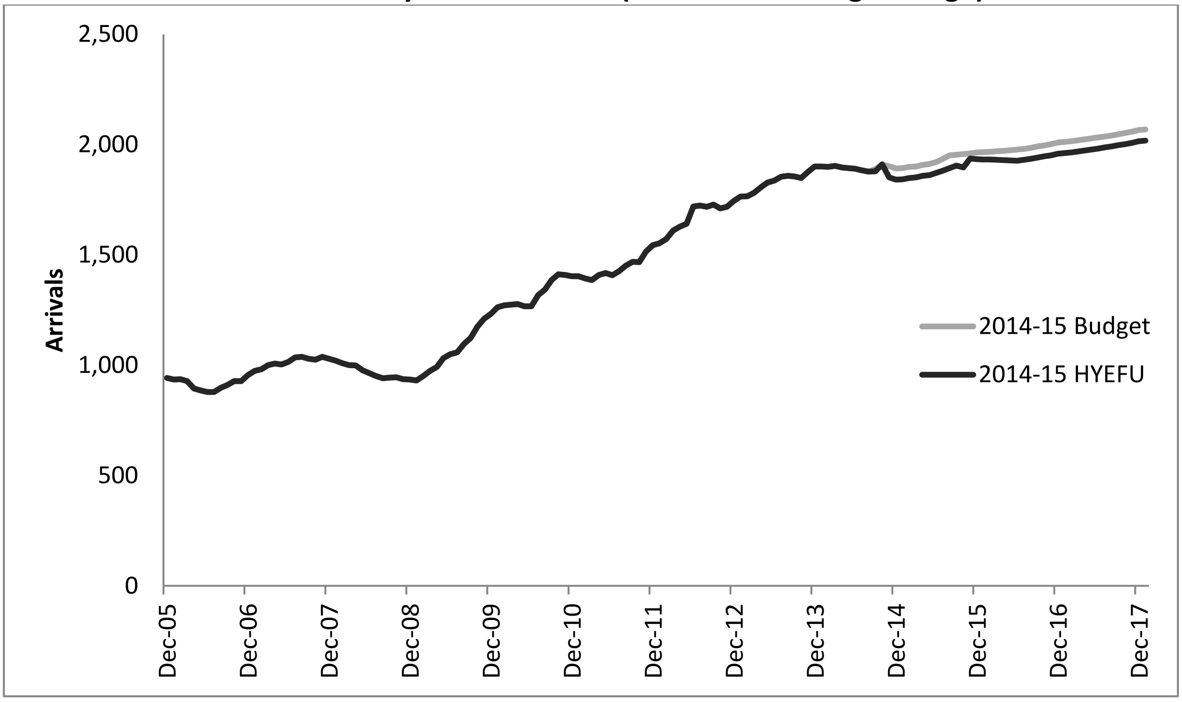


Table 1.6 Actual and forecast Australian tourism numbers by quarter 2012/13 to 2017/18

	Qtr 1	Qtr 2	Qtr 3	Qtr 4	Total
2012/13	5,854	6,528	4,157	5,513	22,052
2013/14	6,064	7,068	4,196	5,362	22,690
2014/15	5,927	6,616	4,300	5,600	22,500
2015/16	6,300	7,000	4,300	5,600	23,100
2016/17	6,500	7,200	4,400	5,700	23,800
2017/18	6,700	7,400	4,500	5,900	24,500

1.4.3 Other markets

Apart from an unexpected rise in European arrivals in November 2014 (1,038 arrivals, the highest for a November since 2009), non-core markets remain relatively flat or declining. The European and Canadian markets are expected to continue their decline from the historic highs experienced in 2000/01. Whilst North American and Canadian markets have shown some recent resilience, growth moving forward is expected to be relatively flat. Despite recent growth, Asia and smaller markets continue to remain relatively minor contributors.

Arrivals from other markets grew 4.7 per cent in 2013/14, due to increases from Asian and US market and relatively stable numbers from Canada and Europe. Continued economic issues for most of the EU countries are likely contain any future growth from this market, although improved economic recoveries in North America and Asia hold some promise for potential growth. European arrivals are expected to fall 1.8 per cent in 2014/15 on the back of relatively weak growth in the European area, before falling a further 3.6 per cent in 2015/16. US arrivals are expected to hold at around 4,900 for 2014/15 before growing 4.5 per cent in 2015/16. A chartered flight from China in early 2015 will add significantly to Asian arrivals in 2014/15, but this is assumed to be a one-off improvement.

Key risks and opportunities in the non-Asian markets relate to the future of the underwritten route to Los Angeles. The significant increase in capacity and associated reduction in per-seat cost present an opportunity to keep fares low and encourage greater arrivals from those markets, but if growth does not improve, the additional expense of the larger aircraft could risk the financial sustainability of the current strategy.

Chart 1.9 Other major markets monthly arrivals (12 month moving average) 2005-2017

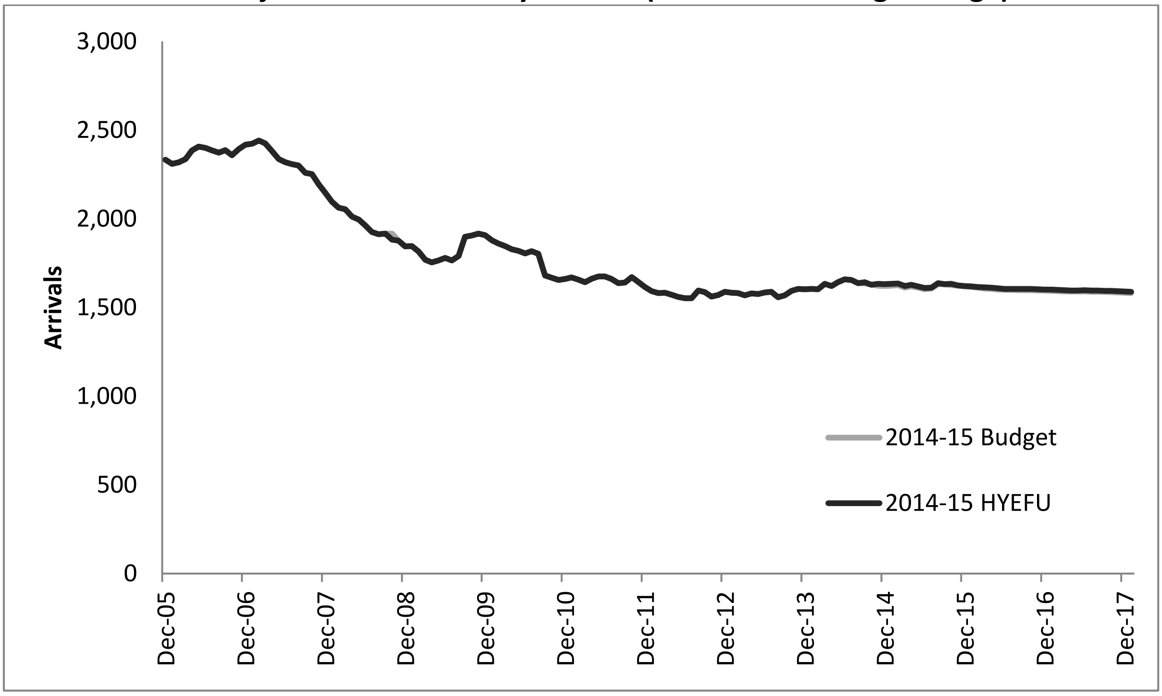


Table 1.7 Actual and forecast tourism numbers by quarter 2012/13 to 2017/18

	Qtr 1	Qtr 2	Qtr 3	Qtr 4	Total
2012/13	4,777	5,110	5,064	4,071	19,022
2013/14	4,585	5,511	5,432	4,385	19,913
2014/15	4,387	5,378	5,300	4,300	19,300
2015/16	4,600	5,300	5,200	4,200	19,300
2016/17	4,600	5,200	5,100	4,200	19,200
2017/18	4,600	5,200	5,100	4,100	19,000

1.5 Marine Resources

The Cook Islands' marine sector is predominantly made up of tuna fisheries and to a smaller degree black pearls, recently, exports have been dominated by fresh fish (mainly tuna). In 2013/14, fresh fish exports were $12.1 million, an almost 2.5 fold increase from 2012 exports.[2]

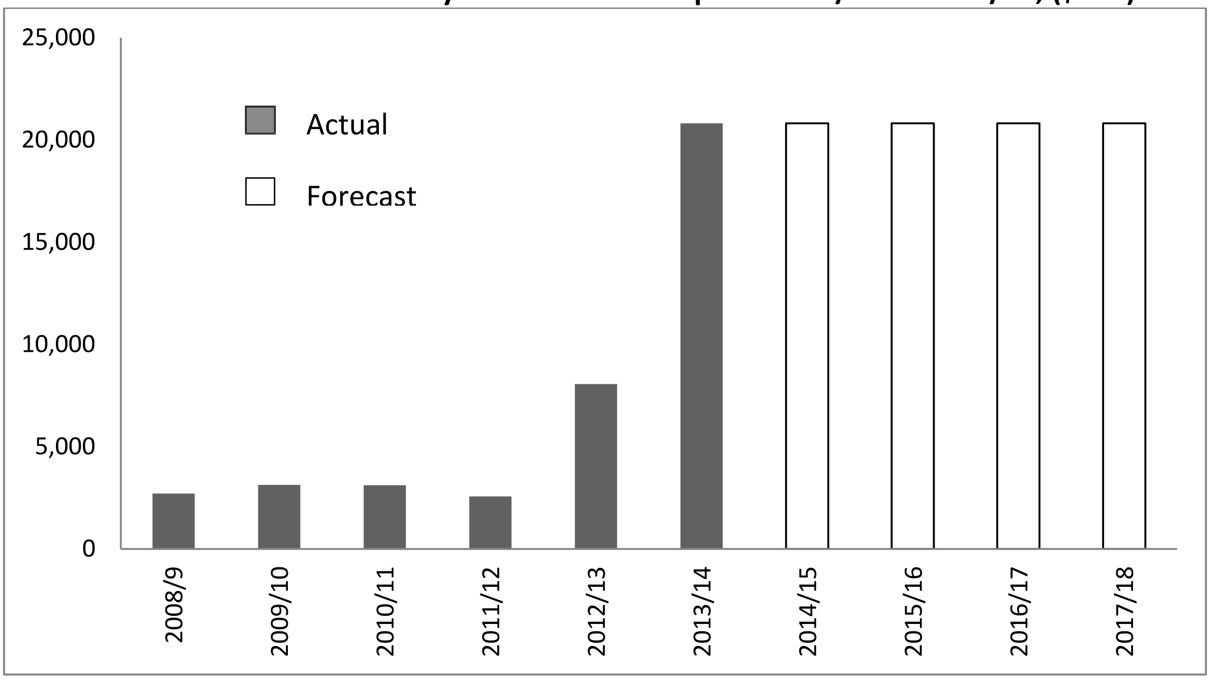
Other marine exports include live fish for aquarium trade and black pearls. Although in 2012/13 the exports of these products were at a historical low of $57,000 for live fish and $241,000 for black pearls.

The recent increases in fresh fish exports are significantly greater than the previous annual average from 2006-2011 of around $2.5 million dollars per year. The recent increase in exports are attributed to efforts to encourage the foreign fishing fleets to offload more of their catch into Rarotonga.

Since 2012, a Taiwanese fishing company has operated two fish carrier vessels to offload its fresh catches into Rarotonga. This offloading is done in partnership with a domestic Cook Islands fishing company. The tuna are exported by airfreight to markets in Japan, U.S and New Zealand.

The main direct revenue derived from fishing activities for government continues to be the licensing revenue received by the Ministry of Marine Resources from treaties and fishing licenses – estimated at $5.5 million in 2013/14 comprising of $2.1 million from foreign purse seiners, $3.0 million from foreign longliners and $0.4 million from Cook Islands flagged longliners.

Chart 1.10 Domestically Processed Fish Exports 2008/09 to 2017/18, ($000)



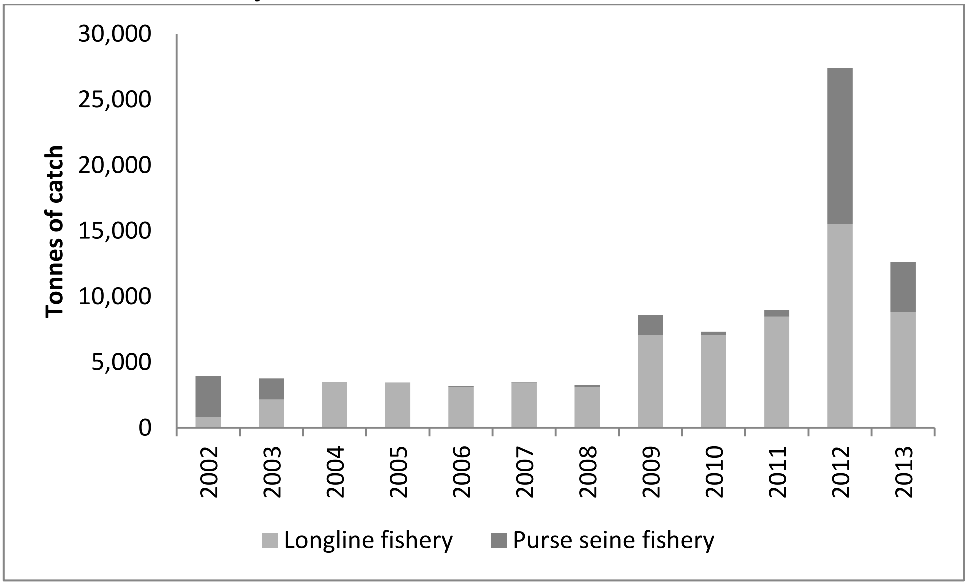
[2] Fish exports (as counted by the Cook Islands Statistics Office) includes any catch landed at Avatiu harbour and excludes fish caught in Cook Islands waters that are offloaded in Pago Pago. The catch landed in Avatiu does not necessarily need to be processed onshore, and includes catch that is simply trans-shipped from one vessel to another. As such, the value of fish exports to the Cook Islands economy is likely to be less than what exports suggest, as the value of the catch is not captured by local production.

1.5.1 Fishing

The Cook Islands EEZ is divided into a Northern and Southern fishery. The majority of fishing takes place in the Northern fishery where the waters are more stable and productive. The main fishing grounds are from Penrhyn in the east, to Pukapuka in the west, and south of Suwarrow.

Since 2002 the main fishery in the Cook Islands EEZ has been long lining for albacore tuna which is offloaded frozen to the cannery in Pago Pago. Many of the fishing vessels are based in Pago Pago or Fiji. From 2009 onwards, the Cook Islands fishery has diversified and expanded from three thousand tonnes of mainly longline catches in 2008 to 27 thousand tonnes of longline and purse seine catches in 2012.

Chart 1.11 Fishery Catch in the Cook Islands Exclusive Economic Zone



In 2013 there were a total of 17 Cook Island flagged longliners, 26 foreign flagged longliners and 17 foreign purse seiners that fished within the Cook Islands waters (Table 1.8). In addition two foreign flagged carrier vessels and four Cook Island flagged vessels operated exclusively on the high seas. This brings the total number of licensed offshore fishing vessels managed by the Ministry of Marine Resources (MMR) to 66 fishing vessels.

Table 1.8 Number of licensed and active fishing vessels

Licensed and active vessels	2012	2013
Offshore fishery		
Longliner	60	45
Purse seiner	16	17
Other commercial	4	4
Total	80	66
Local artisanal and game fishery		223

The total catch for the longline fishery in 2013 was 8,500 tonnes with an estimated landed value of $28 million dollars (Table 1.10), a reduction from the 15,500 tonnes caught in 2012 due to a fall in the number of vessels.

Table 1.9 Fishery Catches in the Cook Islands EEZ by Species

	2012		2013		
	Longline	*Purse Seine*	*Longline*	*Purse Seine*	*Local*
Albacore	8,800	-	6,500	-	1
Bigeye	2,800	100	500	60	<1
Yellowfin	1,800	800	900	300	180
Skipjack	-	11,000	900	3,400	10
Other	2,100	-	-	-	80
Total	**15,500**	**11,900**	**8,800**	**3,760**	**270**

Table 1.10 Landed value of fishery catches ($m)

Landed value	**2012**	**2013**
Longline fishery	40	32
Purse seine fishery	25	9
Local artisanal and game fishery		2
Total	**65**	**43**

The total catch for the purse seine fishery in 2013 (from June 2012 to June 2013) was 3,800 tonnes, with a landed value of $9 million, down from the 11,900 tonnes in 2012 when there was a spike in interest by US purse seiners in the Cook Islands waters.

The recorded catches in artisanal and game charter fishery was 212 tonnes from 9 out of the 12 inhabited islands. The total estimated catch in 2013 was 270 tonnes. The landed value assuming an average price of $8 per kilogram of round weight is $2.2 million dollars.

In 2013, there were 240 tonnes of fresh offshore fishery catches offloaded into Rarotonga for fresh airfreight export and local consumption. Most of the exported tuna are the high value bigeye tuna and the export grade yellowfin tuna.

Additional to fresh catch, in 2013, 340 tonnes of frozen offshore catch were offloaded by the foreign owned Cook Islands registered company Huanan Fishery Ltd into Rarotonga. These catches were mainly trans-shipped from the fishing vessels into container ships for overseas markets. Approximately 40 tonnes of by-catch was sold locally. It was estimated that over $400,000 of direct expenditure was incurred during the offloading process into the local economy, mainly through fuel purchases, employment, food provisions and port charges.

In 2014 the Huanan Fishery Ltd intends to expand the offload of catches into the port of Rarotonga to 2,500 tonnes. As of August 2014 the company has offloaded 900 tonnes of frozen catch for 2014.

The 2014 purse seine catches are already registering peak catches under the US Fishery Treaty. As of April 2014, nine months into the annual reporting cycle, there have been approximately 16,000 tonnes of catch recorded. The Cook Islands has also begun a dual payment system of receiving catch revenues, whereby a regional portion of the catch is paid on a catch tonnage basis and additional catch revenues acquired by selling fishing days in advance on a bilateral basis. So far

400 additional fishing days have been sold to the US treaty under the bilateral arrangement at a rate of USD 5,000 a day.

In 2015 it is anticipated that a purse seine fishing day rate will increase to USD 8,000 per day.

The spike in purse seine fishing activity by the US treaty fleet in the Cook Islands water is attributed to newly established regional quotas set out by the Western Central Pacific Fisheries Commission (WCPFC) which has assigned a national annual allocation of 30,000 tonnes and 1,250 fishing days to the Cook Islands.

In 2014, MMR is proposing to introduce a quota system to limit the longline catches caught in its EEZ for albacore and bigeye tuna. This will ensure catches are restricted to sustainable levels. MMR will continue its efforts to seek compatible catch limits on the high seas to ensure overfishing does not occur at the regional level. There continue to be significant potential growth prospects for the Cook Islands fishery:

- The local fishery is an important economic activity supporting the game-charter operators, semi-commercial sales and subsistence fishing. The local fishery has recorded good catch rates in 2013 with significantly increased catches around Rarotonga in 2013 attributed to the deployment of fish aggregating devices (FADs). Sustained catches can be expected provided these FADs are properly resourced and maintained.
- There is potential for high valued airfreighted export for fresh high quality fish. The medium term targets of 1,000 tonnes per annum are feasible provided the market demand, particularly in the US and Japan, is sustained and there are regular airfreight links.
- The offloading of frozen longline catches into Rarotonga is expected to continue to expand. A medium term target of 6,000 tonnes offloaded into Rarotonga per annum is feasible. The logistical constraints and costs for offloading into Rarotonga will determine whether there are further prospects for value added processing activities. Onshore processing is encouraged as this would lead to wider economic benefits.
- The purse seine fishery is likely to become the most significant source of licensing revenue for the offshore fishery. The Cook Island total allowable catches of 1,250 days or 30,000 tonnes equates to a conservative licensing value of around $11 million per annum. Combined with current licensing revenue from the longline fishery of around $3 million, the total licensing revenues are expected to be in the order of $14 million per annum.

1.5.2 Pearls

Cook Islands pearls are sold on both domestic and international markets. The performance of the Cook Islands pearl industry is mainly assessed on the export trends over time because it is difficult to quantify the size of the domestic market.

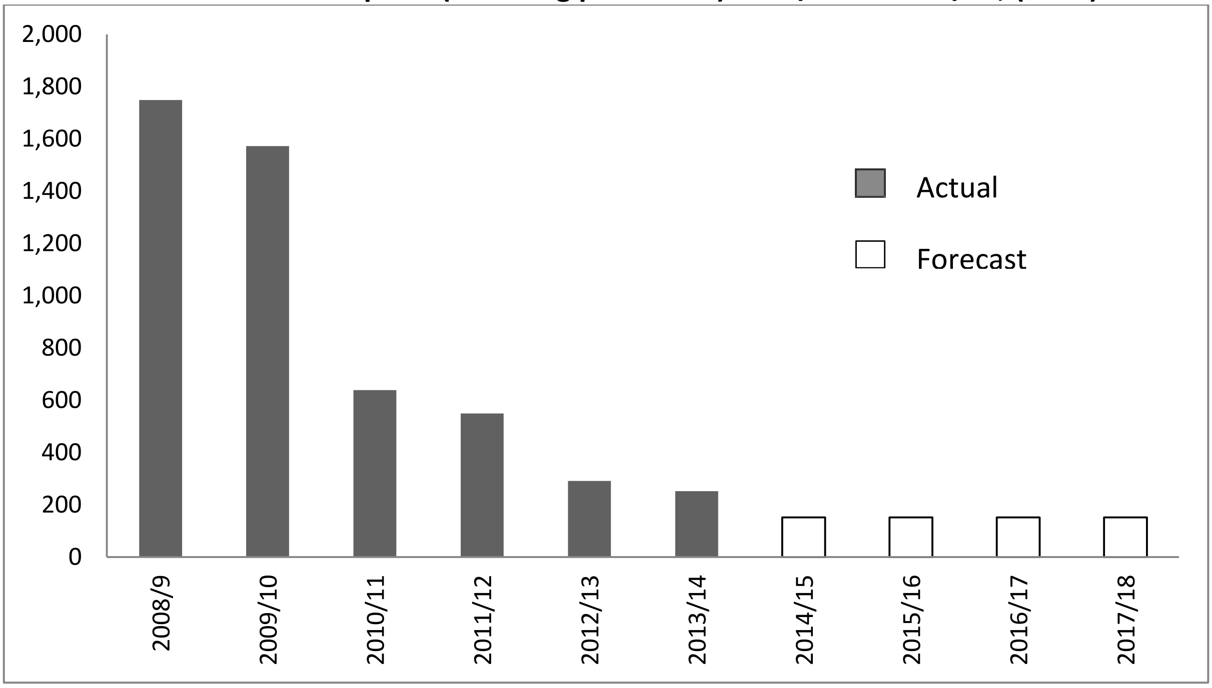
The value of exports has continued to decline from $1.6 million in 2009/10 to $0.142 million for the year ending December 2013. However, the production base in terms of seeded oysters during this period has remained relatively stable at around 290,000 – 300,000 shells. In the December 2012 survey, seeded oysters were estimated at 279,000. The saleable pearl crop for 2013/14 is estimated to be 106,000 pearls – a significant increase on the 70,000 estimated for the 2013 calendar year.

Previously, the bulk of pearls were exported with the domestic market only absorbing around 20 per cent of the annual crop. Since 2009, the declining export figures suggest that an increasing proportion of pearls are being sold on the domestic market where prices are better, or being stockpiled at the Pearl Exchange.

The current plan is to increase the production of Cook Islands pearls with the assistance of a revised pearl production revitalisation programme funded by the New Zealand Aid Programme which was approved in July 2013. Until such time that production increases are evidenced under this programme, the pearl production capacity over the next two to three years will continue to be stable and modest at around 270,000-300,000 seeded oysters, estimated to yield 106,000-115,000 saleable pearls.

The decline in international market prices for black pearls since 2009 (current prices are the lowest on record) has had a major impact on the Cook Islands pearl industry. Demand for high quality pearls from the Chinese jewellery market was beginning to be reflected in improved pearl prices by mid-2014. It is expected that export levels in 2014/15 will continue to decline in comparison to domestic sales.

Chart 1.12 Pearl Exports (including pearl shell) 2008/09 to 2017/18, ($000)



1.6 Agriculture

The Agriculture sector accounted 3.2 per cent of GDP in 2013, an increase of 0.9 per cent or approximately $8.9 million (as compared to $6.8 million in 2012). Agriculture production and export trends appear to show some improvement for 2013, with this trend is expected to continue to improve.

Agriculture food production is an important part of the Cook Islands' cultural tradition, while also forming an important element of food security and overall nutrition. The 2011 Agricultural Census showed that 72 per cent of households in the Cook Islands are engaged in some form of agricultural, horticultural, aboricultural, or livestock activities. In Rarotonga, 67 per cent of households are engaged in agriculture food production (Agriculture Census 2011). These households vary from subsistence agriculture or backyard gardens that supplement brought produce, to semi- and fully-commercial farming.

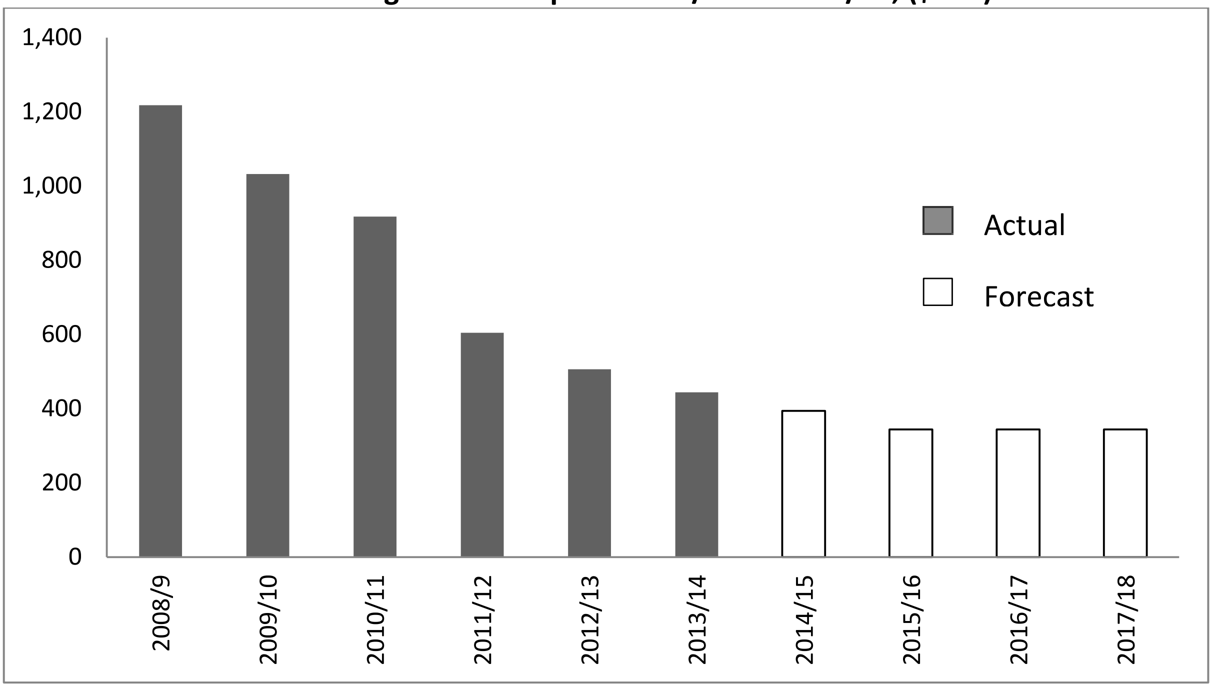
The 2011 Agricultural Census recorded 240 commercial or semi-commercial farmers on Rarotonga, compared to 238 farmers at the time of the 1988 Census of Agriculture.

The Cook Islands has considerable potential for increased local agricultural production (drinking coconuts, root crops, ornamentals, fruits, vegetables, hydroponics vegetables, and processing and value adding products including handicraft products). However, there are numerous constraints that limit further growth in this sector including: substandard facilities for international market access; labour shortages; high fuel costs; high local wages; low water supply; coordination failures in supply chains; land issues; and high costs of transportation to get produce to markets (from the Outer Islands to Rarotonga, or from Rarotonga to abroad).

The Ministry of Agriculture has realised the need to collaborate with other government agencies (such as Health and Education), growers associations, and other non-government stakeholders in an attempt to address the issue of non-communicable diseases (NCDs), especially in relation to the nutritional benefits that could be derived from greater consumption of local food crops.

Current initiatives that the Ministry of Agriculture has underway include the establishment of select high valued crops such as vanilla and maire (under shade cloth) for export. In addition, the use of coconut product for high grade virgin oil and body shop cosmetics, the launching of the Cook Islands Delicious Cactai (dragon fruit), and the newly introduced Cook Islands Golden Pineapple is expected to increase availability on the domestic market from 2013/14 onwards. The forecast of agricultural products has been kept conservative until some of these initiatives show some success.

Chart 1.13 Agriculture Exports 2008/09 to 2017/18, ($000)



Export forecasts continue to decline due to lower maire exports and no growth in the export of noni.

With regards to domestic production, there has been a marked increase in the number of hydroponic and semi hydroponic, biological/organic, and aquaponic systems in Rarotonga, Atiu, Mauke, Manihiki and Aitutaki for the supply of salad products. These products include lettuce, herbs, spring onions, bok choi and some other summer vegetables that cater for the high demands from the local restaurants, super markets and hotels. Together with household consumption, the size and growth in the tourism market suggests that there are still numerous opportunities to fill domestic demand requirements.

1.7 Goods Exports and Imports

1.7.1 Goods Imports

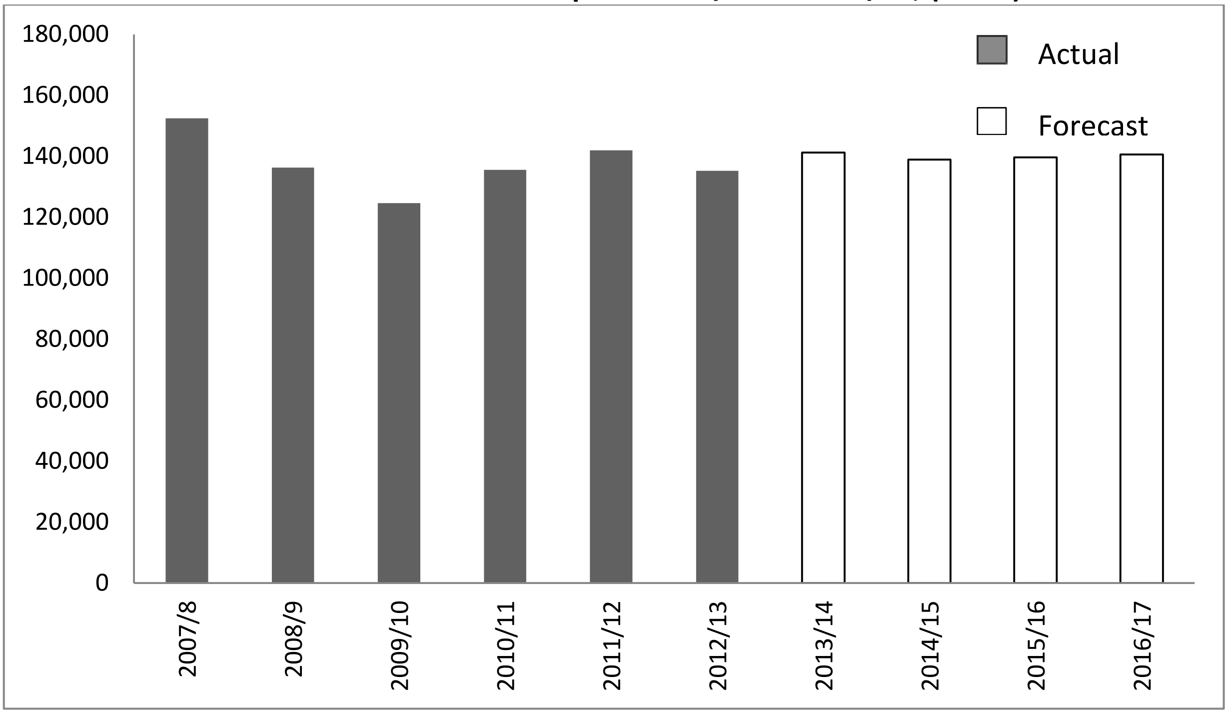
In 2012/13, the total value of imports to the Cook Islands was $135.2 million, a decrease of 4.8 per cent from 2011/12. Imports for 2012/13 were predominantly made up of food and live animals (22.6 per cent); machines, transport and equipment (20.0 per cent); minerals and fuel (19.6 per cent); and miscellaneous manufactured goods (which includes finished or consumer goods) (9.9 per cent).

Data from the 12 months through to September 2013 shows that imports decreased by 0.3 per cent from the year to September 2012. The September quarter 2013 showed 13.9 per cent higher of imports as compared to September 2012, due almost entirely to a 70.7 per cent increase in machinery and equipment. In fact, without the significant contribution from machinery imports (assumedly for construction projects) imports grew just 0.7 per cent from the previous September, and fell 6.7 per cent for the 12 months to September. This is assumed to be a one- off importation of equipment for a construction project and is expected to contribute only to the 2013/14 year, before returning to trend levels in 2014/15.

Imports are expected to grow by 4.5 per cent in 2013/14, and then fall by 1.7 per cent in 2015/16 (due to the purchase of machinery in 2013/14 only affecting that one year).

New Zealand continues to be the leading supplier of imports in to the Cook Islands, accounting for approximately 68 per cent of total imports in 2013.

Chart 1.14 Value of total imports 2007/08 to 2016/17, ($'000)



For 2012/13, it is estimated that import leakage from the Cook Islands was approximately 35 per cent – or more simply, that for every dollar spent in the Cook Islands economy, 35 cents went to foreign production. This is because of the Cook Islands heavy reliance on imported products to meet local demand (including that derived from the tourism industry).

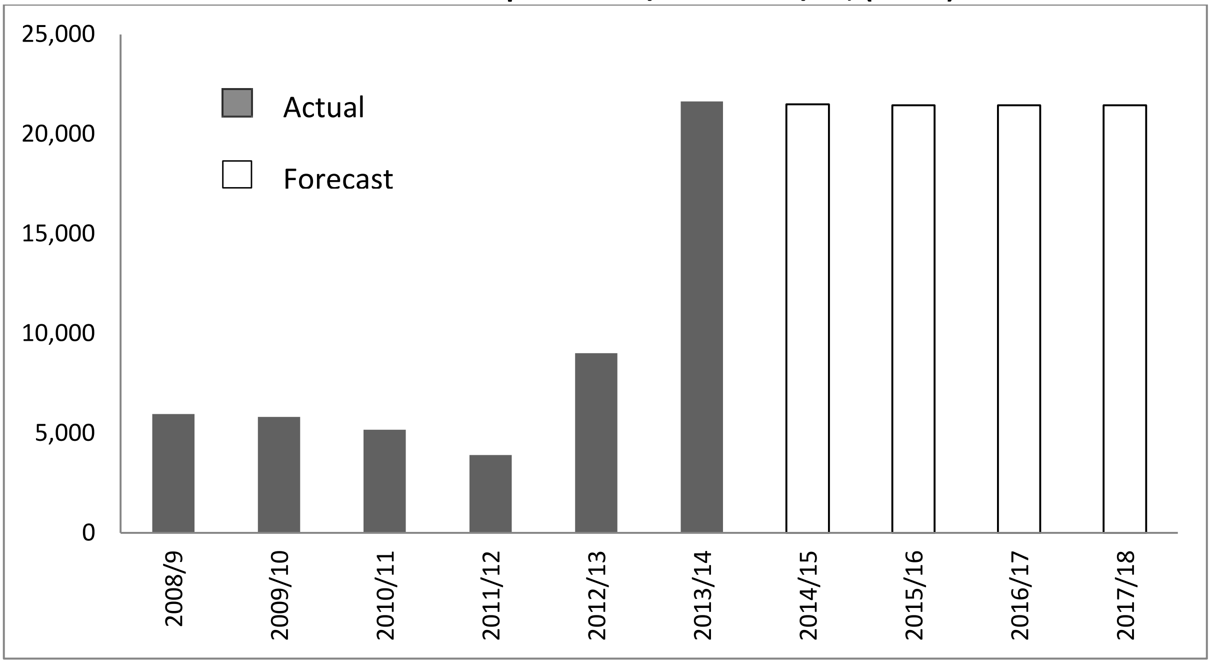
1.7.2 Goods Exports

Total goods exports in 2013/14 grew to $21.6 million, a $12.6 million (40.1 per cent) increase on 2012/13, driven by a $12.8 million increase in the export of fish. The growth in fish exports is due to the arrangement with Chinese fishing vessels (Huanan) being able to offload catch at Avatiu harbour via subsidised fuel costs. It is notable that the all the other categories (noni, pearls, maire and other) experienced declines.

For 2012/13, it is estimated that for every dollar earned in the economy, approximately 63 cents is derived from foreign sources (although this is almost exclusively driven by tourism, with a small contribution from goods exports).

It is expected that total goods exports will decline 0.4 per cent in 2014/15, due largely to declines in non-fish exports. If the arrangement with Huanan is expanded, these forecasts will need to be revised to accommodate the additional fish exports.

Chart 1.15 Total exports 2007/08 to 2016/17, ($'000)



1.7.3 Balance of Trade

A negative merchandise balance of $119.6 million is estimated for 2013/14, improving to a deficit of $117.4 million in 2014/15. The improvement is largely driven by a reduction in the import of capital machinery versus a stable forecast for exports.

Tourism dominates the services trade, with estimates for tourism spend reaching $229.1 million for 2013/14, and $235.5 million in 2014/15.

When estimated services trade is included, the forecast balance of trade is a surplus of $109.5 million for 2013/14, and $118.1 million in 2014/15.[3] This trade surplus is expected to grow in line with increases in tourism spending rising faster than the associated increases in imports (as at least a portion of tourism spending is attributable to local labour and business owners).

[3] While there are no official capital account figures, estimates of a trade surplus (when including tourism arrivals) are supported by cash holdings at Banks in Rarotonga having to be transferred to New Zealand for prudential reasons – this prevents the build-up of cash reserves normally associated with trade surpluses.

Chart 1.16 Balance of Merchandise (goods) Trade 2008/09 to 2017/18, ($'000)

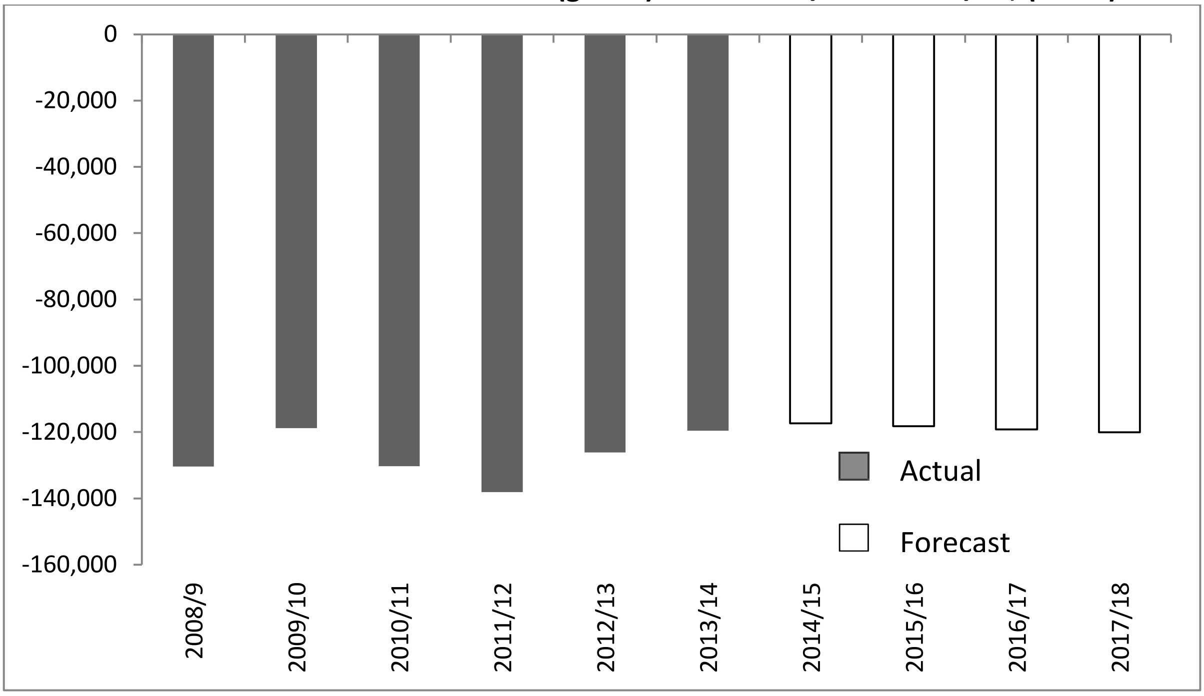


Chart 1.17 Balance of Services Trade 2008/09 to 2017/18, ($'000)

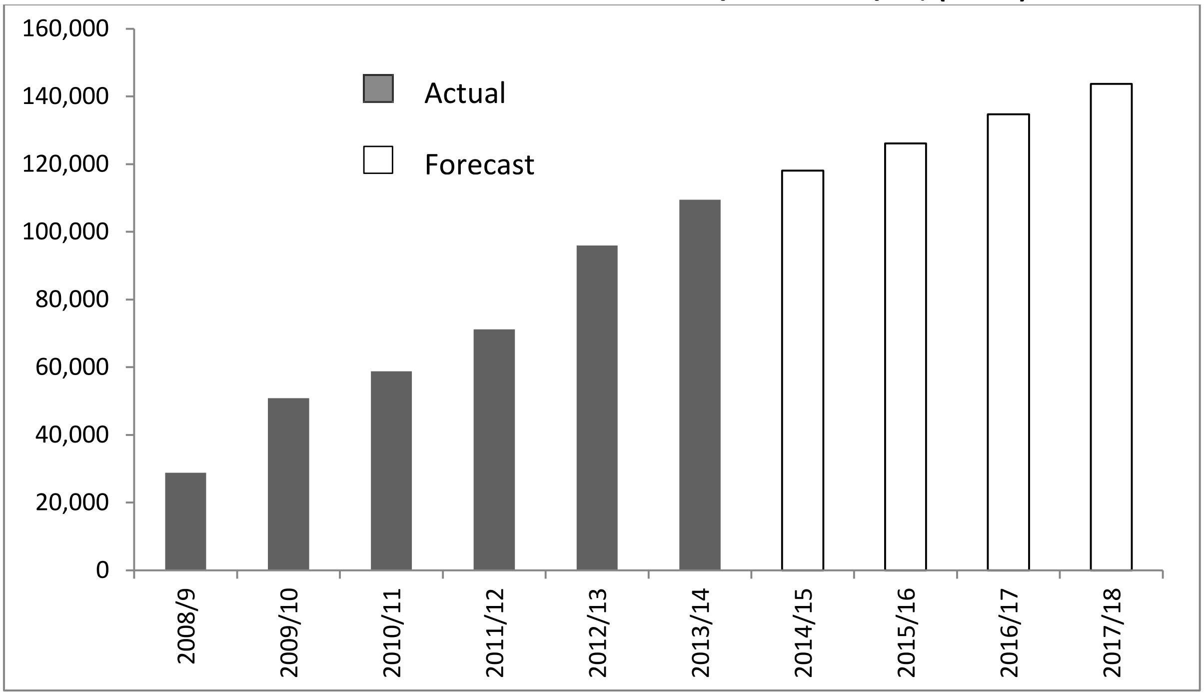
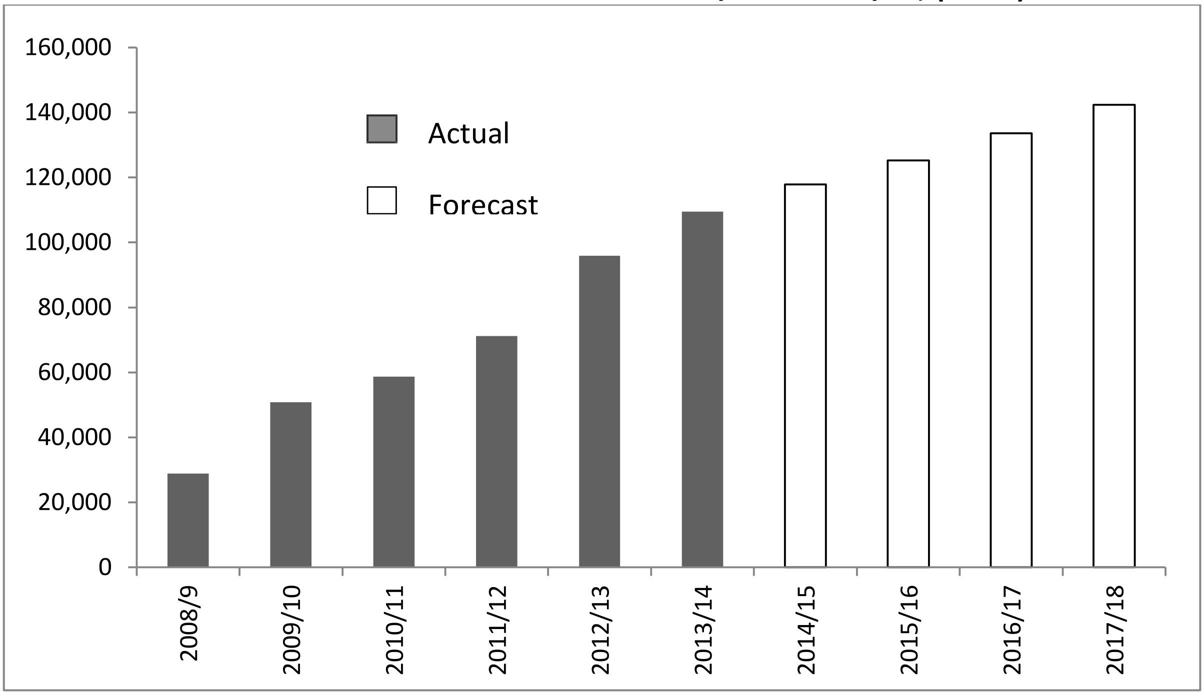


Chart 1.18 Overall Balance of Trade 2008/09 to 2017/18, ($'000)



1.8 Banking and Finance

The Reserve Bank of Australia reports that there has been a continued improvement in financial stability with international financial markets being 'remarkably stable' for the six months to September 2014. The US Federal Reserve has committed to the final tapering off of its monetary stimulus and international markets have broadly been unaffected from the difficulties in the Ukraine and the Middle East. The stability in developed markets, along with a falling oil price, has drawn international financial markets back towards developed economies (particularly the US) at the expense of emerging economies.

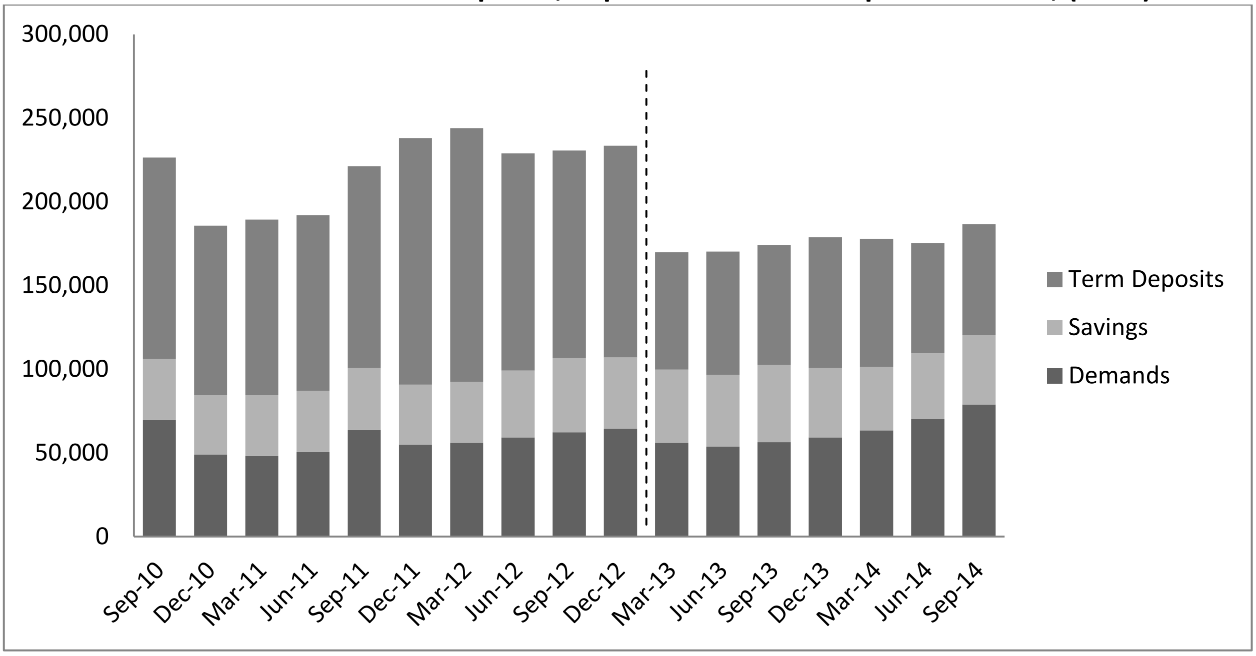
Domestically, there have been positive developments, but non-performing loans and credit rationing remain an issue. The implementation of the Banking Review has been delayed, with future progress likely to be slow. According to the Financial Supervisory Commission, the local banking sector has begun to address the pool of non-performing loans (NPLs), with NPLs falling from 10.36 per cent in the June quarter 2014 to 8.6 per cent in the September quarter of 2014. Some of this improvement has come about through increased efforts to improve loan performance, with the remainder coming from writing off bad debts (with associated effects on profitability and company tax revenue).

1.8.1 Deposits

Due to a revision in the historical series from the 2013 calendar year, it is difficult to make meaningful comparisons prior to 2013. This revision includes the re-classification of codes where balances owed to other banks have now been removed from term deposits and hence the dramatic decrease in reported deposits from December 2012 to March 2013.

Total deposits increased $12.4m between September 2013 and September 2014, to a total of $186.5m. At $120.6m, non-term deposits are the highest on record.

Chart 1.19 Total Value of Deposits, September 2010 to September 2014, ($000)

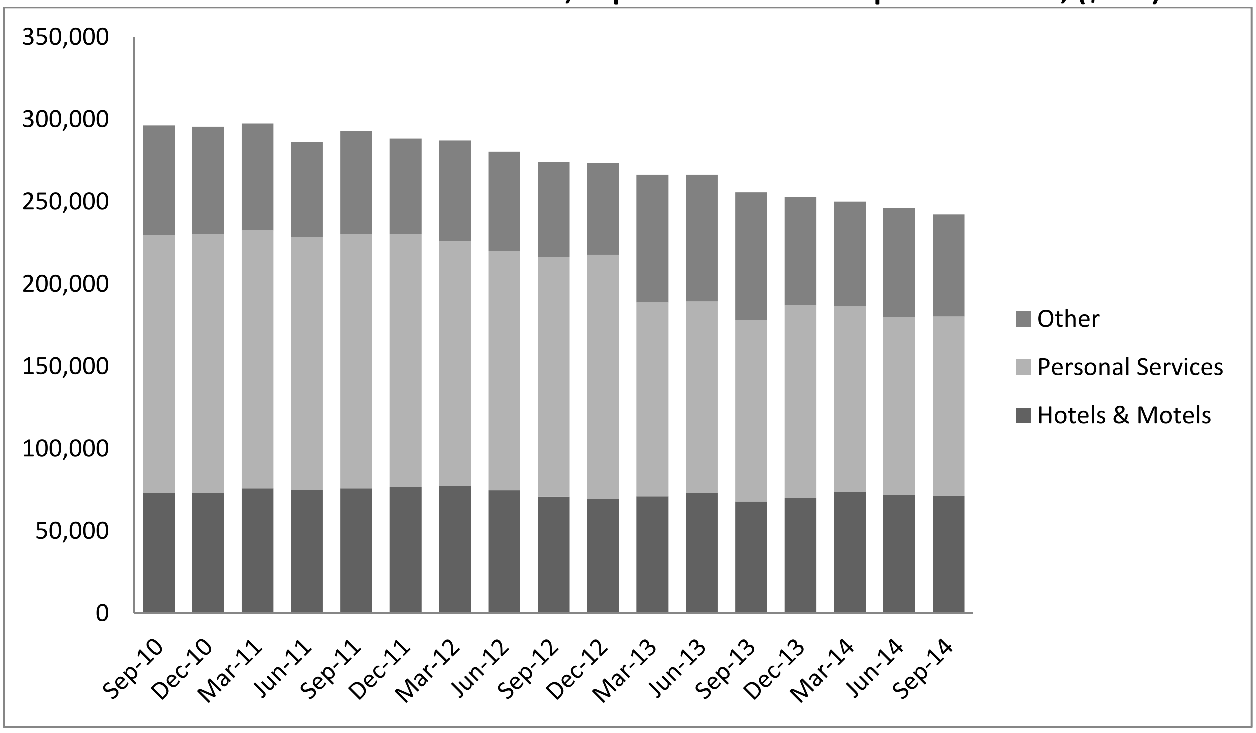


1.8.2 Loans

The overall total value of loans has been in a slow but steady decline since 2008, due largely to declines in personal credit. Total loans fell from $255.5 million in September 2013 to $242.2 million in September 2014, with a $15.3 million decline in 'other loans'.

The on-going portfolio of non-performing loans, together with lenders engaging in credit rationing, is expected to weigh on loan growth going forward. Demand for credit is also assumed to remain weak, with most industries showing little change (or small declines) in overall levels of credit in the past five years.

Chart 1.20 The Total Value of Loans, September 2010 to September 2014, ($000)



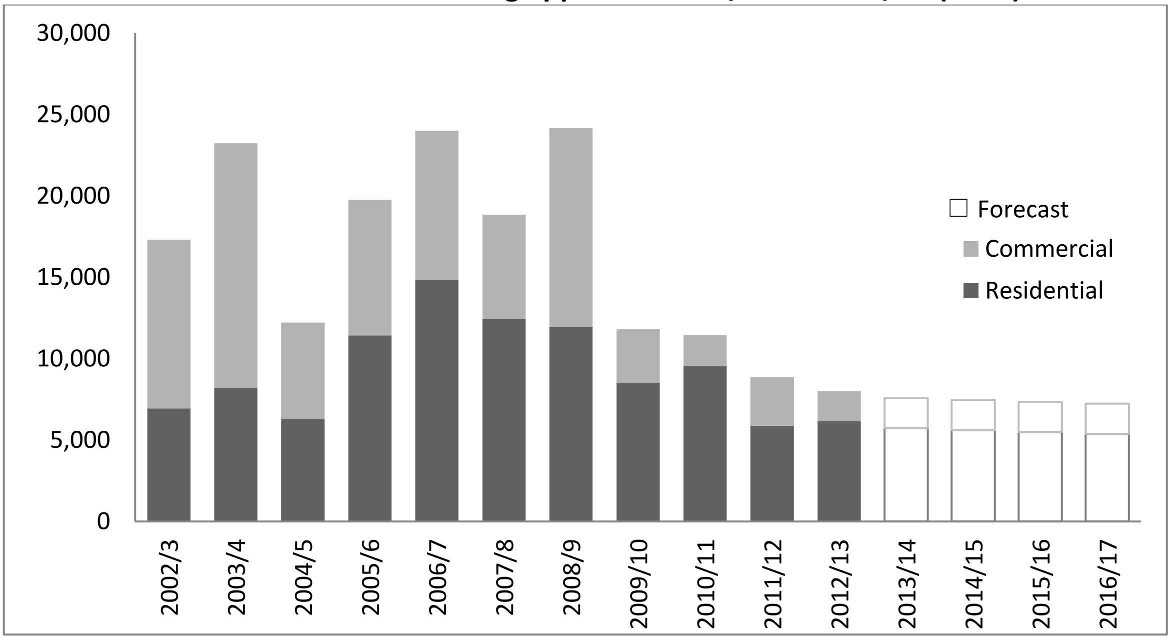
1.8.3 Housing and Construction

The value of building approvals has been in a steady decline since 2008/09 driven by both commercial and residential construction.

The value of approvals for residential construction fell 5.7 per cent between the March quarter 2013 and the March quarter 2014, to a total value of $5.8 million. Residential activity is currently estimated to fall by an annual average of 2.1 per cent for each of the forecast years.

Commercial building approvals were not forecast due to their volatility and sometimes long lead time before construction begins. However, there are significant upside risks to the current level of commercial construction, with the Nautilus Resort likely to add significantly to activity in 2014.

Chart 1.21 Value of building approvals 2002/03 to 2016/17 ($000)



1.9 Financial Services Industry

The financial services industry is estimated to collect fees of a net value of $1.43 million for services undertaken in 2013/14. In 2014/15, net value of services is expected to be slightly lower at $1.4 million due to changes USD exchange rates, as registration fees are generally denominated in USD.

There has been slight decline in trust and limited liability company (LLC) registrations and an increase in company registrations for 2013/14. The Financial Supervisory Commission estimates no annual growth in the number of new international companies, LLCs, trusts and foundations registrations in 2014/15. Foundations are being registered at a slow rate. Captive Insurance is the newest service, with legislation passed in June 2013. It is expected the first captive registration will occur during the 2014/15 Budget year.

New products and services as well as amended legislation for existing services are part of the effort to grow and diversify client markets. The International Companies Act is in the process of being overhauled and is expected to be passed in 2015. Focus continues on promotion of the Cook Islands in Asia, particularly for trusts, foundations, and companies. Promotion of captive insurance in the next year will be targeted to the Australia and New Zealand corporate markets, as well as to existing clients.

The industry continues to comply with international regulatory standards. At the end of 2013, numerous amendments to existing industry legislation were enacted to address areas of improvement highlighted in the country's 2012 OECD Global Forum Phase One Peer Review. The Phase Two Peer Review took place in May 2014 and a positive report is expected at the Global Forum's session in early 2015. New legislation has also been passed to allow banks and trustee companies to comply with international tax information exchange agreements (namely FATCA out of the United States) and each financial institution has registered under FATCA. 2014/15 will see a follow up report to the Asia Pacific Group Mutual Evaluation Report on Anti-Money Laundering and Know Your Customer laws and practices.

1.10 Sensitivity Analysis

There are several risks surrounding the forecasts presented. Modelling alternate scenarios assists officials in planning for possible contingencies should the outlook change and these risks become realised. Four scenarios which are viewed as most likely to affect the forecasts have been modelled and are summarised below:

Scenario 1: **Capital projects experience slippage similar to that experienced in the last two years** – Capital projects contribute a substantial amount to the local economy and missed deadlines delay the economic benefit from wages, contractor fees, and the benefit of the completed infrastructure.

Scenario 2: **Local capacity to carry out capital projects is approaching its limits** – There are concerns that there is not the local capacity to deliver the volume of capital projects scheduled for 2014/15. The capital plans for both 2014/15 and 2015/16 are significantly higher than previous years and may present issues for local contractors to absorb or tender for the new projects.

Scenario 3: **Weaker than expected tourism arrivals** – if the weaker than anticipated tourism arrivals from key markets continue for the remainder for the 2014/15 year, the tourism arrivals will need to be revised downwards.

Scenario 4: **Suppliers of tobacco products stretch out inventories till the end 2015/16** – it has become clear that tobacco suppliers invested significant funds in 2012 to stockpile tobacco products prior to the 33 per cent increase in the tobacco import duties in 2012, 2013 and 2014. Within nine months, importers had stockpiled approximately 3 years worth of supply. Current estimates predict that imports in 2014/15 will be much lower than would have been the case without the bringing forward of stock purchases, with stock running out some time in 2015. If lower consumption means that importers can stretch inventories further into 2015/16, then there will be less need for importing replacement stock in 2014/15.

Table 1.11 Sensitivity Analysis

Scenario	Impact on nominal GDP in 2014/15 (percentage contribution)	Impact on real GDP in 2014/15 (percentage contribution)	Impact on total revenue in... 2014/15 ($000)	2015/16 ($000)
Scenario 1: Slippage in capital projects	-2.6	-2.6	-2,084	-1,957
Scenario 2: Lack of capacity to deliver capital projects	-3.0	-3.0	-2,426	-1,870
Scenario 3: Weak tourist arrivals	-1.4	-1.2	-1,336	-1,491
Scenario 4: Extended tobacco inventories	0.1	0.4	-780	-790

2 FISCAL UPDATE

2.1 Overview

The purpose of the Fiscal Update is to provide necessary revisions to the fiscal forecasts that underpinned the 2014/15 Budget published in October 2014. Due to the general elections held on the 9 July 2014 and the length of time it has taken to confirm the Executive, the normal development process of the budget has been interrupted. Therefore the Fiscal Update provides only two months of new data following the publication of the 2014/15 Budget.

To control the impacts of fiscal policy on fiscal and macroeconomic stability, the Government of the day must operate within the fiscal responsibility principals outlined in the MFEM Act as follows:

- ensuring that unless Crown debt is at prudent levels, operating expenses will be less than operating revenues (i.e. Government will run an operating surplus);
- achieving and maintaining levels of Crown net worth that provide a buffer against factors which may impact adversely on net worth in the future;
- managing prudently the fiscal risks facing the Crown; and
- pursuing policies that are consistent with a reasonable degree of predictability about the level and stability of tax rates for future years.

The purpose of the Fiscal Update is to revise the fiscal forecasts underpinning the 2014/15 Budget published in October 2014. In updating the fiscal forecasts the following factors have been considered:

- year to date assessment of revenues and expenditure patterns against original Budget estimates 2014/15; and
- updated economic forecasts which have impact on forecasted government revenues.

Since the 2014/15 Budget total:

- operating revenue has reduced by $0.510 million and
- operating expenditure remains the same as originally budgeted.

2.1.1 Updated economic forecasts which have a direct impact on forecasted government revenues

Due to the lower than expected tax collections since the formation of the 2014/15 Budget estimates and declines in key tourist markets, tax revenue has been revised down in 2014/15 and all future years.

Nominal economic growth (which is what tax income is derived from) is estimated to be as follows:

- 2.0 per cent decline in 2013/14 (previously 2.6 per cent growth) due new data being available which showed large decreases in financial services and construction;
- 4.8 per cent growth in 2014/15 (previously 4.5 per cent) due to the large increase in public capital projects; and
- 1.3 per cent growth in 2015/16 (previously 1.1 per cent) due to a large reduction in the aid expenditure profile.

2.1.2 Year to Date Assessment of revenues and expenditure patterns

Since the 2014/15 Budget published in October, economic conditions and the availability of new data have resulted in the revenue projections being shifted downwards. The net operating surplus for 2014/15 was originally estimated to be $0.009 million. After reviewing two months of actual receipts, tax revenue has been revised downwards by $1.0 million for the 2014/15 Budget year. Reductions in revenue result in a net operating deficit of $0.501 million for 2014/15, $0.316 million deficit in 2015/16, $3.3 million deficit in 2016/17 and $0.602 million deficit in 2017/18.

In addition other revenue has been adjusted to take into account banking arrangements on behalf of the Financial Supervisory Commission to receive deposits which are bona vacantia assets vested with the Registrar. They become vested with the Registrar when a company has been struck off our registry whilst still holding assets. These deposits can face legal ownership claims for a period of six years. After the six year period no claim can be entertained and the money passes to the Crown. It is anticipated that the Crown will receive approximately $0.500 million for 2014/15.

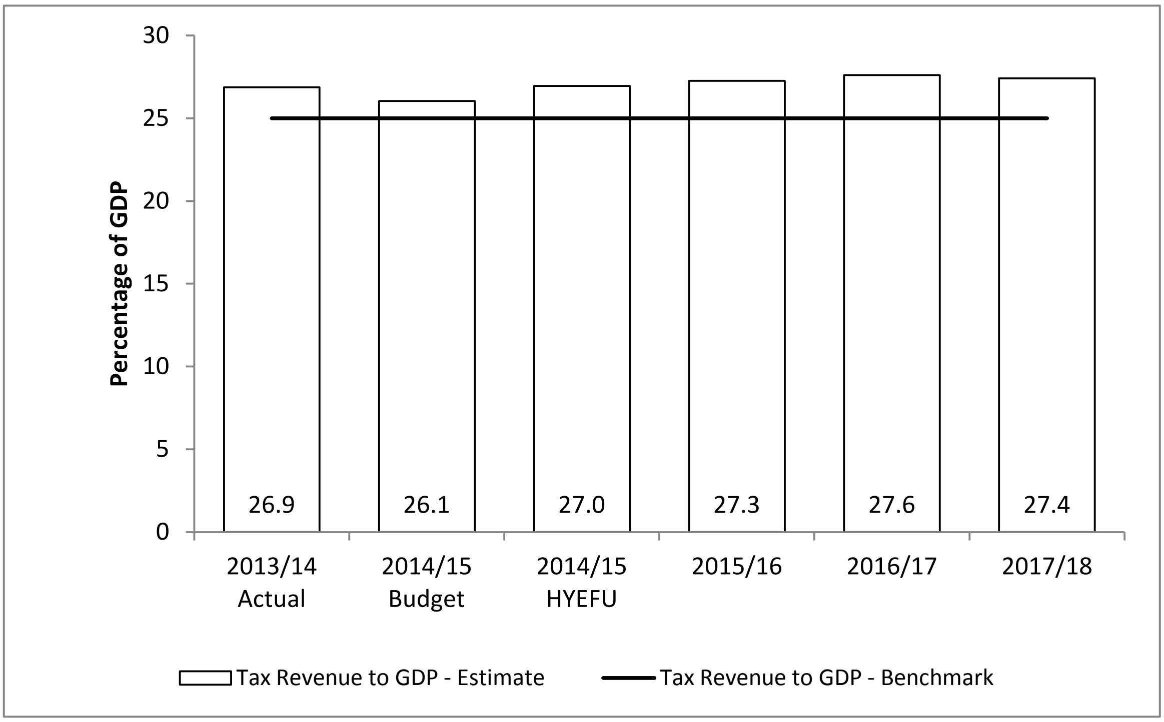
These revisions suggest that the 2015/16 Budget will be carried out under tight fiscal conditions with limited fiscal space for new initiatives. Therefore, Crown expenditures will be monitored closely, and Government will need to consider cost saving policies if new initiatives are to be considered.

The Ministry of Finance and Economic Management quantifies these principles through the Fiscal Responsibility Ratios (FRR) as reported in the 2014/15 Budget. The performance of each of the FRR's are discussed below, discussing the benchmarks of these ratios and performance in 2014/15 and expectations for 2015/16 based on revised forecasts.

2.1.3 Tax Revenue to GDP

This ratio sets the revenue boundary and ensures government limits the diversion of resources away from the private sector. The benchmark government agrees to work within is maintaining collections to within 25 per cent of GDP. The expected performance against this benchmark is illustrated in Chart 2.1 below.

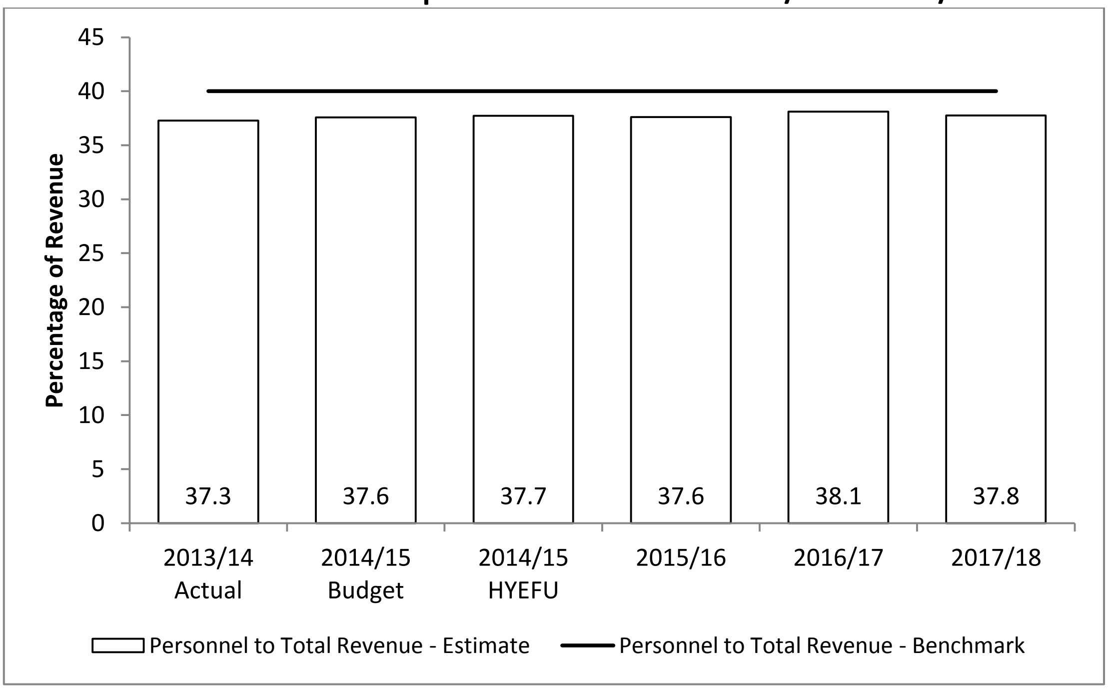
Chart 2.1 Tax Revenue to GDP 2013/14 to 2017/18



2.1.4 Personnel Expenditure to Revenue

This ratio is aimed at controlling the expansion in the size of the public service as the largest expenditure item of Government. The benchmark government agrees to work within is maintaining expenditure on personnel within 40 per cent of total revenues. As illustrated in Chart 2.2, the Government is expecting to remain within the 40 per cent in 2014/15 and outer years.

Chart 2.2 Personnel Expenditure to Revenue 2013/14 to 2017/18

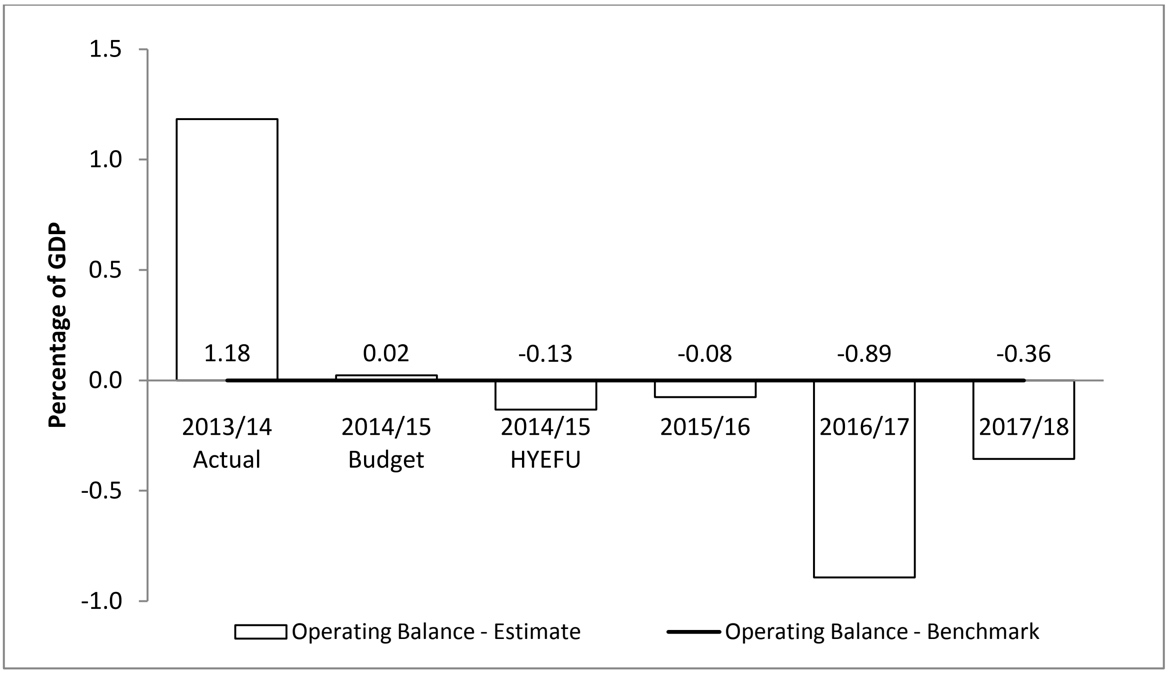


2.1.5 Underlying Net Operating Balance

Maintaining a positive operating balance indicates that Government is able to afford the operational costs of performing the functions of government from its own revenue streams. Government has set a benchmark of running an operating surplus in each Budget. Note the graph represents the underlying operating balance as a percentage of GDP. As illustrated below, it is anticipated that Government has an underlying operating deficit of $0.50 million in 2014/15 due to the parameter changes in taxation revenue. Going forward, expenditure and revenue estimates are predicted to result in a $0.29 million operating deficit in 2015/16, a $3.33 million deficit in 2016/17 and a $1.35 deficit in 2017/18.

Government will need to implement policy measures to improve cost recovery for service rendered by line ministries whilst also taking into account saving measures to improve efficiencies in Government.

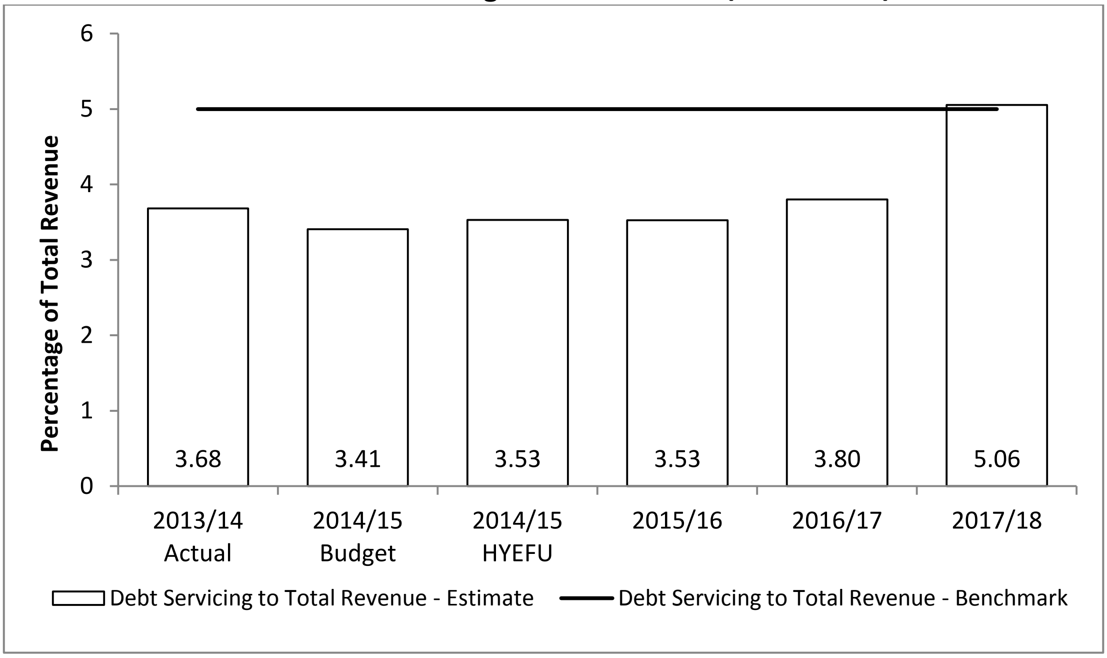
Chart 2.3 Underlying Operating Balance 2013/14 to 2017/18



2.1.6 Net Debt Servicing to Revenue

Debt servicing to total revenue measures the ability of Government to service its debt obligations from revenue collected. Debt servicing includes both interest, principle, and is now net of draw-downs of loan reserves to more accurately reflect the ability of Government to service its debt obligations. The benchmark set is to maintain within five per cent of revenue. With this amendment to the ratio the level of debt servicing against benchmarks within the short to medium term is maintained within the benchmark as shown in Chart 2.4.

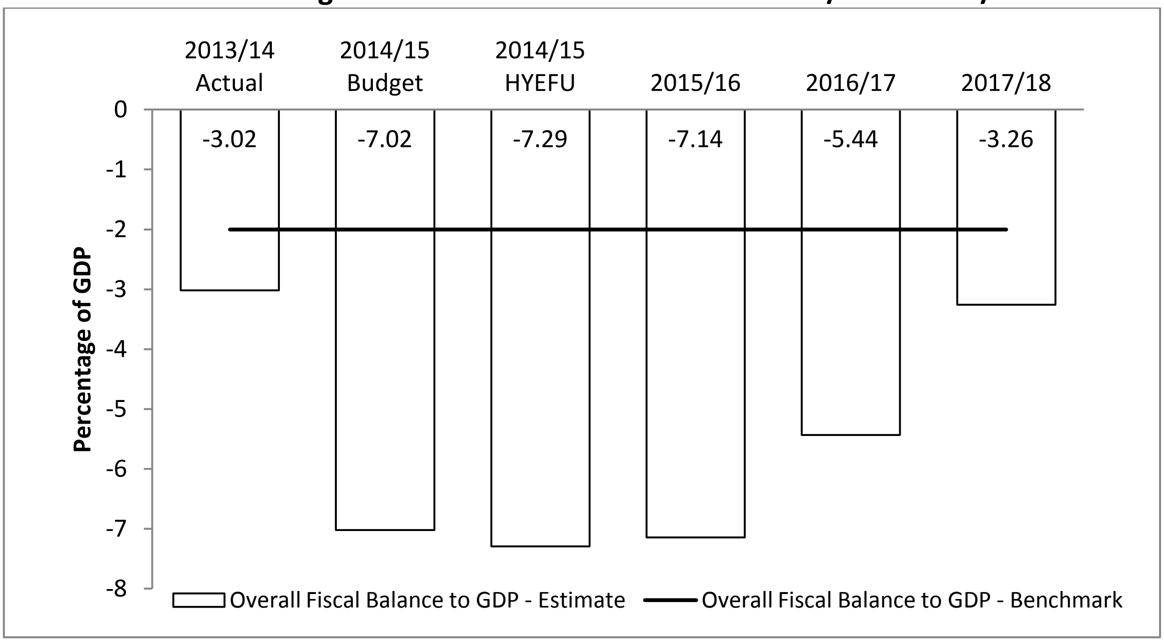
Chart 2.4 Debt Servicing to Revenue 2013/14 to 2017/18



2.1.7 Budget Overall Fiscal Balance to GDP

Budget Overall fiscal balance is the operating balance less non-operating expenditure (purchase of assets and repayment of liabilities). Where the budget overall balance is in deficit, it must be serviced through lending or payment through reserve funds. The benchmark is set to be maintained within -/+2 per cent to ensure that government does not accumulate debt too quickly, and taken together with the debt servicing to total revenue and net debt to GDP ratios, ensures that debt is managed and taken on within sustainable levels. Chart 2.5 illustrates that Government will go outside of benchmark limits over the short to medium term, due to large capital projects.

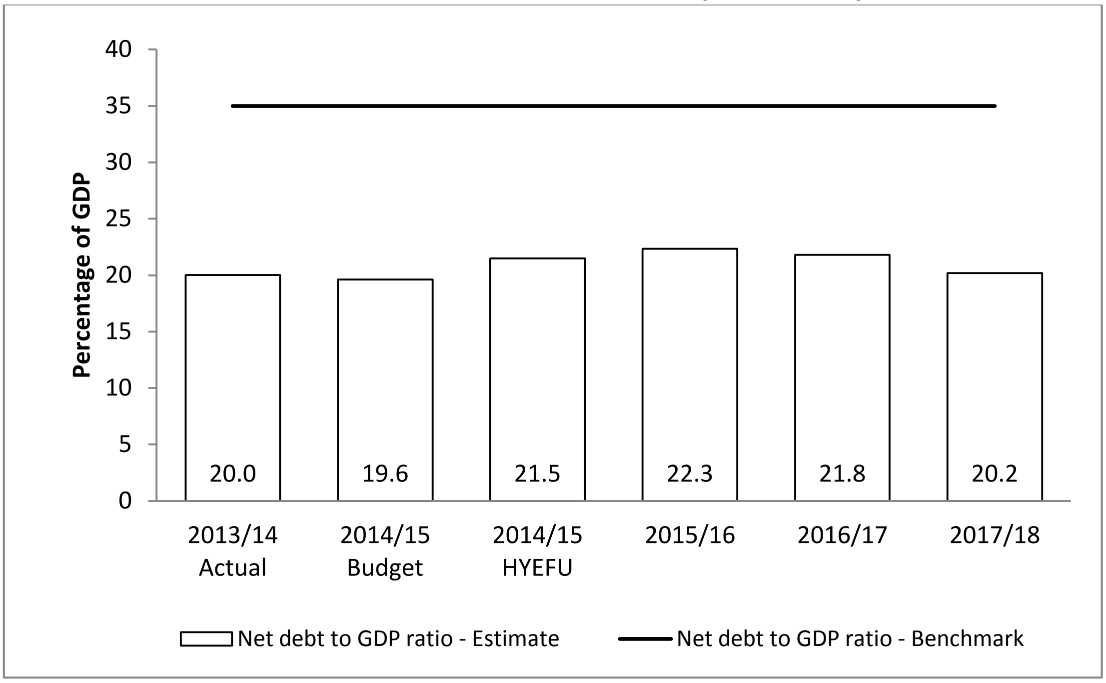
Chart 2.5 Budget Overall Fiscal Balance to GDP 2013/14 to 2017/18



2.1.8 Net Debt to GDP

Net debt to GDP measures the level of debt relative to national income and is intended to control the overall level of debt taken on by Government including SOE's. The benchmark agreed to by Government is to maintain net debt within 35 per cent of GDP. Chart 2.6 illustrates that Government is well within the benchmark over the short and medium term.

Chart 2.6 Net Debt to GDP Ratio 2013/14 to 2017/18



2.1.9 Summary of Medium Term Fiscal Policy

The Government will undertake the following fiscal strategies to ensure the FRR are achieved whilst providing limited space for further policy initiatives:

- Following the revisions for 2015/16 Budget, the fiscal setting should be carried out under tight fiscal conditions. Therefore Government will need to consider cost saving policies and initiatives. New budget initiatives will be supplemented by identifying initiatives that can be funded through efficiencies gained in other areas of government operations;
- Actively engage with donor partners to align development assistance to this policy statement and our longer term priorities outlined in our National Sustainable Development Plan 2011-2015; and
- Continue to put a portion of total tax receipts into the reserve trust fund building a buffer to protect the net worth of the Crown.

Table 2.1 Fiscal Indicators Update

	FY13/14 Estimate	FY14/15 Budget	FY14/15 HYEFU	FY15/16 Estimates	FY16/17 Projection	FY17/18 Projection
Statement of Financial Performance						
Taxation Underlying Revenue ($m)	97.2	103.1	102.1	104.6	103.0	104.1
Social Contributions ($m)	0.0	0.0	0.0	0.0	0.0	0.0
Other Underlying Revenue ($m)	20.9	20.1	20.6	18.7	18.8	18.7
Total Operating Underlying Revenue ($m)	**118.0**	**123.2**	**122.7**	**123.4**	**121.8**	**122.8**
Total Underlying Revenue Percentage of GDP ($m)	32.6	31.1	32.4	32.2	32.7	32.3
Tax Underlying Revenue Percentage of GDP ($m)	26.9	26.1	27.0	27.3	27.6	27.4
Personnel ($m)	**44.0**	**46.3**	**46.3**	**46.4**	**46.4**	**46.4**
Percentage of Total Underlying Revenue	37.3	37.6	37.7	37.6	38.1	37.8
Total Operating Underlying Expenditure ($m)	**113.7**	**123.2**	**123.2**	**123.6**	**125.1**	**124.2**
Percentage of GDP	31.5	31.1	32.5	32.2	33.5	32.7
Percentage of Operating Underlying Revenue	96.4	100.0	100.4	100.2	102.7	101.1
Re-appropriation of Previous Years Funds for Capital ($m)	0.0	0.0	0.0	0.0	0.0	0.0
Underlying Operating Balance ($m)	**4.28**	**0.09**	**-0.501**	**-0.316**	**-3.33**	**-602**
Percentage of GDP	1.2	0.0	-0.1	-0.1	-0.9	-0.4
Non Operating Balance ($m)	15.2	27.9	27.1	27.1	16.9	11.0
Fiscal Balance surplus/deficit ($m) *	**-10.9**	**-27.8**	**-27.6**	**-27.4**	**-20.3**	**-12.4**
Percentage of GDP	-3.0	-7.0	-7.3	-7.1	-5.4	-3.3
Statement of Financial Position ($m)						
Assets ($m)	530.5	600.1	669.2	642.7	660.4	679.6
Liabilities ($m)	119.0	116.0	113.0	120.4	117.0	113.1
Crown Balance ($m)	411.5	484.1	556.1	522.3	543.4	566.5
Percentage of GDP	-113.8	-122.3	-146.8	-136.1	-145.7	-149.1
Statement of Borrowings ($m)						
Gross Debt end of FY ($m)	89.3	93.7	97.6	102.0	96.9	89.9
Percentage of GDP	24.7	23.7	25.8	26.6	26.0	23.7
Net Crown Debt, end of FY ($m)	72.4	77.7	81.4	85.7	81.3	76.7
Percentage of GDP	20.0	19.6	21.5	22.3	21.8	20.2
Loan Repayment Reserves Held ($m)	16.2	16.1	16.3	16.2	15.6	13.2
Development Partner Support ($m)						
Grants ($m)	33.2	63.7	34.7	34.7	24.4	24.4
Percentage of GDP	9.2	16.1	9.2	9.0	6.5	6.4
Net Debt Servicing1 ($m)	4.3	4.2	4.3	4.3	4.6	6.2
Percentage of Total Underlying Revenue	3.7	3.4	3.5	3.5	3.8	5.1
Memo item: Nominal GDP ($m)	361.6	395.7	378.8	383.7	372.9	379.8

1. Note change in formula since the Budget Estimates 2012/13. Net Debt servicing is now net of drawdown of loan reserves used to service SOE debt repayments.

2.2 Government Financial Statistics (GFS) Operating Statement

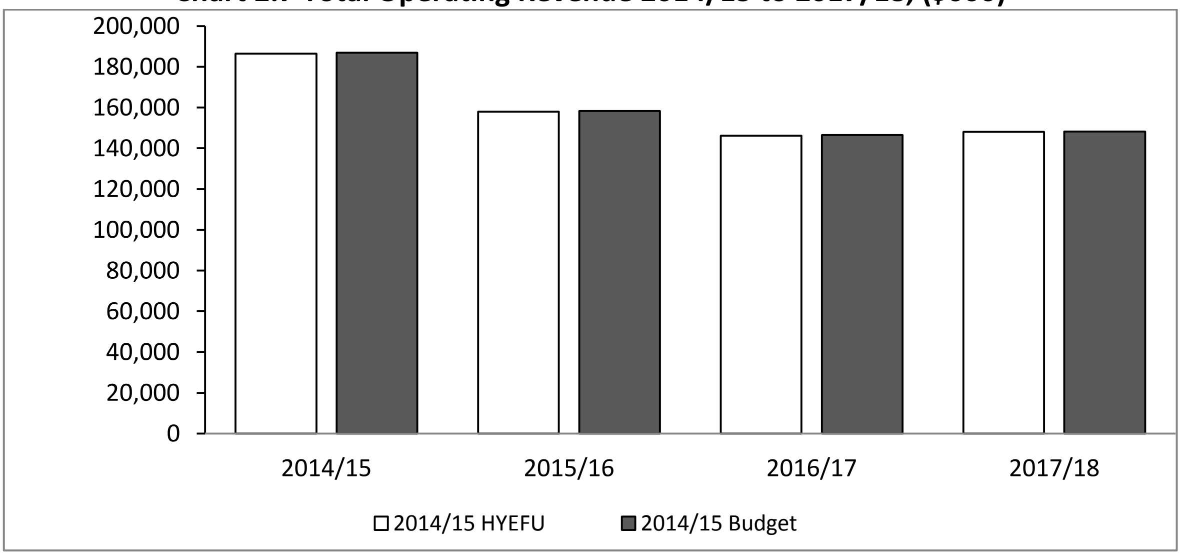
The Operating Statement reflects the financial performance of Government and discusses general trends and revisions of forecasts for operating revenues, operating expenditures and the resultant operating balance.

Table 2.2 GFS Operating Statement

Statement of Government Operations	2014/15 Forecasts	2015/16 Forecasts	2016/17 Forecasts	2017/18 Forecasts
TRANSACTIONS AFFECTING NET WORTH				
REVENUE	**186,456**	**158,073**	**146,215**	**148,057**
Taxes	107,686	110,189	108,568	110,437
Social contributions	20	20	20	20
Grants	63,762	34,749	24,484	24,484
Current	17,597	12,629	9,549	9,549
Capital	46,166	22,120	14,935	14,935
Other revenue	14,988	13,114	13,142	13,115
EXPENSE	**140,792**	**136,268**	**134,609**	**133,724**
Compensation of employees	48,704	48,692	48,689	48,685
Use of goods and services	42,312	37,668	34,078	33,319
Depreciation	9,785	9,758	11,755	11,771
Interest	2,137	2,285	2,223	2,085
Subsidies	15,026	15,026	15,026	15,026
Grants	0	0	0	0
Social benefits	17,501	17,570	17,570	17,570
Other expense	5,323	5,267	5,267	5,267
NET OPERATING BALANCE	**45,664**	**21,805**	**11,606**	**14,333**

2.2.1 GFS Operating Revenue

Chart 2.7 Total Operating Revenue 2014/15 to 2017/18, ($000)



At the time of the 2014/15 Budget published in October 2014, GFS Operating revenues in 2014/15 were estimated to total $186.9 million, of which $108.6 million was expected to be collected in taxes over the financial year.

Since the 2014/15 Budget, movements in taxation revenues have resulted in a downward revision of operating revenues by $0.501 million to $186.4 million, due to parameter changes.

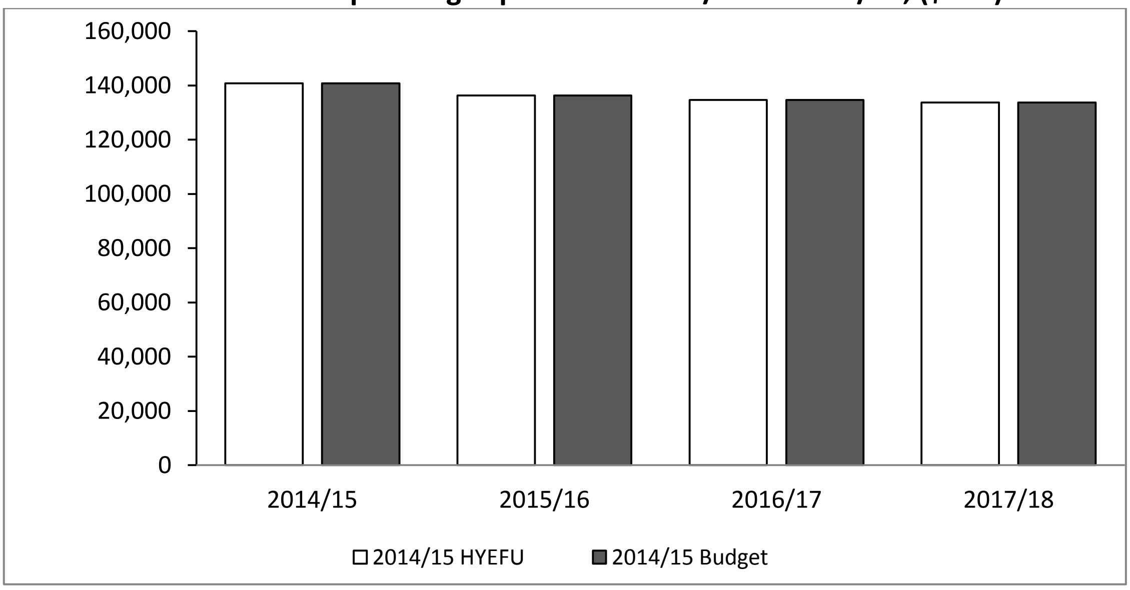
Total tax receipts for 2014/15 are expected to be $1.0 million lower than forecast at the time of the 2014/15 Budget due to downward revisions in income, company and import taxes. Most of the revision in income taxes comes from the writing-off of non-performing assets in the local banking sector, which have negatively affected profitability in the short term. Import duties continue to perform poorly, although data on the reasons behind this are not yet available. It is assumed that the stockpiling of tobacco is still affecting import duty numbers.

There are minor adjustments to other revenue to take into account arrangements on behalf of the Financial Supervisory Commission to receive deposits which are bona vacantia assets vested with the Registrar. They become vested with the Registrar when a company has been struck off our registry whilst still holding assets. These deposits can face legal ownership claims for a period of six years. After the six year period no claim can be entertained and the money passes to the Crown. It is anticipated that the Crown will receive approximately $0.500 million for 2014/15.

2.2.2 GFS Operating Expenditure

Operating expenditure is made up of Compensation of Employees (35 per cent), Use of Goods and services (33 per cent), Subsidies (13 per cent), Social Benefits (12 per cent), Depreciation (7 per cent) and other expenses, which include interest expense (4 per cent).

Chart 2.8 Total Operating Expenditure 2014/15 to 2017/18, ($000)



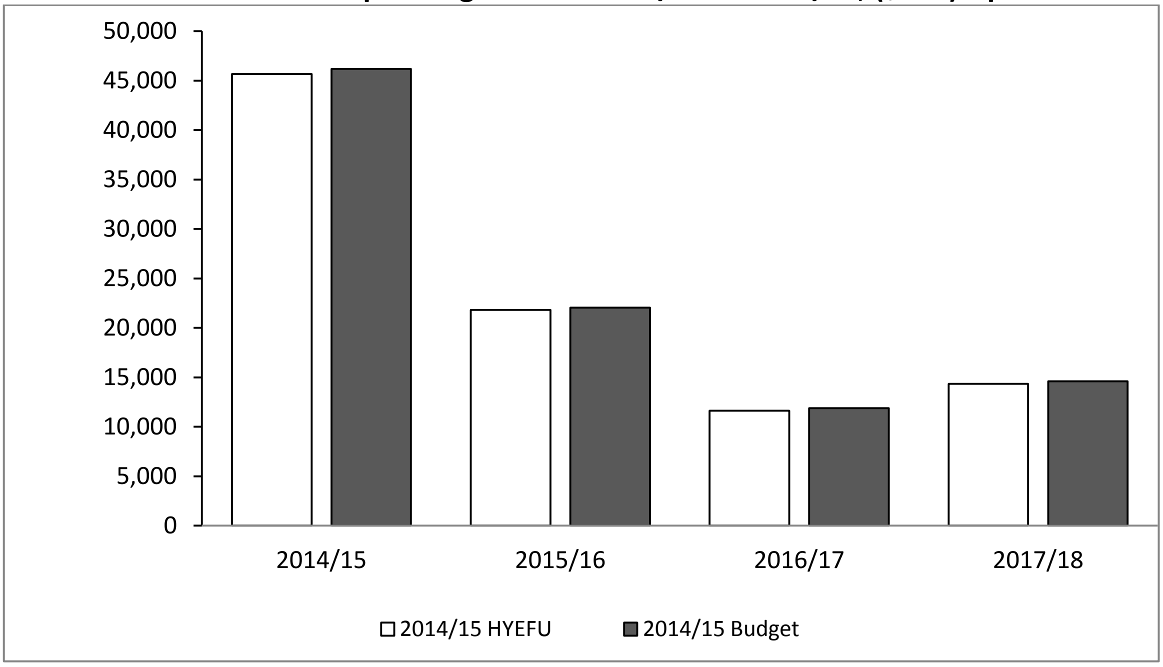
Operating expenditures at the time of the 2014/15 Budget were estimated at $140.7 million in October 2014, at this time the estimates remain the same as previously forecasted. It is anticipated that operating expenditure will be reviewed again in February 2015 to monitor actual spending of the Crown.

2.2.3 GFS Net Operating Balance

The GFS operating balance is the balance of operating revenues minus operating expenditure as prescribed by the MFEM Act. Given the analysis provided in sections 2.2.1 and 2.2.2, the net underlying operating balance in 2014/15 at the time of the budget was estimated at $0.009 million, considering the revised estimates mentioned above, the net operating balance has been revised to a larger deficit of $0.501 million, due in large part the reduction in taxation revenue from the local banking sector writing off bad debts affecting revenue estimates more than the once-off revenue from the FSC.

Going forward, changes in revenue estimates are predicted to result in a $0.501 million operating deficit in 2014/15, and a $0.316 million deficit in 2015/16. It is anticipated that the completion of capital works before the 2016/17 year negatively impacts on revenue in that year, leading to a deficit of $3.3 million in 2016/17 and a further deficit of $0.602 million in 2017/18. GFS Net Operation surplus is demonstrated below in Chart 2.9.

Chart 2.9 GFS Net Operating Balance 2014/15 to 2017/18, ($000) Update



Changes to the GFS operating balance and the underlying operating balance since the time of the 2014/15 Budget are shown below in Table 2.3, Table 2.4 and Table 2.5 respectively.

Table 2.3 Changes to GFS Operating Balance since 2014/15 Budget Estimates ($000)

	2014/15	2015/16	2016/17	2017/18
GSF Operating Balance as at 2014/15 Budget	**46,174**	**22,030**	**11,862**	**14,600**
Change to Operating Revenues	-510	-226	-256	-267
Change to Operating Expenditures	0	0	0	0
GSF Operating Balance as at 2014/15 HYEFU	**45,664**	**21,805**	**11,606**	**14,333**

Note: The table above summarises total movements in operating revenues and operating expenditure since the time of the Budget 2014/15 in the GFS format published in October 2014.

Table 2.4 Reconciliation of GFS Operating Balance and the Underlying Net Operation Balance 2014/15 to 2017/18 ($000)

Statement of Government Operations	2014/15 Projected $'000	2015/16 Projected $'000	2016/17 Projected $'000	2017/18 Projected $'000
NET GFS Operating Balance	**45,664**	**21,805**	**11,606**	**14,333**
GFS Revenue	186,456	158,073	146,215	148,057
Remove ODA Revenue	63,763	34,749	24,484	24,484
Underlying Revenue	**122,693**	**123,324**	**121,730**	**123,573**
GFS Expenditure	140,792	136,268	134,609	133,724
Remove ODA Revenue	17,597	12,629	9,549	9,549
Underlying Expenditure	**123,195**	**123,639**	**125,059**	**124,175**
Underlying Budget Balance	-501	-315	-3,329	-602
FINAL UNDERLYING NET OPERATING BUDGET BALANCE	**-501**	**-315**	**-3,329**	**-602**

The above table provides an updated reconciliation on the net operating balance between the GFS framework standard and the previous budget framework format, recognising the two different budget measures.

Table 2.5 Reporting of Underlying Net Operation Balance 2014/15 to 2017/18

Statement of Government Operations	2014/15 Projected $'000	2015/16 Projected $'000	2016/17 Projected $'000	2017/18 Projected $'000
Net Underlying Operating balance 2014/15	**9**	**-90**	**-3,073**	**-335**
Revenue				
Total Parameter Changes	**-510**	**-226**	**-256**	**-267**
VAT Adjustments	0	0	0	0
Income Adjustments	-388	0	-10	-17
Import Levies Adjustments	-200	-204	-210	-215
Company Tax Adjustments	-494	14	-5	-9
Departure Tax Adjustments	-33	-36	-31	-27
Withholding Adjustments	105	0	0	0
Other ROBOCs				
FSC-Vested Assets	500	0	0	0
Total Revenue Changes	**-510**	**-226**	**-256**	**-267**
Total Expenditure Changes	**0**	**0**	**0**	**0**
FINAL NET UNDERLYING OPERATING BALANCE	**-501**	**-316**	**-3,329**	**-602**

The 2014/15 underlying operating balance takes into account the removal of ODA revenue and expenditure.

The underlying operating balance was initially estimated at $0.009 million at the time of the Budget, after the revision of estimates this has arrived to a budget deficit of $0.501 million for 2014/15. Going forward, changes in revenue estimates are predicted to result in a $0.316 million operating deficit in 2015/16, $3.3 million deficit in 2016/17 and a $0.601 million deficit in 2017/18. It should be noted that the 2014/15 net underlying operating balance is still in deficit and Government will need to implement policy measures to improve cost recovery for service rendered by line ministries whilst also taking into account saving measures to improve efficiencies in Government.

2.3 Crown Debt and Net Worth

2.3.1 Gross Debt owed by the Crown

Total gross debt owed by the Crown is now estimated to be $97.6 million, a variance of $3.9 million from what was initially estimated during the 2014/15 Budget. Table 2.6 shows the movement was due to an unfavorable movement in exchange rate of $3.9 million, all major trading currencies appreciates against the New Zealand dollar (NZD);

Table 2.6 Reconciliation on 2014/15 Loan Movement

Movement Reconciliation	$ Million
Initial estimated gross debt for 30 June 2015 (Budget)	93.7
Movement during the period	
Unrealised exchange (gain)/loss	3.9
Estimated gross debt for year ending 30 June 2015	97.6

The exchange rate used for this write up reflects the 10 day average up to 10 December 2014. Past changes in major exchange rates against the NZD are reflected in Chart 2.10.

The main cause for this unfavourable movement in exchange rate was the movement in the RMB with an 8.5 per cent appreciation against the NZD followed by the USD with 8.3 per cent, 4 and 1 per cent to the SDR and Euro respectively.

Chart 2.10 Changes in Major Exchange Rates

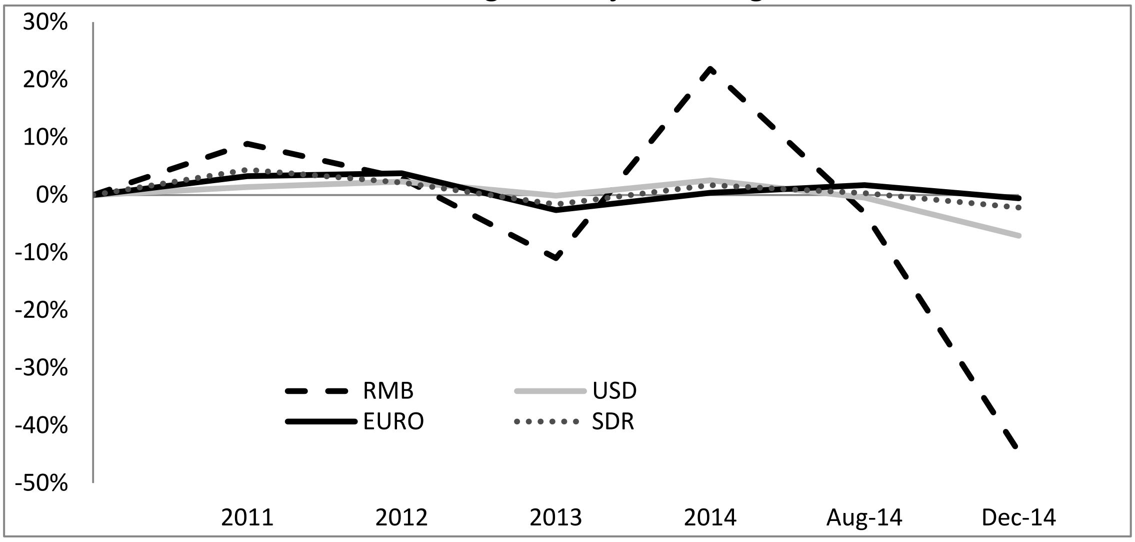


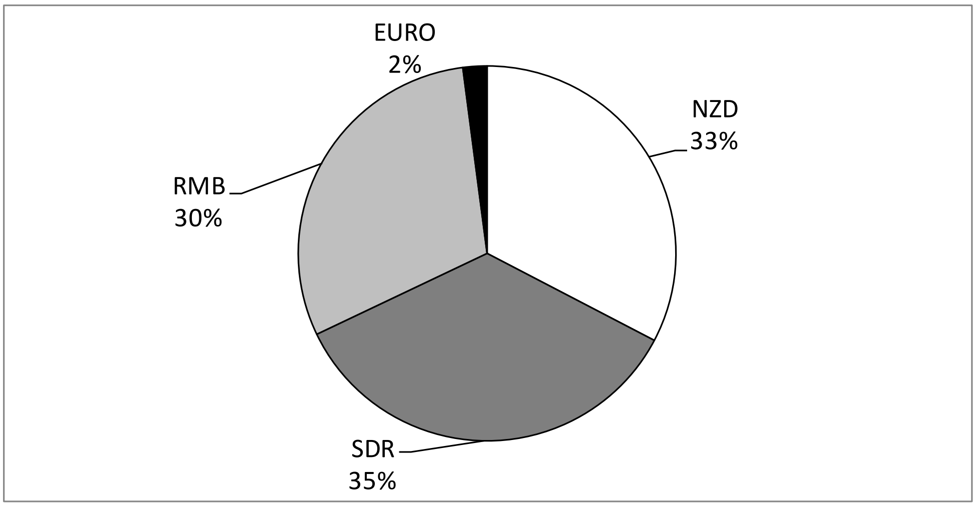
Table 2.7 shows the movement between exchange rates used during the 2014/15 estimates and this half year fiscal update.

Table 2.7 Average Exchange Rates Used

Foreign Exchange Currency	10 day Dec 2014 Average	10 day Aug 2014 Average	changes
EURO	0.6270	0.6330	-0.95%
RMB	4.7780	5.2240	-8.54%
USD	0.7760	0.8470	-8.38%
SDR	0.5320	0.5540	-3.97%

New Zealand dollar (NZD) depreciated against all major trading currencies in which Government debt is denominated.

Chart 2.11 Composition of Crown Debt as at 30 November 2013 by Currency



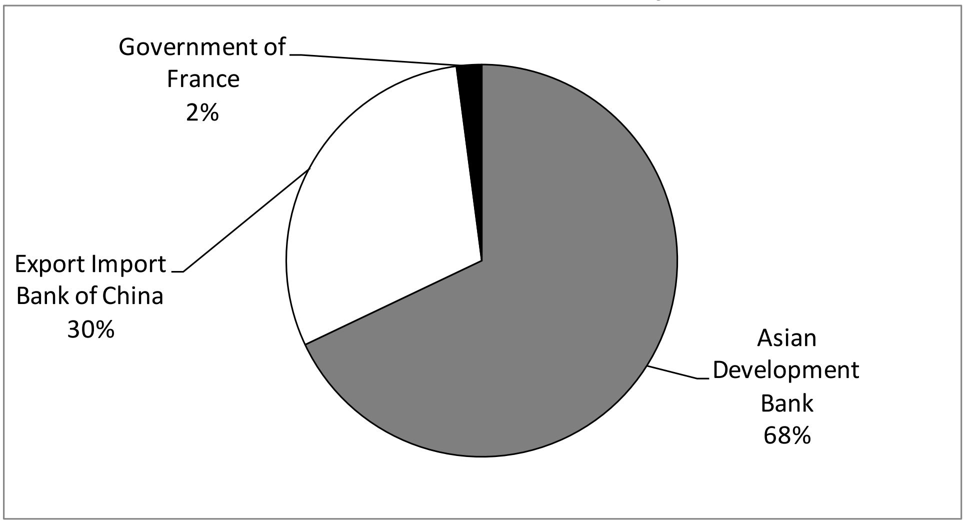
Total Crown debt as reported is mainly denominated in Special Drawing Right (SDR) with 35 per cent, followed closely by NZD with 33 per cent, Renminbi (RMB) 30 per cent and Euro (EUR) with two per cent. The Crown have converted all USD loan held with the Asian Development Bank (ADB) to the local currency, however the movement in the exchange rate for the USD is still monitored as all SDR loans held with the ADB are repaid in USD equivalent.

The share of the RMB has slightly increased from 29 per cent during the time of the 2014/15 Budget to 30 per cent reflecting the appreciation of the RMB against the NZD.

2.3.2 Gross Debt by Lenders

The estimated gross debt by lender is estimated as at the end of November 2014:

Chart 2.12 Gross Debt Estimates by Lender



As illustrated in Chart 2.12, the Crown has borrowings with three major creditors: the ADB holding 68 per cent followed by the Export Import bank of China (EXIM Bank) with 30 per cent and the Government of France holding two per cent.

The EXIM bank share of the overall borrowing portfolio is estimated to increase to 34 per cent in the latter half of the 2014/15 fiscal year due to the drawdown of $8.7 million planned to complete the Rarotonga water ring main project.

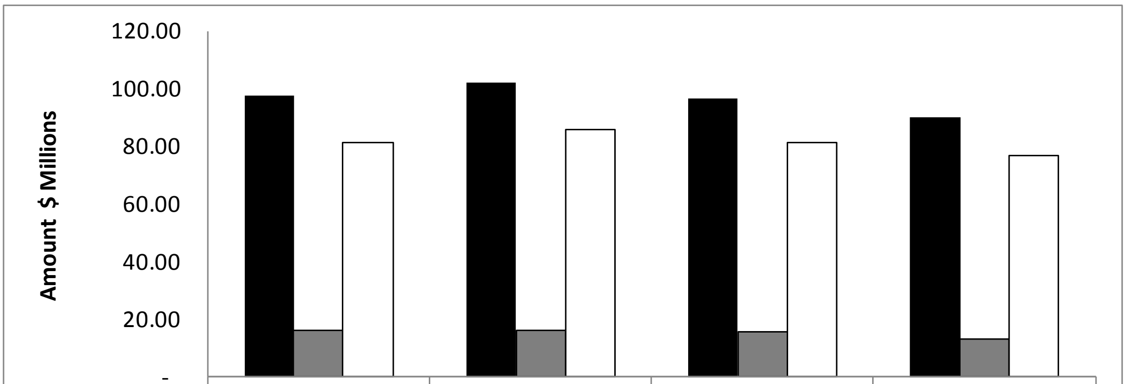
The Government is in the final stages of presenting a further proposal (as per the requirements of the Loan Repayment Fund Act 2014) with the ADB for renewable energy development in the Southern Group.

The project will be resourced through a combination of European Commission grant, ADB loan and PEC funding. The project will support the construction of up to six solar photovoltaic power plants in the Southern group, provide institutional strengthening to the Office of the Energy Commissioner (OEC) and Renewable Energy Development Division (REDD) at OPM, and provide project management support to the power utilities (Te Aponga Uira (TAU) and REDD) to implement core and non-core subprojects. Government has not yet committed itself to further debt as at the time of this write up.

2.3.3 Crown Debt burden

As it stands, total gross debt gradually reduces in the outer years as principle gets repaid, with the assumption that Government is not taking on new loans. The same indication is reflected on the Loan Reserve Fund (LRF) as it continues to reduce as the loans borrowed by the Crown on behalf of State Owned Enterprises (SOEs) are repaid.

Chart 2.13 Cook Islands overall debt burden



	2014/15	2015/16	2016/17	2017/18
Gross Debt	97.63	101.97	96.90	89.92
Loan Reserve	16.26	16.22	15.61	13.22
Net Debt	81.37	85.75	81.28	76.69

2.3.4 Status of Government Loans

Table 2.7 shows that the total amount currently drawn down is $97.6 million, which does not include the proposed $13 million loan from the ADB for renewable energy projects and a future $8.7 million drawdown on the Rarotonga Water Ringmains Upgrade project.

The additional proposed new debt will take the total gross debt portfolio for the Crown to $119.4 million. Offsetting this is the LRF estimated to be $16.4 million by the end of 2014/15.

If the Government were to take up the $13 million loan from the ADB it would be denominated in NZD, and the annual contribution to the LRF would be expected to increase from $6.1 million to $6.5 million.

Table 2.8 Status of Government loans estimated at 30 November 2014

Loans drawn down	Date loan taken	Original loan amount (000)	Current balance (000) (NZD)	Expected date of repayment	Amount covered by LRF
ADB 461 (SF) Multi Project	November, 1980	SDR 1,000	546	August, 2020	-
ADB 567 (SF) CIDB Project	July, 1982	SDR 1,500	509	April, 2022	509
ADB 849 (SF) 2nd Multi-Project	December, 1987	SDR 2,067	1,880	August, 2027	1,880
ADB 1031 (SF) Outer Islands Telecom Project	October, 1990	SDR 3,541	4,457	August, 2030	4,457
ADB 1155 (SF) 2nd CIDB Project	March, 1992	SDR 939	1,123	December, 2031	1,123
ADB 1171 (SF) Emerg. Telecom Rehab Project	August, 1992	SDR 291	387	June, 2032	387
ADB 1309 (SF) Pearl Industry Dev. Project	December, 1994	SDR 336	433	August, 2034	-
ADB 1317 (SF) Educ'n Dev Project	February, 1995	SDR 1,836	2,640	August, 2034	-
ADB 1380 (SF) 3rd CIDB Project	January, 1996	SDR 1,538	2,215	September, 2035	2,215
ADB 1466 (SF) Economic Restructure Program	September, 1996	SDR 3,430	4,894	September, 2036	-
ADB 1588 (SF) Cyclone Emergency Rehab Project	January, 1997	SDR 475	821	January, 2038	-
Restructured French Loans	January, 1999	Euro 5,413	2,015	September, 2018	2,015
ADB 1832 (SF) Waste Mgt Project	December, 2001	SDR 1,695	2,231	June, 2033	-
ADB 2174 (SF) Cyclone Emergency Assist Project	June, 2005	SDR 1,895	3,795	June, 2045	-
China - Multi-Functional Indoor Sports Stadium	August, 2008	RMB 74,100	13,441	August, 2028	-
ADB 2472 (OCR) Avatiu Port Development Project*	September, 2009	NZD 10,058	9,796	November, 2033	-
ADB 2473 (SF) Avatiu Ports Development project	September, 2009	SDR 8,346	8,504	November, 2040	-
ADB 2565 OCR Economic Recovery Support Program 1*	January, 2010	NZD 11,053	9,546	October, 2024	-
ADB 2739 (OCR) Amendment Avatiu Port project*	December, 2011	NZD 5,290	5,290	November, 2035	-
China - Rarotonga Water Ring Main Upgrade	December, 2012	RMB 118,000	15,861	December, 2032	-
ADB 2565 OCR Economic Recovery Support Program 2	December, 2012	NZD 7,250	7,250	December, 2028	-
Total loans drawn down			**97,633**		**12,586**
Debt Committed but not yet drawn					
China - Rarotonga Water Ring Main Upgrade	December, 2012	RMB 118,000	8,774	December, 2032	-
ADB Renewable Energy Project	December, 2014	NZD 12,980	12,980	December, 2039	-
Total proposed new debt			**21,754**		**-**
Total loans commitment			**119,387**		**12,586**

Chart 2.14 Current Bilateral and Multilateral Estimate Loans Outstanding Next 10 Years

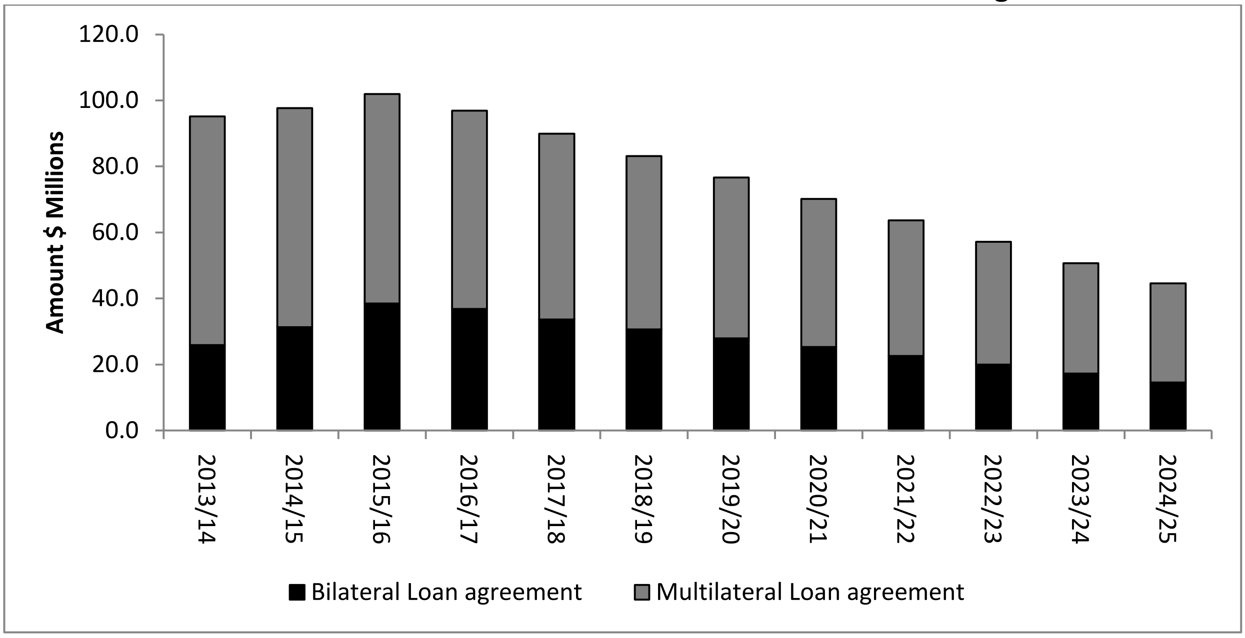


Chart 2.14 shows the bilateral and multilateral amount of borrowings that the Crown has on its record for the next 10 years from 2014/15 to 2024/25. The bulk of the debts are committed from multilateral agreements with the ADB, compared to bilateral agreements with the EXIM bank of China and the Government of France.

2.3.5 Loan Reserve Fund (LRF)

In 2001 an informal reserve was established to enable the Crown to access and subsequently on lend concessional loans to State Owned Enterprises (SOEs). Repayment terms with the external lenders included a grace period (of normally five years) that was not extended to the SOEs. SOEs were required to service the average debt servicing cost at the initial point of drawing down the loan. These funds were subsequently set aside into a debt reserve.

In February 2014, the Parliament of the Cook Islands passed the Cook Islands Loan Repayment Fund Act 2014 formally creating a Loan Reserve Fund (LRF). The effect of the LRF is to quarantine those monies previously accumulated from being utilised for anything outside of debt servicing requirements. The LRF Act also enacts a framework for management of all sovereign public debt and ensures the timely allocation of money from the Budget for repayment as required of all sovereign debt held by the Crown.

At the time of this publication, the LRF has sufficient funds to fully cover all debts owed by on behalf of SOEs to lenders. These SOEs include the Bank of the Cook Islands, Te Aponga Uira as well as Telecom Cook Islands Limited.

MFEM, has put out to tender the analytical services and management of the LRF to local banking institutions, it is expected a formal commercial arrangement will be in place by January 2015.

Table 2.9 Loan Reserve Fund Statement

	2014/15	2015/16	2016/17	2017/18	2018/19
Opening LRF balance	16,211	16,262	16,225	15,614	13,224
Transfer in	6,161	6,161	6,161	6,161	6,161
Interest earned (avg 2%)	324	325	324	312	264
Total transfer in	6,486	6,487	6,486	6,474	6,426
Repayment from LRF balance					
Principal	1,232	1,259	1,287	1,287	999
Interest	129	118	107	96	84
Total repayment from LRF	1,361	1,378	1,394	1,382	1,083
Repayment of other debt					
Principal	3,199	3,177	3,786	5,696	5,750
Interest	1,874	1,970	1,917	1,785	1,652
Total repayment other debt	5,074	5,146	5,703	7,481	7,403
Other service fees *	-	-	-	-	-
LRF stock balance	**16,262**	**16,225**	**15,614**	**13,224**	**11,164**

Table 2.9 illustrates the movement in the LRF in the next four years. The transfers into the LRF have increased from $5.7 million during the time of the 2014/15 Budget to $6.2 million due to the unfavourable movement in exchange rates.

2.3.6 Net Debt

For the purpose of this chapter, 'Net Debt' is the total gross debt net of the LRF or the difference between the total gross debt and monies held in the LRF.

Net debt is estimated to be $81.4 million (21.5 per cent of GDP) by the end of June 2015, an increase of $3.7 million since the 2014/15 Budget estimated in August 2014. This movement reflects the depreciation of the NZD against all major exchange rates reported earlier in this chapter.

Table 2.10 Current Borrowing Statement

Current Statement	**2014/15 Proj**	**2015/16 Proj**	**2016/17 Proj**	**2017/18 Proj**
Statement of Borrowings	$m	$m	$m	$m
Gross Crown Debt, End of FY	97.6	102.0	96.9	89.9
... net of loan reserves, End of FY	81.4	85.7	81.3	76.7
as percentage of GDP	21.5%	22.3%	21.8%	20.2%
Loan Repayment Reserves Held	16.3	16.2	15.6	13.2
Gross Debt Servicing	6.4	6.5	7.1	8.9
Net Debt Servicing	4.3	4.3	4.6	6.2
... as percentage of Total Revenue	3.5%	3.5%	3.8%	5.1%

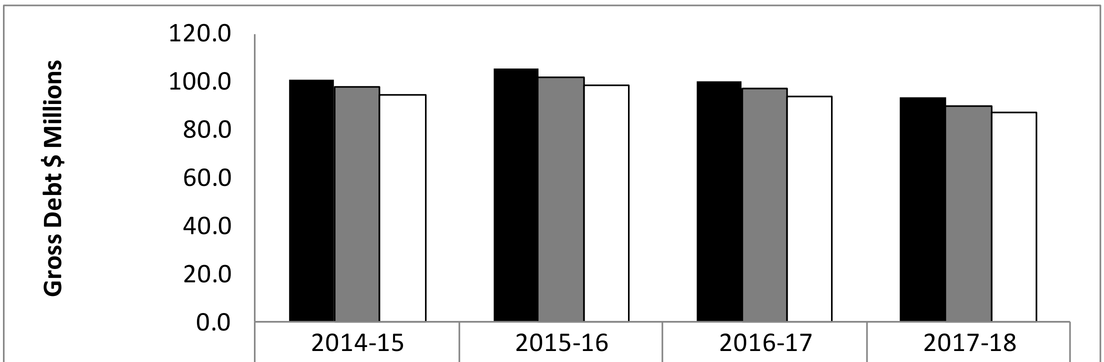
2.3.7 Crown Debt Sensitivity Analysis

Table 2.11 Base rate used for budget assumption with +/- five per cent

Foreign Exchange Currency	-5%	Budget assumption base rate	+5%
EURO	0.6600	0.6270	0.5971
USD	0.8168	0.7760	0.7390
RMB	5.0295	4.7780	4.5505
SDR	0.5600	0.5320	0.5067

The largest risk to the stock of debt is the long term level of the New Zealand dollar. The sensitivity analysis demonstrates the impact of a five per cent appreciation or depreciation in the New Zealand dollar to determine the impact on the gross borrowings and the debt servicing cost.

Chart 2.15 Sensitivity of Total Crown Gross Debt

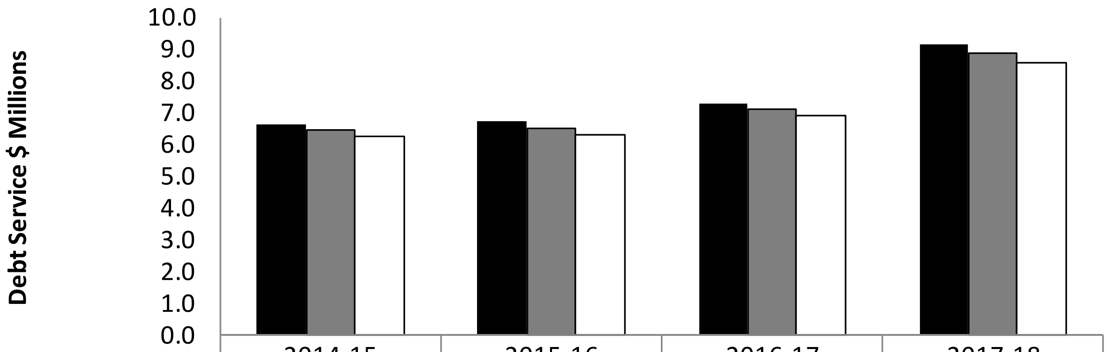


	2014-15	2015-16	2016-17	2017-18
Increase by 5%	100.9	105.6	100.3	93.1
Base Rate	97.6	102.0	96.9	89.9
Decrease by 5%	94.3	98.4	93.5	86.7

If the exchange rate was to depreciate by five per cent, gross Crown debt would increase by an estimated $3.3 million (as compared to a $3.1 million increase at the time of the 2014/15 Budget). A change of $0.2 million within a period of four months shows how sensitive our debt stock is to movement in exchange rate.

If the New Zealand dollar depreciated by more than five per cent, this would reduce the opportunity for further borrowings and increasing debt servicing costs to unsustainable levels.

Chart 2.16 Sensitivity of Gross Debt Servicing Costs



	2014-15	2015-16	2016-17	2017-18
Increase by 5%	6.6	6.7	7.3	9.2
Base Rate	6.4	6.5	7.1	8.9
Decrease by 5%	6.2	6.3	6.9	8.6

The impact of the five per cent increase or decrease on debt servicing cost is relatively consistent to the impact on gross debts. Any decision to commit to further bowings should be assessed carefully due to the sensitivity of the New Zealand dollar.

2.3.8 Future Borrowings and Fiscal Responsibility Ratios relating to Debt

Proposals to take on new loans must be treated under transparent processes as required by the MFEM Act 1995/96 and the LRF Act 2014. The fiscal responsibility ratios will prudently assist Government to manage the growth of its future borrowing plan.

The LRF Act 2014 requires MFEM to analyse and report to the Parliament and the public on the impact of new borrowing in the context of Government lending policy, including the amortisation schedule, the impact on debt service burden of the government over the life of the loan, and an assessment of the sustainability of aggregate government debt. Reports should be made in advance of loan agreements being finalised.

The Government is proposing to take a loan from the Asian Development Bank's (ADB) ordinary capital resources (OCR) along with a grant from European Commission (EC). The combined amount of $24.3 million will support the construction of up to six solar photovoltaic power plants in the Cook Islands Southern group, provide institutional strengthening to the Office of the Energy Commissioner (OEC) and Renewable Energy Development Division (REDD), as well as provide project management support to the power utilities, Te Aponga Uira (TAU), and REDD to implement core and non-core subprojects.

It is expected that the project will provide increased energy security in an environmentally sustainable manner. The outcome will be an increased access to a higher share of electricity generated by renewable energy sources.

The project will have two outputs:

- Solar Photovoltaic Power System Development. The project will construct up to six solar photovoltaic power plants with a total installed capacity of about 3 megawatt peak coupled with advanced secondary battery energy storage installation, and rehabilitate the existing distribution network for core and non-core subprojects. The project will feature three core subprojects on Mangaia, Mauke, and Mitiaro and up to three non-core subprojects on Aitutaki, Atiu, and Rarotonga.

- Institutional Strengthening and Project Management Support. The project will provide institutional strengthening to OEC and REDD for (a) developing the energy efficiency policy implementation plan including an energy audit and monitoring scheme to enhance demand side energy efficiency management practices for targeted major electricity consumer groups; (b) developing capacity for renewable energy technology assessment and appropriate off-take tariff setting for power purchase agreements for private sector funded projects, and (c) updating the CIRECIP through refining electricity load demand up to 2020, renewable technology choice, and least cost investment plan. The consultants to be engaged under this component will be the project owner's engineers (POE) who will also provide project management support for REDD and TAU to help implement core and non-core subprojects in the Southern group islands.

The total estimated cost of the project is $27.18 million.

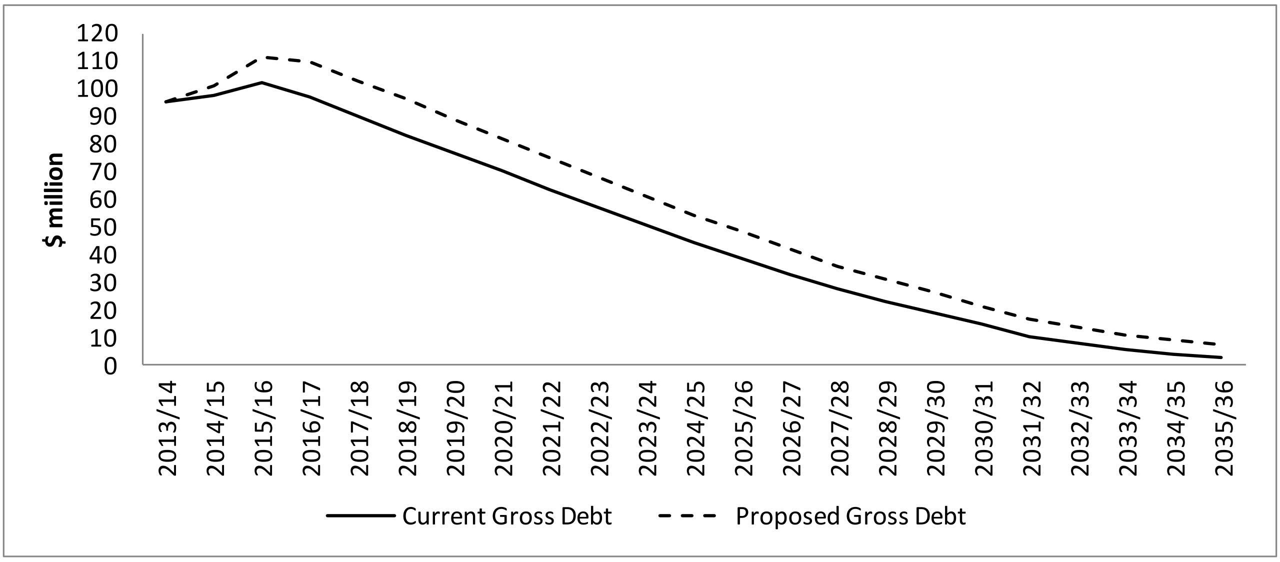
Table 2.12 Statement of Borrowings for Proposed Debt

	2014/15 Proj	2015/16 Proj	2016/17 Proj	2017/18 Proj
Statement of Borrowings	$m	$m	$m	$m
Gross Crown Debt, End of FY	100.9	111.7	109.9	102.9
... net of loan reserves, End of FY	84.6	95.5	94.3	89.7
as percentage of GDP	22.3%	24.9%	25.3%	23.6%
Loan Repayment Reserves Held	16.3	16.2	15.6	13.2
Gross Debt Servicing	6.5	6.8	7.5	9.3
Net Debt Servicing	4.4	4.6	5.0	6.6
... as percentage of Total Revenue	3.6%	3.8%	4.1%	5.4%

As can be seen from Table 2.12, Government is well within its fiscal responsibility ratio threshold of 35 per cent. For this to reach 35 per cent would require an additional amount equivalent to $41.8 million to be added on to the current level of debt. However, the commitment for debt servicing to remain under 5 per cent of total revenue will be breached in 2017/18.

However, these ratios should not be looked at in isolation. Any proposal to take on additional borrowing should be looked at in the context of the whole of Government budget and its ability to pay annual debt servicing.

Chart 2.17 Estimated net debt for next 20 years

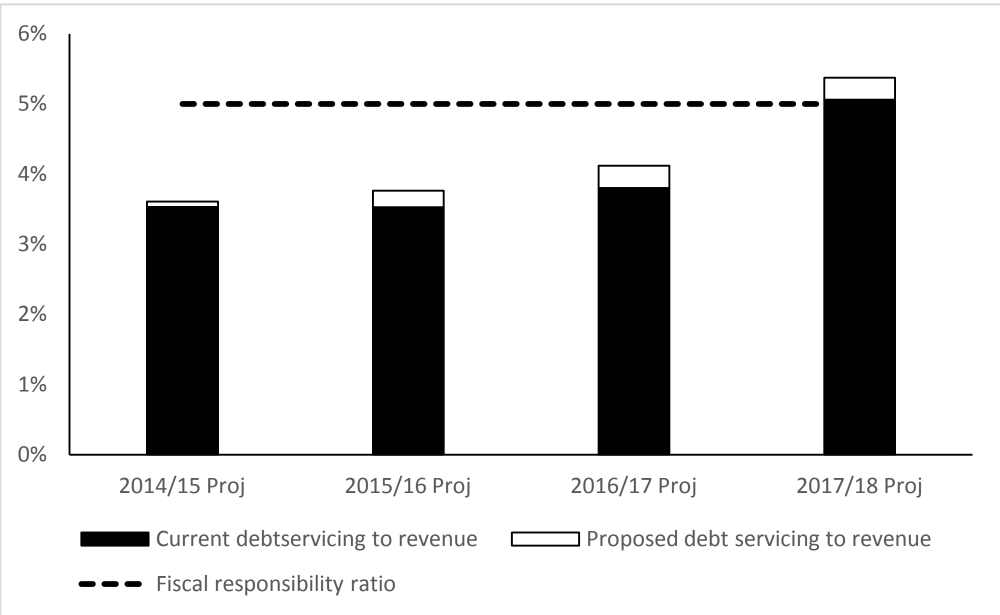


2.3.9 Net debt Service to Total Revenue

This ratio controls the servicing of debt. It primarily ensures that there are sufficient means to service debt from the operating revenue. Taken together with the tax revenue envelope, this ratio measures how much debt servicing is crowding out other components of government spending. Debt servicing includes interest and principal payments.

The benchmark for debt servicing to the total revenue ratio is not to exceed 5 per cent of the Crown total revenue.

Chart 2.18 Net Debt as a proportion of Revenue

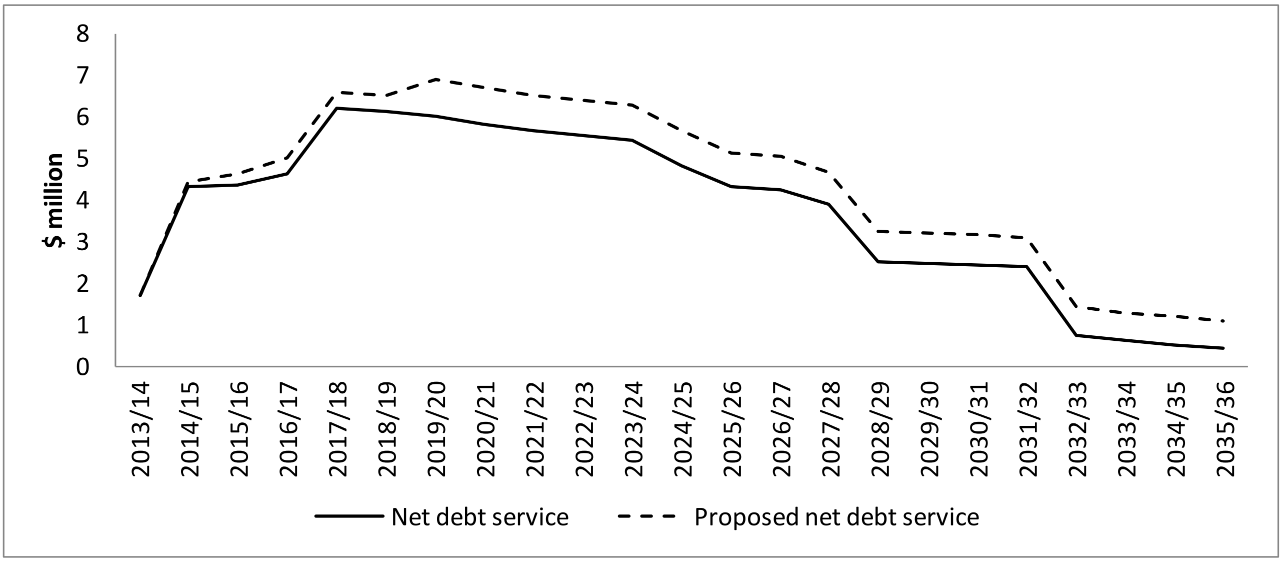


Whilst this ratio is projected to be surpassed in 2017/18, there are considerations that need to be taken into account when concluding whether the net debt servicing ratio is a significant issue or not.

Firstly, the total debt servicing includes loans which are currently serviced by the Port Authority (the numerator) but the revenue portion (denominator) is limited to revenue earned by the General Government Sector, including the Port Authority revenue, inclusion of these revenues reduces the rate from 3.5 per cent in 2014/15 to 3.4 per cent and from 5.1 per cent in 2017/18 to 5.0 per cent (not including the proposed loan for renewable energy).

Secondly, there is a question at the appropriateness of five per cent level and whether it is in fact too low. An independent assessment undertaken by the ADB outlined that the debt servicing to revenue ratio was too conservative and inconsistent with the debt to GDP ratio, and that a more reasonable and consistent ratio of debt servicing to GDP would be 10 per cent.

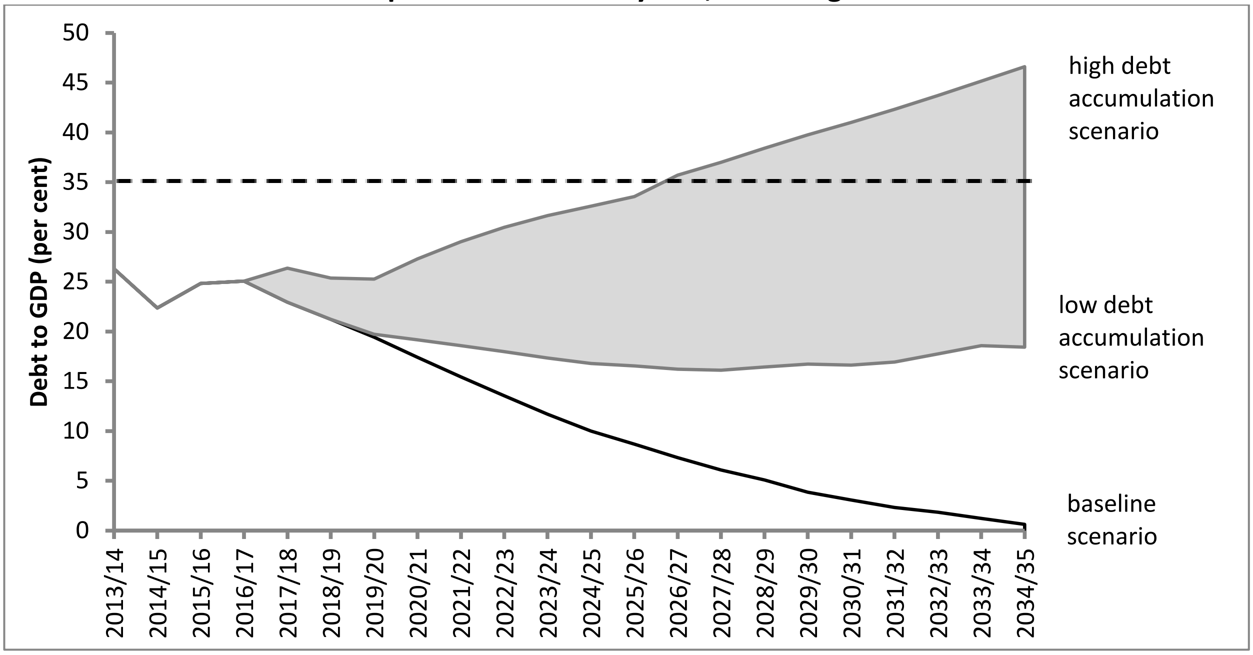
Chart 2.19 Estimated net debt service for next 20 Years



2.3.10 Projected debt profile including unknown future loan commitments

It is important to note the difference between the profile on the current debt stock and the expected debt profile. In evaluating the capacity to take on new debt-funded initiatives, it is important to estimate what the likely evolution of the debt profile is over time given the likely spending pressures. While this chapter relates mainly to the current or near-term debt commitments, it is unlikely that that Government will not take on new debt relating to other infrastructure needs.

Chart 2.20 Forecast debt profile for next 20 years, including future loan commitments



In Chart 2.20, two alternate scenarios are presented relating to the expected profile of debt for the next 20 years, with the shaded area representing the range of likely debt profiles.[4]

The high debt accumulation scenario assumes that operational and capital spending continues to grow at recent trends and that economic growth follows its long-term average. Under this set of assumptions, cash reserves are depleted by operational deficits, and capital needs become increasing financed by debt financing. The persistence of overall deficits in the face of continued infrastructure needs leads to a breaching of the 35 per cent debt to GDP ratio in 2025/26.

The low debt accumulation scenario assumes that net operating surpluses are achieved over the medium term, with these surpluses being diverted into financing the capital budget. This becomes increasingly difficult over the long term however, with growth in expenditures outpacing revenue. Debt financing of the capital program again becomes a dominant feature of the Budget from 2027/28 onwards.

Both of these scenarios suggest that current expectations of expanding operational budgets cannot coexist with the recent growth in capital spending. At some point in the future, either capital or operational spending will need to be scaled back to match revenue growth (the low accumulation scenario presented above). Importantly, neither scenario assumes major capital works beyond those already scheduled, despite major infrastructure needs still being prevalent after the current projects are completed. On the other hand, neither scenario includes major cost-saving initiatives in personnel nor operating, although both scenarios show that in the absence of strong revenue growth, such savings plans could eventually be necessary.

[4] The two frameworks for fiscal forecasting were developed in conjunction with the Asian Development Bank (the ADB Fiscal Management Model) and the International Monetary Fund (Fiscal Analysis and Forecasting workshop, Fiji, March 2014), with the models being used for the low debt accumulation and high debt accumulation scenarios respectively.

2.3.11 Other State Owned Enterprise Debt

State Owned Enterprises can take loans directly without Government guarantee, this analysis does not include those loans.

The Airport Authority reported in 2010/11 financial report that it had recently financed its loan with a new provider. The terms of the loan was for $8.1 million taken over a five year term with current interest rate at 5.54 per cent with a drawn amount of $7.3million.

The loan is repayable by monthly instalments of $0.07 million which is inclusive of interest and is based on a 15 year amortization term with balloon payment at the end of term.

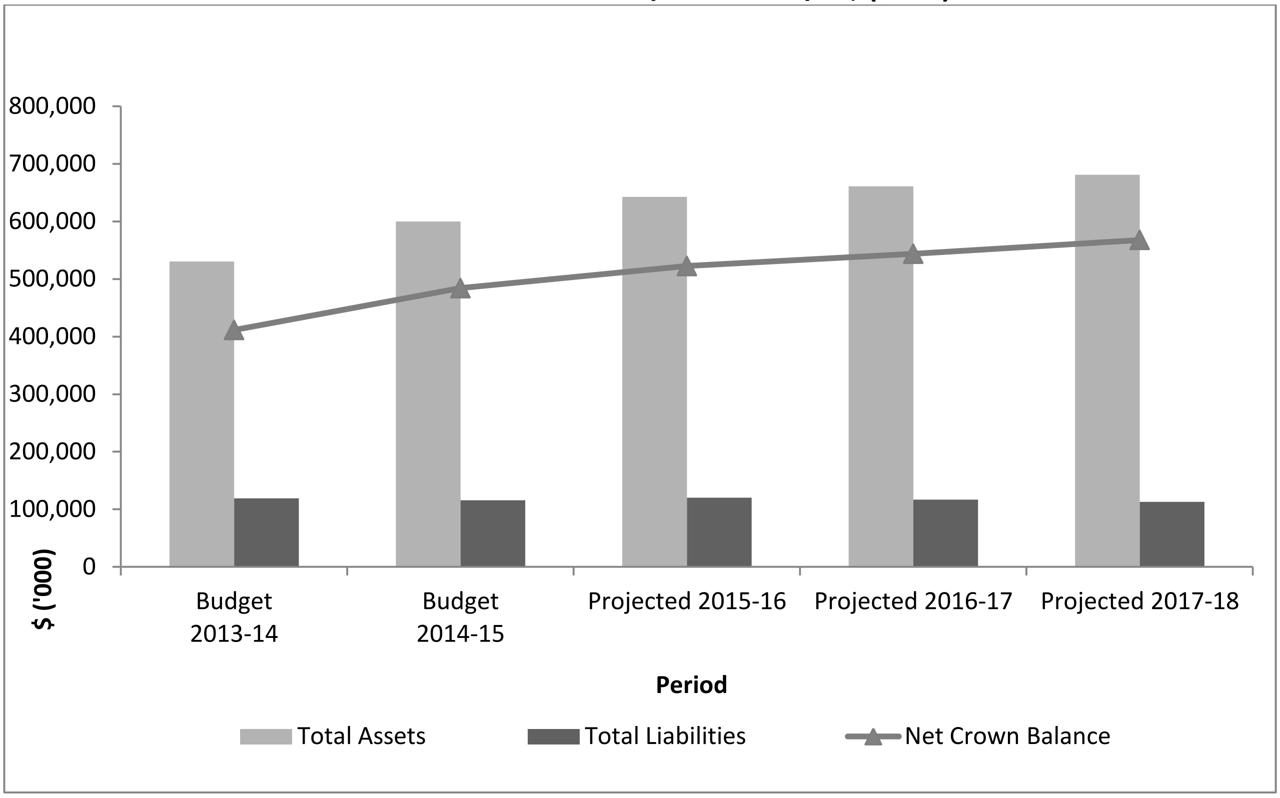
The loan is secured by registered mortgage debenture over the assets and undertakings of the Airport Authority. A financial covenant will apply where the amount of EBITDA generated less dividend paid will at all times be greater than twice the annual debt servicing commitments. The Covenant will be measured annually in arrears. The Airport Authority is considering additional borrowing of $23 million for further airport upgrades of Rarotonga International Airport.

Te Aponga Uira have also indicated they are considering new borrowings to finance new investments in electricity generation and supply assets including infrastructure aimed at improving renewable energy distribution and supply.

2.4 Net Worth

Government's net worth is the difference between Crown assets and Crown liabilities providing a snapshot of government's ability/inability to service all its creditors. There are currently no clear guides to determining an optimal level of public sector net worth; however analysing the government's net worth and what causes it to change can lead to understanding the need for appropriate policies.

Chart 2.21 Net Worth 2013/14 to 2017/18, ($000)



The estimated net worth of the Crown at December 2015 has increased from the 2013/14 Budget Estimates of $530.50 million to $600.09 million. This is a net movement of $69.6 million. This was a result of increases in the forecasted physical assets against decreases in the Crown's total liabilities.

The Crown's net worth will increase in the outer years from 2015/16 as long as there is an estimated operating surplus. Also a major contributor to the forecast upward trend is the decrease in borrowings, decrease in tax receivables and an injection to the Crown's asset from development partner funding.

3 OVERSEAS DEVELOPMENT ASSISTANCE (ODA) FLOWS

Total ODA contribution from development partners was estimated at $63.7 million in the Budget 2014/15.

Major capital projects funded by ODA covering equipment (China grants in kind), water (Te Mato Vai), sanitation and renewable energy are progressing steadily in 2014/2015.

Contracts were awarded for Te Mato Vai (Rarotonga water upgrade) to Water Loss & Pressure Management (Aus) Pty Ltd to carry out household surveys, GHD is in the final stages of completing the Detailed Design for the project and a tender is running for Stage 2 Supervision Services for ring main work. The Sanitation Upgrade Program (NZ) has experienced some delays, but activities are moving along and physical works are anticipated within the first half of 2015. Due to delays in implementation of sanitation sector reform activities in 2013/14, the EU budget support payment request for EDF Tranche 2 (€1million) will be delayed until March 2015, following a sanitation sector meeting at the Development Partners Meeting in February 2015. The blended financing program for the Southern Group/Rarotonga Renewable Energy Program (ADB-EU-Japan-GEF) has gained ADB board approval and negotiations are being finalized with ADB and PIFS/Japan (PEC).

Greater access to climate change financing opportunities is anticipated with the Cook Islands recent submission to the UN Adaptation fund for accreditation as a National Implementing Entity (NIE). MFEM engaged the services of the Frankfurt School of Finance and Management to develop the application and also received support from UNEP and the EU. A decision from the Adaptation Fund Board is expected in April 2015, with establishment of an ongoing dialogue with the Fund on improvements to the Government's public financial management, procurement and activity management system. As part of the NIE application process, a new activity management system, Te Tarai Vaka (http://www.mfem.gov.ck/ams) has been developed and is being disseminated across government, CSOs, and the private sector.

Since July there have been some development partners committing additional funds or signalling changes. These are:

- EU budget support payment request for EDF Tranche 2 (€1million) will be postponed from July until March 2015 due to implementation delays in sanitation sector restructuring in the previous year.
- Funding allocation of US$970,000 over the next three years was confirmed for "Strengthening the Implementation of the Nagoya Protocol on Access to Genetic Resources and Benefit Sharing" to be implemented by NES via UNDP, with funding from GEF/Nagoya Protocol Implementation Fund.
- Establishment of the GEF Small Grants Program ($900,000) from 2015-17 with Cook Islands Red Cross as national hosting institution, to be aligned with SRIC Small Grants.
- Additional funding for agriculture through the FAO Small Grants Facility (US$270,000) through the Chamber of Commerce and technical assistance for the agriculture sector plan for improved production, processing and marketing of agricultural produce (US$480,000).
- Increase in India grant funds from US$150,000 to US$200,000.

- The New Zealand Aid Programme has provided funding to Marine Sector Resource Support under the Pacific Maritime Safety Program, up to the amount of NZD$450,000.

Some development partners have also indicated emerging funding opportunities. These are:

- UNDP to develop Regional Women in Politics Program that includes the Cook Islands, to be launched next FY 2015-16.
- The Tindall Foundation (a New Zealand philanthropic organisation) conducted a scoping visit to Rarotonga in December to explore the possibility of working in partnership with Volunteer Services Abroad to provide support through agricultural projects.

In July 2014, the Pacific Islands Forum Secretariat launched a Peer Review of the Cook Islands national development planning and budget processes, available at www.mfem.gov.ck. The objective of the peer review process is to guide improvements in development coordination, which includes informing discussions at the Pacific Islands Forum and Post Forum Dialogue through reviews of coordination at a country level. Progress achieved in relation to the management of ODA includes:

- New system of quarterly donor reporting being implemented by MFEM; reports received from ADB, EU and NZ (http://www.mfem.gov.ck/reporting-templates).
- New system of ODA funded mission clearance and reporting being implemented by MFEM (http://www.mfem.gov.ck/reporting-templates) .
- Shifting to issues based program reviews with donors to support the move away from project based approaches to sector based or budget support; reviews started with China, and NZ/A, UNDP reviews to be held during the Development Partners Meeting, February 2015.
- Development of Te Tarai Vaka to improve review and quality control practices of all government funded projects included those funded with ODA.

A Public Expenditure and Financial Accountability (PEFA) assessment was conducted in November 2014 by the IMF Pacific Financial Technical Assistance Centre (PFTAC) team and showed improved scores on the public financial management capacity across the Cook Islands government. This is expected to act as a catalyst for donors to increase the use of national systems.

The Government continues to foster partnerships with local and international partners through the annual Development Partners Meeting scheduled for 9-12th February 2015, with the 50 year Self-government commemorative theme of "Journey to Development – 50 years in the Cook Islands". This meeting aims to create a focused space to share inclusive views on development, innovations for more effective development and demonstrate the credibility of Cook Islands national systems in a manner that increases coordinated development efforts across organisations.

4 SPECIFIC FINANCIAL RISKS

The total quantifiable contingent liabilities are estimated at $18.0 million in 2014/15. This is made up of the guarantees and indemnities outlined below. Possible liabilities stemming from the Outer Island Governments are also discussed.

4.1 Guarantees and Indemnities

The total quantifiable contingent liabilities are estimated at $3.2 million in 2014/15. This is made up of the following:

Guarantees and Indemnities

The Government has entered into a program under the New Zealand Aid Programme focused on Pearl Sector Support run through the Cook Islands Pearl Authority. Through the program the CIG has agreed to guarantee up to $0.5 million as security for loans associated with the Pearl Production Credit Scheme. The full guarantee has been included as a contingent liability. There has been no change since the time of the 2013/14 Budget Estimates.

Uncalled Capital

The Government also holds $1.4 million in the Asian Development Bank - Cook Islands Government Property Corporation. This takes the form of 88 uncalled shares with a par value of USD 13,500 each.

Legal Proceedings and Disputes

Total quantifiable risk to the Crown under legal proceedings and disputes is $0.3 million.

$1.1 million in relation to smaller legal claims against government departments, namely Police and the Ministry of Health.

4.2 Financial liabilities relating to the Island Governments

Currently, MFEM has not approved any of the Island Governments to take out any contract or security that could result in a potential liability for the Crown.

In terms of public liability or other indemnity, the Island Administrations are not treated differently to other government agencies. The capacity for the Island Administrations to generate such liabilities is estimated to be low. No risk mitigation has been undertaken to ameliorate risk any more than for other government bodies that are based in Rarotonga.

Unpaid invoices are a potential risk that would be difficult to mitigate without tighter financial controls than those imposed on other Government agencies. Island Administrations are fully covered by the MFEM Act, MFEM financial policies and procedures, and are accountable to the National Audit Office and the Cook Islands Parliament.

5 ASSUMPTIONS UNDERLYING THE FISCAL PROJECTIONS

Various assumptions must be made to forecast government's fiscal performance and position in the outer years.

- Operating Revenues are forecasted on the basis of recent trends in economic activity as well as one off considerations.
- GDP data is updated to June 2014 (provisional estimates) and trade data is updated to the September quarter 2013; new data was released a few days after the finalization of the forecasts, and as such are not included here – they will be included in future updates. The data sets used were those available as at 18 December 2013.
- Nominal GDP is expected to grow by:
    - -2.0 per cent in 2013/14
    - 4.8 per cent in 2014/15
    - 1.3 per cent in 2015/16
    - -2.8 per cent in 2016/17
    - 1.9 per cent in 2017/18
- The general model used to forecast nominal economic growth is based on the expenditure national accounting measure and uses estimates of public final demand (including aid assistance), net merchandise trade, total tourism spending, domestic investment, and domestic consumption.
    - Tourism expenditure is the largest single component of the forecasts, and is based on:
        - An average stay of 7.9 days for New Zealand arrivals, 8.4 for Australia, 7.4 for USA, 8.8 for Canada, 8.6 for the UK and Europe, 6.2 for Asia, and 7.9 for other – an overall average of around 8.0 days depending on the composition of total arrivals in any given month. This data was collected from the Customs and Immigration database of arrivals and departures, which uses the passport numbers of visitors to determine how long an individual passport holder is in the country.
        - Average visitor spend of NZD 200-230.00 per day, which is estimated from quarterly visitor surveys and a CPI indexation of a basket of tourist services.
    - Public final demand is the second largest single item and is estimated based on the personnel and operating appropriation, as well as the capital expenditure profile, for both Government and aid spending. A realisation (or completion) rate is applied to capital projects to allow for project slippage from one year to the next. This rate sits between 40 per cent and 50 per cent, depending on the year.
        - Government expenditure is based on the Operating Estimates for 2013/14, Appropriation for 2014/15, and existing government policy, and is expected to grow as follows:
            - 9.7 per cent in 2013/14
            - 9.2 per cent in 2014/15
            - -2.7 per cent in 2015/16
            - -18.7 per cent in 2016/17
- Growth in prices measured through movements in the Consumer Price Index are assumed to remain around the historical yearly averages, with a small increase in

inflation in 2014/15 due to the 2.5 percentage point increase to the VAT. Inflation is forecast to be:

  - 1.6 per cent in 2013/14
  - 3.8 per cent in 2014/15
  - 2.6 per cent in 2015/16
  - 3.1 per cent in 2016/17
  - 3.1 per cent in 2017/18

- Operating Expenditure movements in the outer years are based on actual commitments and are modeled through the Medium Term Budgeting Framework.
- The level of borrowings is based on 10 day average exchange rates up to 10 December 2014.

6 FINANCIAL STATEMENTS

Financial Statements for BPS
As at 31 December 2014

The forecasted financial estimates of the Crown are set out on the following pages.

(1) Statement of Financial Performance

(2) Statement of Financial Position

(3) Statement of Cash flows

(4) Statement of Borrowings

(5) Summary of Revenue Levied on Behalf of the Crown

(6) Statement of Financial Risks

Statement of Financial Performance

For the years ending 31 December 2014

	Budget 2013/14 ('000)	Budget 2014/15 ('000)	HYEFU 2014/15 ('000)	Projected 2015-16 ('000)	Projected 2016-17 ('000)	Projected 2017-18 ('000)
Revenue						
Taxation revenues	99,653	103,095	102,085	104,615	102,968	104,086
Other revenue						
Revenue on behalf of the Crown	9,092	9,943	10,443	8,568	8,578	8,578
Sale of goods and services	5,452	5,518	5,518	5,518	5,518	5,518
Interest	2,147	2,532	2,532	2,551	2,569	2,543
Dividends	2,561	2,115	2,115	2,096	2,096	2,096
Total Revenue	***118,905***	***123,203***	***122,693***	***123,348***	***121,729***	***122,821***
Expenditure						
Appropriations to agencies	63,591	65,002	65,003	65,147	65,144	65,161
Payments on behalf of Crown	43,229	45,456	45,456	45,943	45,429	44,667
Debt-servicing interest	1,429	2,137	2,137	2,048	1,986	1,848
Building maintenance	1,800	1,800	1,800	1,800	1,800	1,800
Infrastructure depreciation	5,070	6,020	6,020	6,020	8,020	8,020
Other expenditure	3,739	2,779	2,779	2,680	2,679	2,678
Total Expenditure	***118,858***	***123,194***	***123,195***	***123,638***	***125,058***	***124,174***
NET OPERATING SURPLUS / (DEFICIT)	***47***	***9***	***-502***	***-290***	***-3,329***	***-1,353***

Statement of Financial Position
As at 31 December 2014

	Budget 2013/14 ('000)	Budget 2014/15 ('000)	HYEFU 2014/15 ('000)	Projected 2015-16 ('000)	Projected 2016-17 ('000)	Projected 2017-18 ('000)
Assets						
Cash and equivalents	55,136	38,279	20,911	20,556	13,324	15,357
Loan reserves	16,211	16,090	15,969	15,896	15,135	12,737
Trust accounts	6,235	6,751	7,266	7,274	7,788	8,309
Inventory	4,395	4,395	4,395	4,395	4,395	4,395
Tax receivables	16,944	16,713	16,482	16,480	15,986	15,766
Debtors and other receivables	10,699	10,699	10,699	10,699	10,699	10,699
Advances to SOEs	26,206	24,826	23,446	23,358	21,623	19,685
Investment in SOEs	146,733	146,733	146,733	146,733	146,733	146,733
Plant, property, and equipment	247,943	335,604	423,265	397,329	424,714	445,925
Total Assets	***530,501***	***600,089***	***669,166***	***642,719***	***660,397***	***679,606***
Liabilities						
Creditors and other payables	10,412	9,907	9,402	9,393	9,393	9,393
Trust liabilities	8,510	9,015	9,520	9,529	9,529	9,529
Borrowings	100,112	97,108	94,104	101,484	98,077	94,225
Total Liabilities	***119,034***	***116,030***	***113,026***	***120,406***	***116,999***	***113,147***
Net Crown Balance	***411,467***	***484,059***	***556,140***	***522,313***	***543,398***	***566,459***

Statement of Cashflows
For the years ending 31 December 2014

	Budget 2014/15 ('000)	HYEFU 2014/15 ('000)	Projected 2015-16 ('000)	Projected 2016-17 ('000)	Projected 2017-18 ('000)
Cashflows from Operating Activities					
Cash provided from:					
Taxation and levies	103,095	102,085	104,615	102,968	104,086
Collection of tax arrears	231	231	233	494	220
Sale of goods and services	5,518	5,518	5,518	5,518	5,518
Interest	2,532	2,532	2,551	2,569	2,543
Dividends	2,115	2,115	2,096	2,096	2,096
Other income	9,943	10,443	8,568	8,578	8,578
	123,434	*122,924*	*123,581*	*122,223*	*123,041*
Cash applied to:					
Appropriations to agencies (less depn)	61,270	61,271	61,388	61,388	61,389
Payments on behalf of Crown	45,456	45,456	45,943	45,429	44,667
Debt-servicing interest	2,137	2,137	2,048	1,986	1,848
Building maintenance	1,800	1,800	1,800	1,800	1,800
Other expenditure	3,284	3,284	3,194	2,679	2,678
	113,947	*113,948*	*114,373*	*113,282*	*112,382*
Net Operating Activity Cashflows	***9,487***	***8,976***	***9,208***	***8,941***	***10,659***
Cashflows from Investing Activities					
Cash provided from:					
Subsidiary loan repayments	1,380	1,380	0	0	0
	1,380	*1,380*	*0*	*0*	*0*
Cash applied to:					
Capital expenditure	33,720	33,720	36,826	14,747	3,825
Advances to Subsidiaries	0	0	0	0	0
	33,720	*33,720*	*36,826*	*14,747*	*3,825*
Net Investing Activity Cashflows	***-32,340***	***-32,340***	***-36,826***	***-14,747***	***-3,825***
Cashflows from Financing Activities					
Cash provided from:					
Loans drawn down	9,679	9,679	14,515	3,245	0
Cash drawn from loan reserves	6,232	6,232	6,303	6,866	8,488
	15,911	*15,911*	*20,818*	*10,111*	*8,488*
Cash applied to:					
Loan repayments	3,288	3,288	4,291	4,917	6,678
Loan reserves	6,111	6,111	6,109	6,105	6,090
Other reserves	515	515	523	515	520
	9,914	*9,914*	*10,923*	*11,537*	*13,288*
Net Financing Activity Cashflows	***5,997***	***5,997***	***9,895***	***-1,426***	***-4,800***
Net cash movements	-16,857	-17,367	-17,723	-7,231	2,033
Add: Opening Cash and Equivalents	55,136	38,279	38,279	20,556	13,324
Closing Cash and Equivalents	***38,279***	***20,911***	***20,556***	***13,324***	***15,357***

Statement of Borrowings
As at 31 December 2014

	Budget 2013/14 ('000)	Budget 2014/15 ('000)	HYEFU 2014/15 ('000)	Projected 2015-16 ('000)	Projected 2016-17 ('000)	Projected 2017-18 ('000)
Total Gross Borrowings	***100,112***	***97,108***	***94,104***	***101,484***	***98,077***	***94,225***
Assets Held Against Borrowings:						
Advances to subsidiaries	26,206	24,826	23,446	23,358	21,623	19,685
Loan reserves	16,211	16,090	15,969	15,896	15,135	12,737
Total Assets Held Against Borrowings	***42,417***	***40,916***	***39,415***	***39,254***	***36,758***	***32,422***
Net Borrowings of the Government	***57,695***	***56,192***	***54,689***	***62,230***	***61,319***	***61,803***

Revenue Levied on Behalf of the Crown
For the years ending 31 December 2014

	Budget 2013/14 ('000)	Budget 2014/15 ('000)	HYEFU 2014/15 ('000)	Projected 2015-16 ('000)	Projected 2016-17 ('000)	Projected 2017-18 ('000)
Taxation						
Income tax	27,734	20,664	20,276	21,347	20,656	21,047
Company tax	10,812	12,309	11,815	12,457	12,094	12,300
Import levies	13,207	12,419	12,219	12,435	12,858	13,153
Departure tax	8,205	7,731	7,698	7,917	8,141	8,366
VAT	39,095	49,972	49,972	50,458	49,220	49,220
Withholding tax	600	0	105	0	0	0
Total Revenue Levied on Behalf of the Crown	***99,653***	***103,095***	***102,085***	***104,615***	***102,968***	***104,086***

Statement of Fiscal Risks
As at 31 December 2015

	('000)
Quantifiable Contingent Liabilities	
Guarantees and indemnities	500
Uncalled capital	1,531
Legal proceedings and disputes	1,332
Total Quantifiable Contingent Liabilities	

Guarantees and indemnities relate to the following:
Government has entered into a program under the New Zealand Aid Programme focused on Pearl Sector Support run through the Cook Islands Pearl Authority. Through the program the Government has agreed to guarantee up to $0.5million as security for loans associated with the Pearl Production Credit Scheme. The full guarantee has been included as a contingent liability.

Uncalled capital relates to shares in the Asian Development Bank - Cook Islands Government Property Corporation owns 88 uncalled shares with a par value of USD13,500 each.
Legal proceedings and disputes relate to current cases against the Crown.

7 STATEMENT OF ACCOUNTING POLICIES

7.1 Basis of Preparation

Reporting Entity
These financial statements are for the Government of the Cook Islands (Crown). This consists of:

- Ministers of the Crown;
- Ministries;
- Island Administrations;
- Offices of Parliament; and
- Public Enterprises and Other Authorities

A schedule of the entities included in these financial statements is detailed on page 13.

The primary objective of the Crown is to provide goods or services for the social benefit of all Cook Islands citizens and permanent residents living in the Cook Islands. The achievement of social responsibility is paramount to the making of a financial return.

Statement of Compliance
These financial statements have been prepared in accordance with the Ministry of Finance and Economic Management (MFEM) Act 1995/96 and the International Public Sector Accounting Standards (IPSAS).

Measurement Base
The financial statements have been prepared on the going concern assumption and the accounting policies have been applied consistently throughout the period except where stated elsewhere in this Statement of Accounting Policies.

These financial statements have been prepared using the historical cost method to report results, cash flows and the financial position of the Crown except certain assets are revalued. The financial statements have been prepared under the accrual basis of accounting and are presented in New Zealand dollars rounded to the nearest thousand dollars ($000). The functional currency is New Zealand dollars.

7.2 Significant Accounting Policies

The following accounting policies, which significantly affect the measurement of financial performance, financial position and cash flows have been applied:

Recent Standards
Of significant relevance to the Crown is the recent development of new standards at the IPSAS Board. These include:

List of IPSASs Issued	Effective for periods beginning on or after	Crown accounting period
IPSAS 28 Financial Instruments: Presentation	January 1, 2003	2013-2014
IPSAS 29 Financial Instruments: Recognition & Measurements	January 1, 2003	2013-2014
IPSAS 30 Financial Instruments: Disclosures	January 1, 2003	2013-2014

These new standards have been issued but are not effective for the Crown for the 2011/12 period.

Basis of Consolidation
Ministries, public enterprises and other authorities (including state owned enterprises (SOEs)) comprising the reporting entity are consolidated by adding together like items of assets, liabilities, equity, revenues and expenses on a line by line basis.

The effect of all material inter-entity transactions and balances are eliminated on consolidation.

Commitments and contingent liabilities of public enterprises and other authorities are reported in the Statements of Commitments and of Contingent Liabilities.

Associate
The Crown's associate investment is accounted for in the group financial statements using the equity method. An associate is an entity over which the Crown has significant influence where the entity is neither a subsidiary nor an interest in a joint venture. Investment in an associate is initially recognised at cost and the carrying amount is increased or decreased to recognise the Crown's share of the surplus or deficit after the date of acquisition. When the Crown transacts with an associate, all surplus and deficits related to the Crown are eliminated. Distributions received from an associate reduce the carrying value of the investment in the Crown Financial Statements.

7.2.1 Revenue

Revenue is measured at fair value of the consideration received or receivable.

Revenue Levied Through the Crown's Sovereign Power
Payment of tax does not of itself entitle a taxpayer to an equivalent value of services or benefits, such revenue is received through the exercise of the Crown's sovereign power. Revenue arising through taxes is recognised when the taxable event occurs and when the criteria for recognition of revenue is met.

Revenue Type	Revenue Recognition Point
Individual Income Tax	Income tax is earned when individuals earn taxable income.
Company Income Tax	When the corporate community earns taxable income.

Value Added Tax	When taxable sales are made.
Customs levies	When goods liable to duty are assessed, except for Oil Companies which are accounted for when the liability to the Crown is incurred.
Departure Tax	When departure tax coupons are purchased.

Revenue Earned Through Operations
Revenue from sales of goods or services is recognised when the product is sold or the services are provided to the customer.

Interest Income
Interest income is earned on cash or cash equivalent assets. This is recognised in the period in which it is earned.

Fines
Fines are economic benefits or services potentially received by the Crown from an individual or other entity, as determined by a court or other law enforcement body, as consequence of the individual or other entity breaching the requirements of laws and regulations.

Investment Income
Investment income is earned from the leasing or rental of Crown assets to third parties that is neither a Crown entity or a Crown related party. Investment income is recognised in the period in which it is earned.

Gains
Realised gains arising from sale of assets or from the early settlement of a liability are recognised in the Statement of Financial Performance in the period in which the transaction is concluded.

Dividends
Dividends are recognised when the right to receive the payment has been established.

Aid (Development Partner) Revenue
Revenue is recognised when donor funds are expensed on approved projects and upon receipt of aid donated assets.

7.2.2 Expenses

General
Expenses are recognised when incurred and are reported in the financial period to which they relate.

Welfare Benefits
Welfare benefits are recognised in the period to which the payment of these benefits relates to.

Grants and Subsidies
Where grants and subsidies are discretionary until payment, the expense is recognised when the payment is made. Otherwise, the expense is recognised when the specified criteria have been fulfilled and notice has been given to the Crown.

Losses
Realised losses arising from sales of assets or the early settlement of a liability are recognised in the Statement of Financial Performance in the period in which the transaction is concluded.

Borrowing Costs
Borrowing costs are recognised as an expense in the period in which they are incurred.

Foreign Currencies
Transactions in foreign currencies are translated into New Zealand dollar (NZD) using the exchange rate on the date of the transaction. Foreign exchange gain and losses arising from these transactions are included in the Statement of Financial Performance.

Any monetary assets and monetary liabilities held at year end are translated at the exchange rate at the balance sheet date.

Aid Expenses
Expenses are recognised when incurred on approved projects and are reported in the financial period to which they relate.

Depreciation
Each part of an item of plant, property, and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately.

Depreciation of plant, property, and equipment is provided on a straight line basis so as to allocate the cost of assets to their estimated residual value over their estimated useful lives. Typically, the estimated useful lives are:

Office and computer equipment	3 – 4 years
Motor vehicles	5 years
Furniture and fittings	4 – 10 years
Plant and Equipment	5 - 15years
Buildings and improvements	10 - 40 years
Coastal protection	25 years
Power distribution network	20 years
Road network	30 years
Water network	15 years
Airport runways	15 – 100 years
Harbour and ports structures	10 – 20 years
Waste management facilities	15 years
Plant and Equipment Tools	4 – 5 years
Marine Equipment	5 years
Leased Land and Leasehold improvements	Term of the lease
Specialised Buildings and Other Buildings	15 years

7.2.3 Non-Current Assets

Plant, Property, and *Equipment*
Plant, property and equipment is recorded at cost less accumulated depreciation.

The cost of purchased plant, property, and equipment is the value of the consideration given to acquire the assets and the value of other directly attributable costs which have been incurred in bringing the assets to the location and condition necessary for their intended service.

The cost of assets constructed by the Crown includes the cost of all materials used in construction, direct labour on the project, financing costs that are directly attributable to the project and an appropriate proportion of variable and fixed overheads. Costs cease to be capitalised as soon as the asset is ready for productive use and do not include any inefficiency costs.

Disposals
When an item of plant, property and equipment is disposed, the gain or loss (disposal proceeds less carrying value) associated with that item will be recognised in the Statement of Financial Performance.

Additions
The cost of an item of plant, property and equipment is recognised as an asset if, and only if, there will be future economic benefits evident and where these benefits will flow to the Crown and the cost of the item can be measured reliably.

Work in Progress
Work in Progress is recognised as cost less impairment and is not depreciated.

Infrastructure Assets
Infrastructure assets are recorded at cost less accumulated depreciation.

The cost of purchased infrastructure assets is the value of the consideration given to acquire the assets and the value of other directly attributable costs which have been incurred in bringing the assets to the location and condition necessary for their intended service.

The cost of assets constructed by the Crown includes the cost of all materials used in construction, direct labour on the project, financing costs that are directly attributable to the project and an appropriate proportion of variable and fixed overheads. Costs cease to be capitalised as soon as the asset is ready for productive use and do not include any inefficiency costs.

Infrastructure assets include: road networks, water networks, power distribution networks, coastal protection systems, harbour and ports structures, waste management and airport assets. When an infrastructure asset is disposed of, the gain or loss (disposal proceeds less carrying value) associated with that item will be recognised in the Statement of Financial Performance.

Intangible Assets
Intangible assets are software acquisition costs and are recorded at cost less accumulated amortisation and accumulated impairment losses.

The cost of purchased intangible assets is the value of the consideration given to acquire the assets and the value of other directly attributable costs which have been incurred in bringing the assets to the location and condition necessary for their intended service. Intangible assets might include: databases, software purchased, or software developed.

When an intangible asset is disposed of, the gain or loss (disposal proceeds less carrying value) associated with that item will be recognised in the Statement of Financial Performance.

Amortisation of intangible assets is on a straight line basis so as to allocate the cost of assets to their estimated residual value over their estimated useful lives. Typically, the estimated useful lives are:

Software, databases	3 - 5 years

Cash and Cash Equivalents
Cash and cash equivalents includes cash on hand, deposits held at call with banks, other short term highly liquid investments with original maturities of three months or less and bank overdrafts. Bank overdrafts are shown within borrowings in current liabilities in the statement of financial position.

Receivables and Advances including Debtors and Other Receivables
Receivables and advances are recorded at cost.

After initial recognition, loans and receivables are measured at amortised cost less any provision for impairment. Gains and losses when assets are impaired or derecognised are recognised in the statement of financial performance.

Tax receivables have been calculated on a subsequent receipt bases. All tax revenue received in the years subsequent to 30 June 2012 has been disclosed as tax receivables at year end.

Inventories
Inventories held for distribution or consumption in the provision of services that are not supplied on a commercial basis are measured at cost. Where inventories are acquired at no cost or for nominal consideration, the cost is the current replacement cost at the date of acquisition.

Inventories held for use in the production of goods and services on a commercial basis are valued at the lower of cost and net realisable value.

Investments
Investments in associates are accounted for in the consolidated financial statements using the equity method. That is, investments in associates are initially recognised at cost and the

carrying amount is increased or decreased to recognise the Crown's share of the surplus or deficit of the associate after the day of acquisition.

Banking portfolio investments

Loans are valued at net realisable value after provisions. Applicable security is obtained depending on the size and nature of loans. Non-performing loans are reviewed monthly on a case by case basis.

Provision for doubtful debts

Provision is made for taxation debt where recovery is considered doubtful.

Provision is made for banking portfolio Investments (specific loans) where recovery is considered doubtful or they have become non-performing. The accounting policy relating to measuring the impairment of loans and advances requires the Bank to assess impairment at least at each reporting date. The credit provisions raised represent management's best estimate of the losses incurred in the loan portfolio at balance date based on their experienced judgement and in accordance with the Financial Supervisory Commission's (FSC) guidelines. The use of such judgements and reasonable estimates is considered by management to be an essential part of the process and does not impact on reliability. Management regularly reviews and adjusts the estimates and methodologies as improved analysis becomes available. Changes in these assumptions and methodologies could have a direct impact on the level of provision and impairment. There is no general provision against banking portfolio Investments.

All bad debts are written off against specific provisions in the period in which they become classified as irrecoverable.

Aid (Development Partner) Assets

Donor funds are deposited into bank accounts until expensed on approved assets. Where an asset is acquired at no cost, or is donated for use by the Crown or other Crown entity, it is recognised at fair value as at the date of acquisition.

7.2.4 Liabilities

Borrowings

Borrowing liabilities are accounted for at amortised cost on the Statement of Financial Position. Any changes are recognised in the Statement of Financial Performance. Borrowings or the proportion of borrowings expected to be settled within 12 months of balance date are disclosed as current liabilities in the statement of the financial position. All other borrowings are disclosed as non- current liabilities.

Pension Liabilities

Pension liabilities, in respect of the contributory service of current and past Members of Parliament, are recorded at the latest (30 June 1997) actuarial value of the Crown's liability for pension payments. There are no pension liabilities accruing to the Crown as a result of Government employees' membership of the Government Superannuation Fund (New Zealand).

Employee Entitlements
These include annual leave earned but not yet taken at balance date and long service (bonus) leave. Long service bonus is paid out on the completion of three years continuous service within the Government. The bonus is equivalent to a fortnight pay of the employee and is provided for on a pro-rata basis in the statements of financial position. Annual leave and long service leave are expected to be settled within 12 months of balance date, are classified as current liability. All other employee entitlements are classified as a non-current liability.

Other Liabilities
All other liabilities are recorded at the estimated obligation to pay. No liability for ongoing welfare payments has been recognised because no legal entitlement is considered to exist beyond the end of the current financial year until a new Appropriation Act is passed and is provided for on a pro-rata basis in the statement of financial position. Annual leave and long service leave to be settled within 12 months of the balance date, are classified as current liability. All other employee entitlements are classified as a non-current liability.

Aid Liabilities
Funds received from various donors are treated as liabilities until expensed on approved projects at which stage the funding is included within the Statement of Financial Performance as revenue.

7.2.5 Cash Flow

A cash flow statement identifies the sources of cash inflow, the items on which cash was utilised and the cash balance at the reporting date. Included in the cash flow statement are financing activities which are activities that result in the change of size and composition of the contributed capital and borrowings of the Crown.

Investing activities are the acquisition and disposal of long term assets and other investments.

Operating activities identify how much the Crown received from its actual operations.

Cash flow information allows users to ascertain how the Crown raised the cash it required to fund its activities and the manner in which that cash was utilised.

The direct cash flow method has been applied.

7.2.6 Leases

Finance leases transfer, to the Crown as lessee, substantially all the risks and rewards incidental to the ownership of an asset. The obligations under such leases are capitalised at the present value of minimum lease payments. The capitalised values are amortised over the period in which the Crown expects to receive benefits from their use.

Operating leases, where the lessors substantially retain the risks and rewards of ownership, are recognised in a systematic manner over the term of the lease. Operating leases are recognised as an expense in the statement of the financial performance in the periods in which they are incurred.

The cost of leasehold improvements is capitalised and amortised over the lesser of the leasehold improvements useful life or the original lease term.

7.2.7 Commitments

The Statement of Commitments discloses those operating and capital commitments arising from non-cancellable contractual or statutory obligations. Interest commitments on debts and commitments relating to employment contracts are not included.

7.2.8 Contingent Liabilities

Contingent liabilities are recorded when a possible obligation has arisen from an event in the past and which the existence will only be confirmed through the occurrence or non-occurrence of future events. Such liabilities will be disclosed if they are deemed to materially affect the reading of the presented financial statements.

7.2.9 Changes in Accounting Policies

There have been no changes to the accounting policies. All policies have been applied on a consistent basis with the prior year.