Economic Planning Division

Cook Islands Economic Update

November 2019

Highlights

- **The Cook Islands economy continues to perform at the macro level** – the economy grew by 8.9 per cent in 2017/18 and is expected to grow by 4.2 per cent in 2018/19. Growth is expected to moderate to 3.5 per cent in 2019/20, falling further to 1.8 per cent by 2023/24. This October 2019 outlook reflects three things: GDP historical data revisions, a flatter growth profile for tourist arrivals, and lower global growth expectations amid mounting trade-related uncertainty.

- **Inflation falls again** – minus 0.3 per cent on average in 2018/19, but expected to rise on the back of expected increases in capacity constraints such as labour and skills shortages, resulting in inflationary pressure.

- **Growth in visitor arrivals flatten off** – 1.3 per cent growth in 2018/19 to 167,000 visitors. Arrivals expected to grow at about 1.5 per cent per year over the period to 2023/24 to about 180,870.

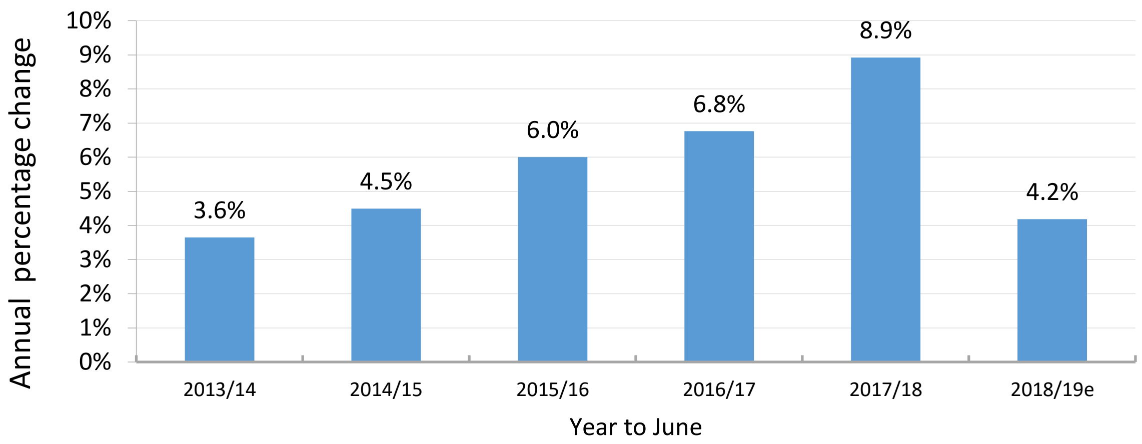
- **Government finances in good condition –** revenues have been rising at a faster rate than operating expenditure over the last few years. The fiscal balance in June 2019 was $28 million, 36 per cent higher than the $20 million balance in June 2018.

Economy – Cook Islands

GDP performance – still ticking along

The Cook Islands economy (Gross Domestic Product or GDP) is estimated to grow in real terms by 4.2 per cent in 2018/19, increasing from $505 million in 2017/18 to $526 million (Chart 1). This is lower than the estimate of 6.3 per cent in the 2019/20 Budget, largely due to historical revisions to the GDP data series. Although expanding at a much slower rate than the 8.9 per cent recorded in 2017/18, this continues a strong run of annual economic growth since 2014.

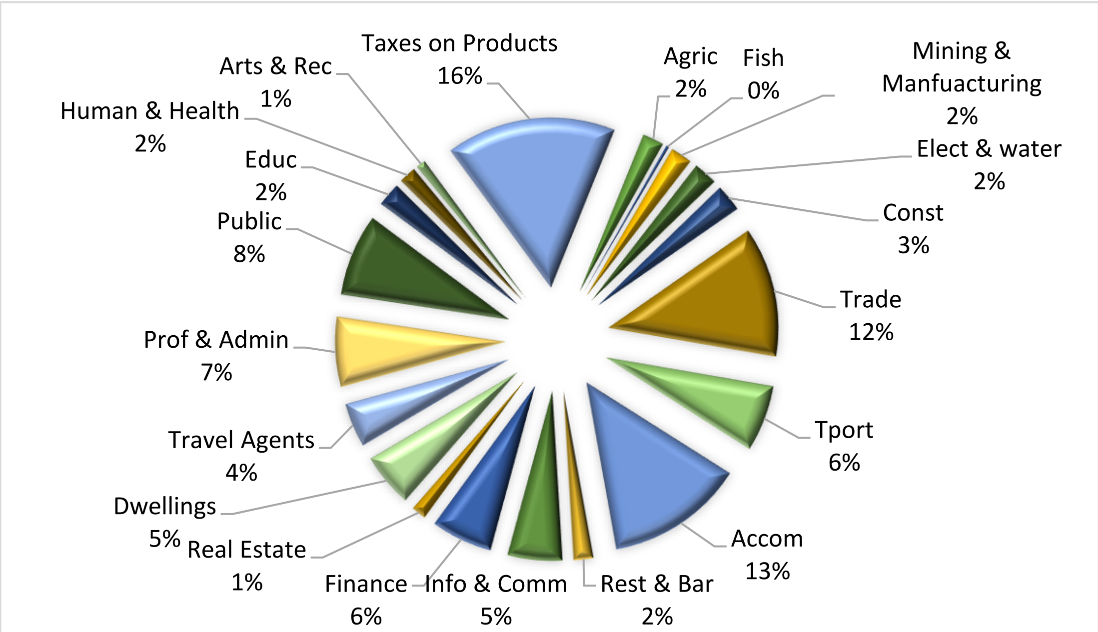
Chart 1: Historical real GDP growth (percentage change)



Source: Cook Islands Statistics Office, National Accounts Statistics, March Quarter 2019; MFEM estimates.

Chart 2 shows the breakdown of the Cook Islands economy by industry in 2017/18, the most recent complete financial year for which GDP data is available. The economy is dominated by the tertiary or services sector, accounting for about 77 per cent of the total economy in 2017/18, with the two largest tertiary industries, trade and accommodation services, accounting for more than a quarter of total economic output.

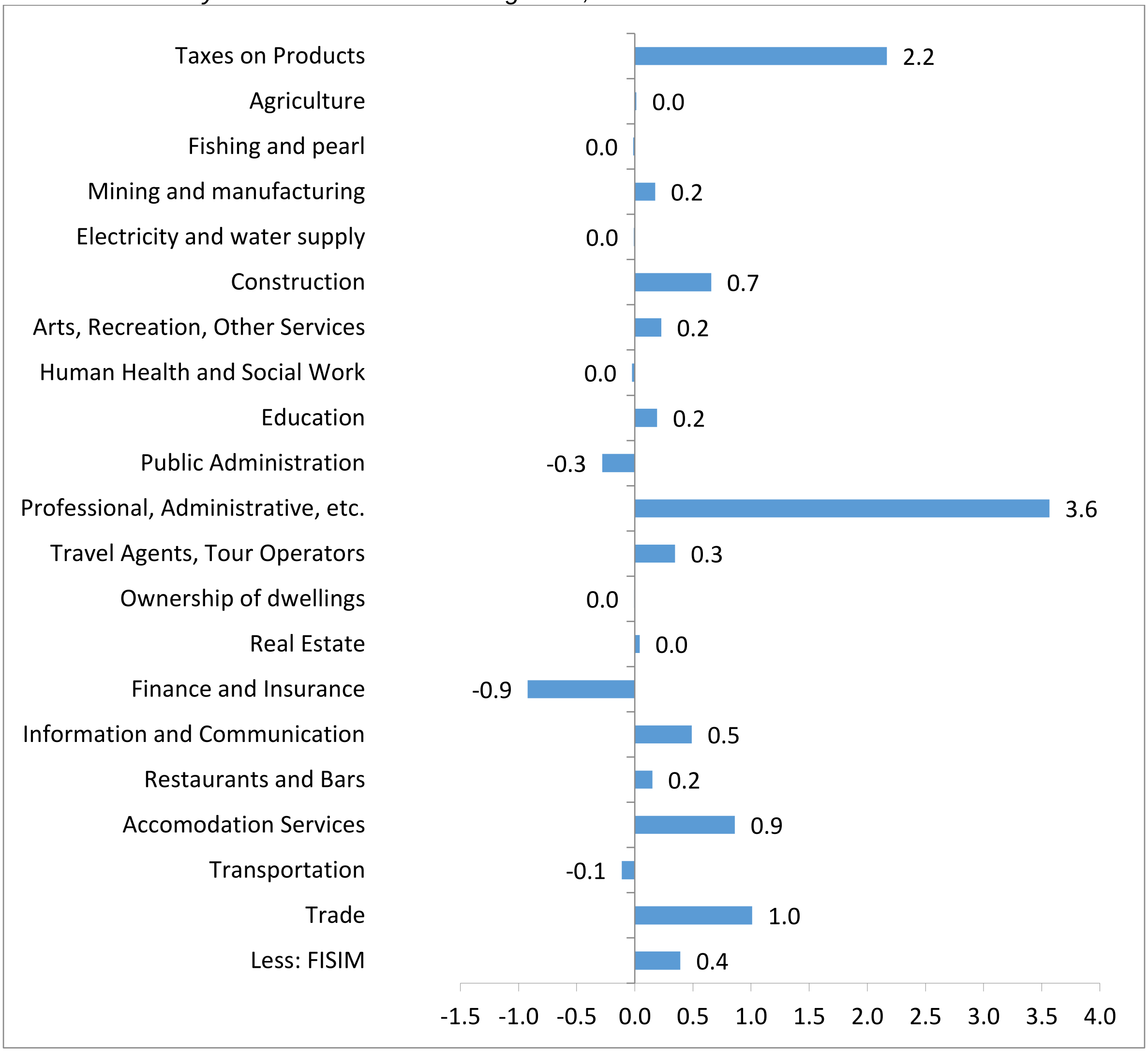
Chart 2: Cook Islands economy by industry, 2017/18



Source: Cook Islands Statistics Office, National Accounts Statistics, March Quarter 2019.

In 2017/18, high tourist arrivals drove strong growth in the economy along with Government use of professional consulting services, with the tertiary sector contributing 5.5 percentage points to real economic growth (Chart 3). The strongest industry contributions were from professional and administrative services (3.6 percentage points) and trade (1 percentage point). During this period, professional and administrative services grew by 91 per cent from $18 million to $35 million and trade rose by 8 per cent from $60 million to $65 million. A number of industries contracted in 2017/18, including finance and insurance and public administration.

Chart 3: Industry contribution to real GDP growth, 2017/18

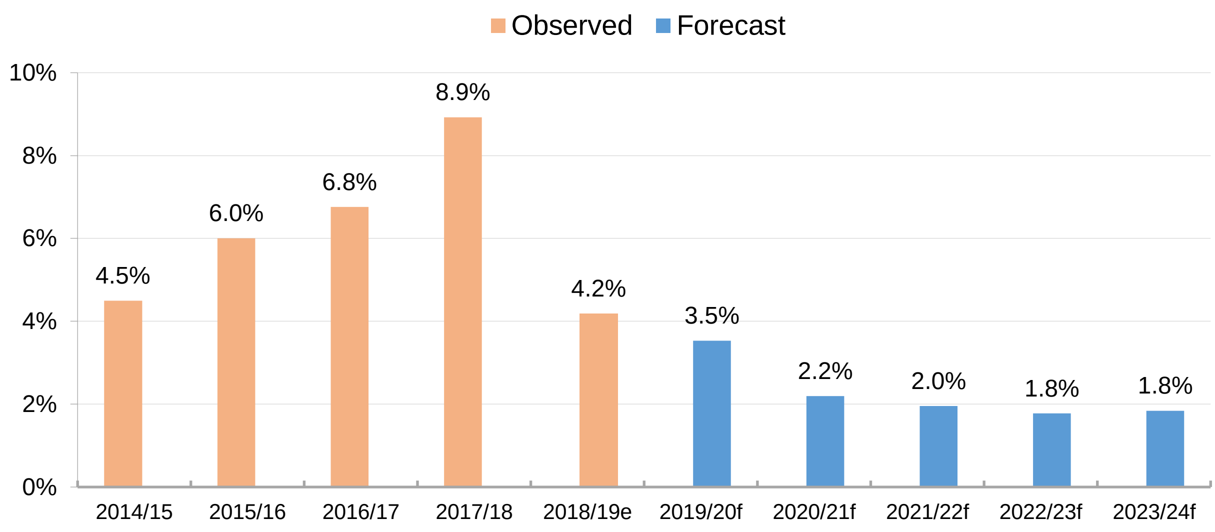


Source: Cook Islands Statistics Office, National Accounts Statistics, March Quarter 2019.

GDP outlook – growth moderating further

Forecast growth over the period 2019/20 to 2023/24 is shown in Chart 4. Growth is expected to moderate to 3.5 per cent in 2019/20. This compares to the 3.8 per cent forecast in the 2019/20 Budget. Growth is expected to fall further to 1.8 per cent by the end of the forecast period. Annual average growth over the 5-year period is forecast at 2.3 per cent. This more conservative outlook than that presented in June 2019 reflects three things: GDP historical data revisions, a flatter growth profile for tourist arrivals, and lower global growth expectations amid mounting trade-related uncertainty.

Chart 4: Forecast real GDP growth (percentage change)

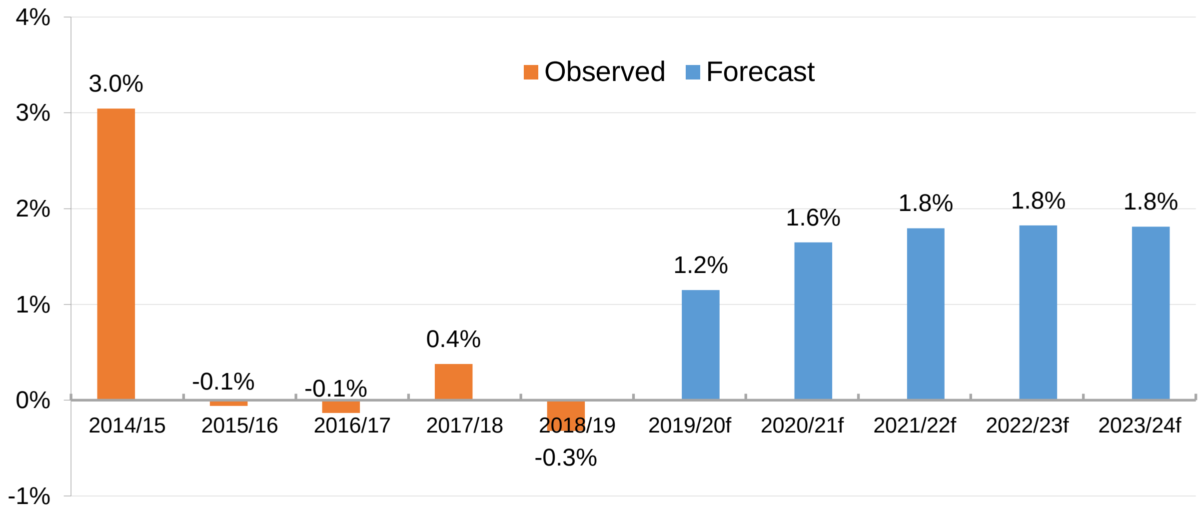


Source: MFEM estimates.

Inflation – deflation once again, but expected to rise

The Consumer Price Index (CPI) for 2018/19 averaged minus 0.3 per cent over the year, compared to 0.4 per cent the year before (Chart 5). Inflation is forecast to pick up to 1.2 per cent in 2019/20 before rising further to about 1.8 per cent per year over the forecast period, on the back of expected increases in capacity constraints such as labour and skills shortages, resulting in inflationary pressure.

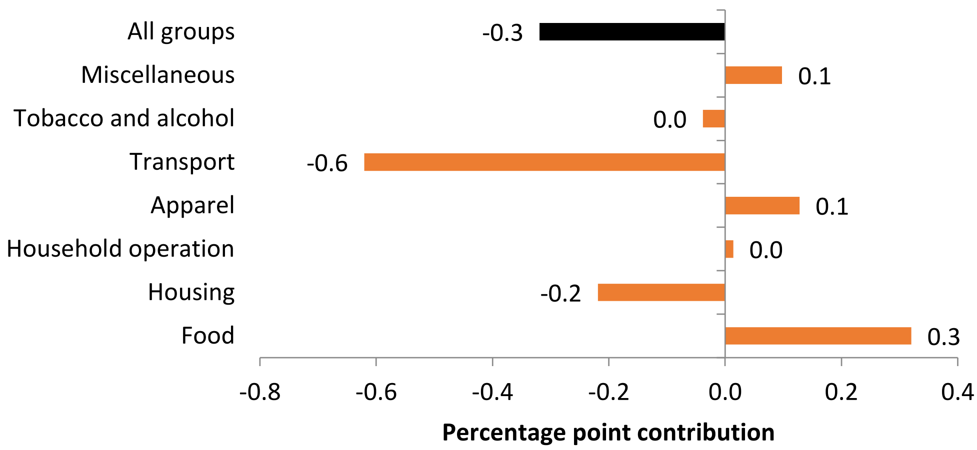
Chart 5: CPI (average annual percentage change)



Source: Cook Islands Statistics Office, Consumer Price Index, June Quarter 2019; MFEM estimates.

In 2018/19, rises in the Food, Apparel and Miscellaneous groups were more than offset by a significant fall in the Transport and Housing groups (Chart 6).

Chart 6: Contribution to 2018/19 average inflation (percentage point)

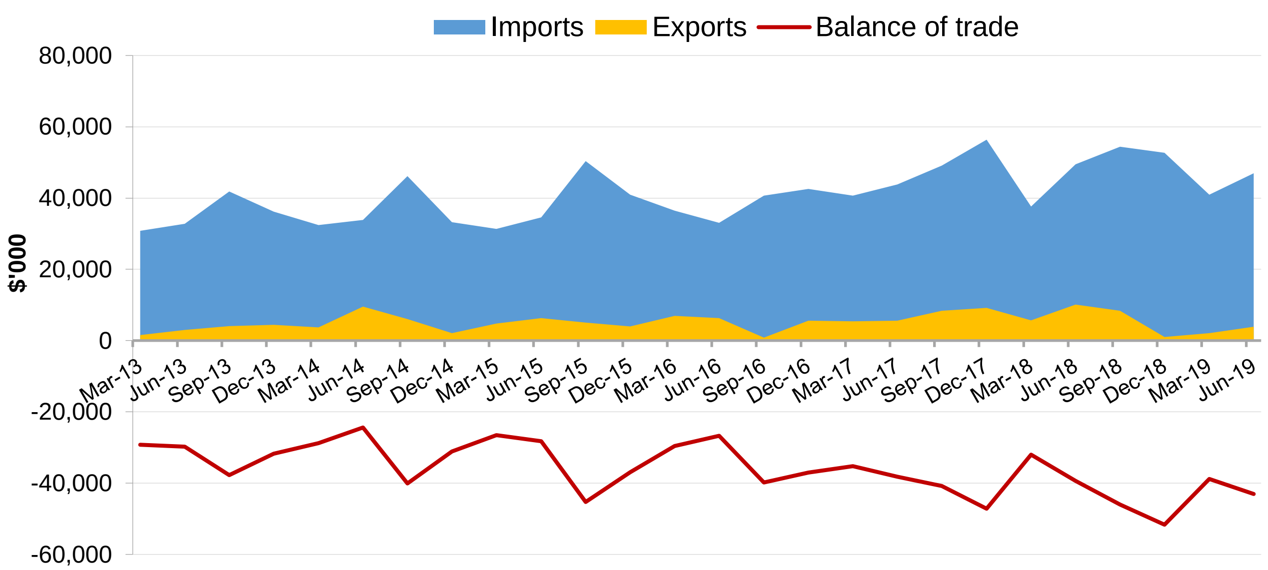


Source: Cook Islands Statistics Office, Consumer Price Index, June Quarter 2019.

Merchandise trade – balance improves, following the regular seasonal pattern

The balance of merchandise trade, which is the value of exports minus the value of imports, fell in the June 2019 quarter to -$43 million, with a 15 per cent rise in the value of imports more than offsetting an 83 per cent increase in the value of exports (Chart 7). This follows the regular seasonal pattern, with Food and live animals accounting for 70 per cent of the increase in import value.

Chart 7: Cook Islands balance of trade, by quarter ($'000)



Source: Cook Islands Statistics Office, Overseas Trade Statistics, June 2019.

New Zealand remains the Cook Islands major trading partner by far (Chart 8), a reflection of transport connections.

Chart 8: Cook Islands major trading partners, year to June 2019 ($'000)

Source: Cook Islands Statistics Office, Overseas Trade Statistics, June 2019.

Economy – International

The Cook Islands is a small, open economy whose economic growth is heavily reliant on the export of services to a number of key partner countries, New Zealand and Australia in particular. As such, the economy is vulnerable to global financial shocks.

New Zealand – monetary easing and fiscal stimulus as domestic growth slows

In August 2019, the Reserve Bank of New Zealand (RBNZ) reduced its official cash rate by 50 basis points to 1 per cent 'to continue to meet its employment and inflation objectives' in the face of slowing GDP growth and rising growth headwinds. This rate was maintained at its September 2019 meeting.

The RBNZ *Monetary Policy Statement* August *2019* reports annual GDP growth slowing to 2.5 per cent in the March 2019 quarter, lower than expectations thanks to softening growth in business investment, with inflation remaining below its 2 per cent target.

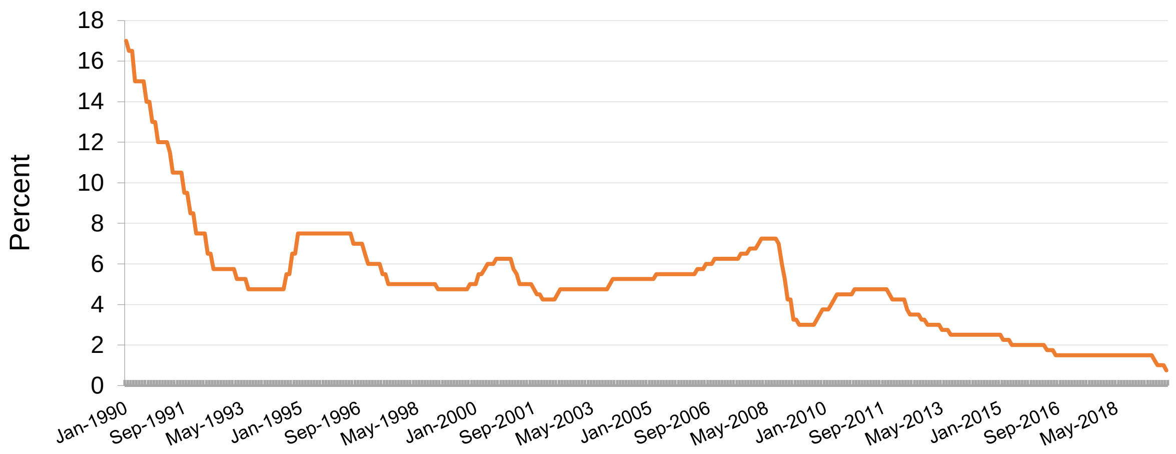
The RBNZ expects weak global conditions to continue, with declining trade and heightened uncertainty contributing to lower trading partner growth. Factoring in low interest rates and increased government stimulus in New Zealand, the RBNZ expects a pick-up in local demand over the coming year, with business investment expected to rise, along with increased construction activity.

Australia – cash rate falls to record low level

In October 2019, the Reserve Bank of Australia (RBA) lowered its cash rate to a historical low of 0.75 per cent. This followed two consecutive 25 basis points reductions in June and July 2019 (Chart 9).

In its *Statement on Monetary Policy August 2019*, the RBA reported GDP growth expectations of 2.5 per cent in 2019, rising gradually to 3 per cent by 2021, supported by lower interest rates and recent tax measures.

Chart 9: Australian cash rate, (percentage)



Source: RBA, 2019.

Asia Pacific – outlook remains robust despite trade tensions

The Asian Development Bank's (ADB) September 2019 *Asian Development Outlook 2019 Update* expects growth to moderate but remain robust. As global trade slows and investment weakens, the ADB has revised its regional growth forecasts down by 0.3 percentage points for 2019 and 0.1 points for 2020. Expansion in the region is projected to slow from 5.9 per cent in 2018 to 5.4 per cent in 2019, recovering slightly to 5.5 per cent in 2020. The revisions reflect gloomier prospects for international trade—in part because of re-escalation in the trade conflict between the United States and China—and evidence of slowing growth in the advanced economies and China, as well as in India and the larger economies in East and Southeast Asia.

The ADB expects economic growth in the Pacific to rebound from near stagnation in 2018 at 0.4 per cent, to 4.2 per cent in 2019 mainly because gas production in Papua New Guinea has outpaced projections, but also with higher than expected construction expenditure in Solomon Islands and Samoa higher than expected and Nauru suffering less economic decline than predicted. The ADB lowered its growth projections for the Cook Islands to 4.2 per cent in 2019 and 4.5 per cent in 2020, citing a 'tourism downturn'.

Global — IMF downgrades global growth forecasts

The International Monetary Fund (IMF) in its October 2019 W*orld Economic Outlook* presents a dimmer view of global growth prospects — 'the global economy is in a synchronized slowdown, with growth for 2019 downgraded again—to 3 per cent—its slowest pace since the global financial crisis.'

The IMF expects global growth in 2020 projected to improve modestly to 3.4 percent, a downward revision of 0.2 per cent from their April projections. The IMF notes this recovery is not broad based and is precarious. The IMF cites a number of reasons for its downward growth revision including rising trade barriers, elevated uncertainty surrounding trade and geopolitics and structural factors, such as low productivity growth and aging demographics in advanced economies.

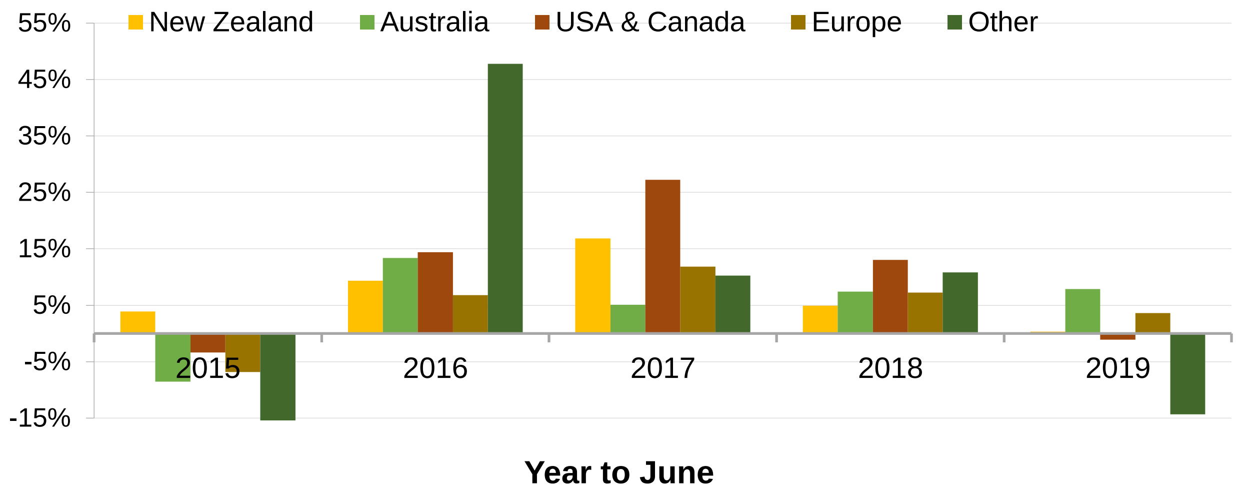
Sector, industry & business – Cook Islands

Tourism

Visitor arrivals performance – falling to more sustainable levels

In the year to June 2019, visitor arrivals in the Cook Islands reached a new high of 166,874, but only 1.3 per cent higher than the year to June 2018. New Zealand visitor numbers were flat over this period, with Australia recording the highest visitor growth rate with an 8 per cent rise on the previous year's 26,398 visitors to 28,482 (Chart 11). European visitor numbers also showed a healthy increase, with North American visitor numbers falling slightly.

Chart 11: Visitor arrivals by country of usual residence, year to June (percentage change)



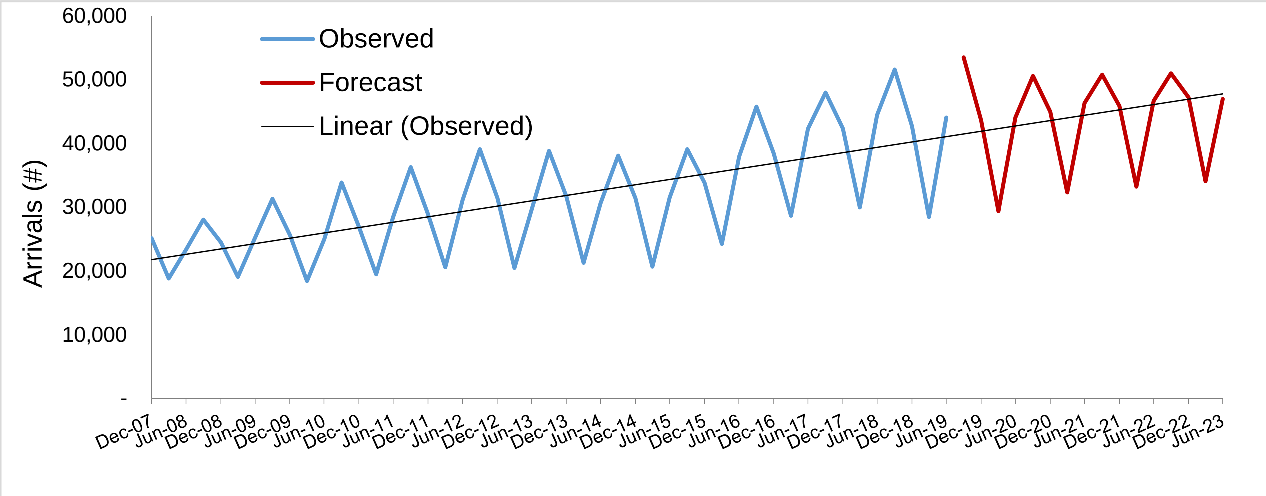
Source: Cook Islands Statistics Office, Tourism and Migration Statistics, June Quarter 2019.

Arrivals outlook – growth expected to moderate after pick up in 2019/20

Total arrivals for 2019/20 are estimated to be about 170,611, 2 per cent higher than the 166,874 seen in 2018/19. This expected rise on the 2018/19 growth rate largely reflects a strong start to 2019/20. July 2019 saw a new overall record of 18,612 visitors, with August reporting 18,464 visitors, the highest ever for that month. As shown in Chart 12, growth is then expected to fall to about 1 per cent per year by 2023/24. This forecast is subject to a number of downside risks, including global growth concerns and uncertainty over future decisions by Virgin Australia on its Pacific routes.

Markets	2018/19	2019/20f	2020/21f	2021/22f	2022/23f	2023/24f
New Zealand	110,607	112,301	114,746	115,124	116,654	116,558
Australia	28,482	29,864	30,092	30,850	31,199	31,809
USA & Canada	11,291	11,395	11,867	12,287	12,571	12,936
Europe	12,358	12,591	13,098	13,747	14,239	14,813
Other	4,136	4,460	4,488	4,602	4,662	4,754
Total	**166,874**	**170,611**	**174,292**	**176,610**	**179,324**	**180,870**

Chart 12: Visitor arrivals forecasts, quarterly



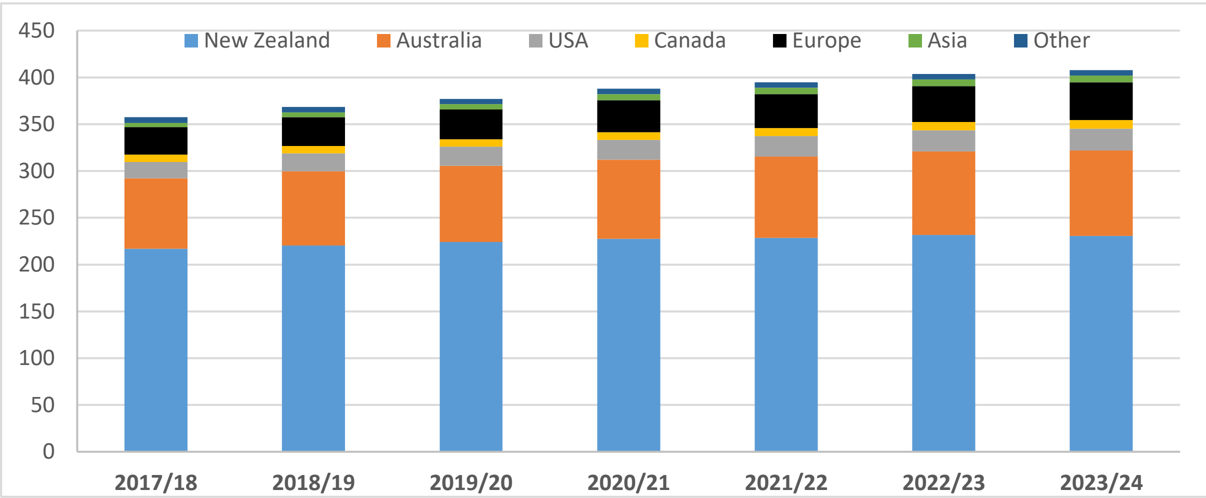
Source: MFEM.

Tourism expenditure

Preliminary MFEM estimates show total visitor expenditure rising from $368 million in 2018/19 to $377 million in 2019/20, an increase of 2 per cent (Chart 13). Growth of about 2 per cent per year is expected thereafter, falling to 1 per cent by the end of the forecast period as arrivals growth declines. Expenditure is dominated by New Zealand, accounting for 59 per cent of the total in 2019/20, followed by Australia with 22 per cent and Europe with 9 per cent.

These estimates provide a proxy for the overall contribution of the tourism sector to the Cook Islands economy, with tourism estimated to account for about 66 per cent of nominal GDP in 2019/20.

Chart 13: Total expenditure, major market, $ million current prices, 2017/18 to 2022/24

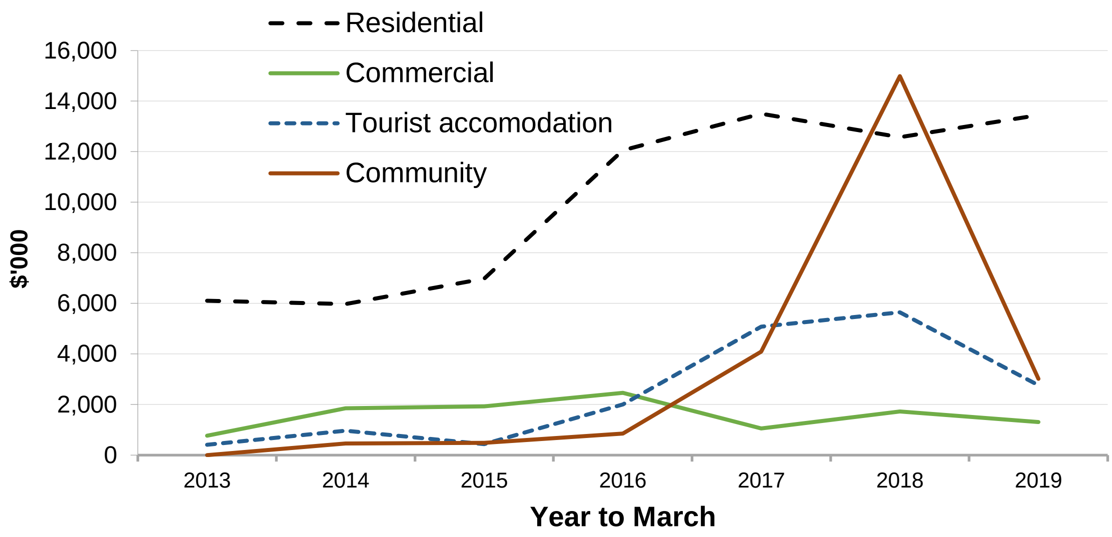


Source: MFEM.

Building approvals – falling but still at historically high levels

The total value of Cook Islands building approvals in the year to March 2019 fell by 41 per cent to $20.5 million from $34.9 million the previous year (Chart 14). The bulk of the reduction was accounted for by an 80 per cent fall in the value of Community approvals, following the completion of a number of large projects such as the Tereora College redevelopment, and a 20 per cent reduction in Tourist accommodation approvals. These falls more than offset a small rise in residential approvals. Nonetheless, the total value remains well above historical trend.

Chart 14: Building approvals, year to March ($'000)



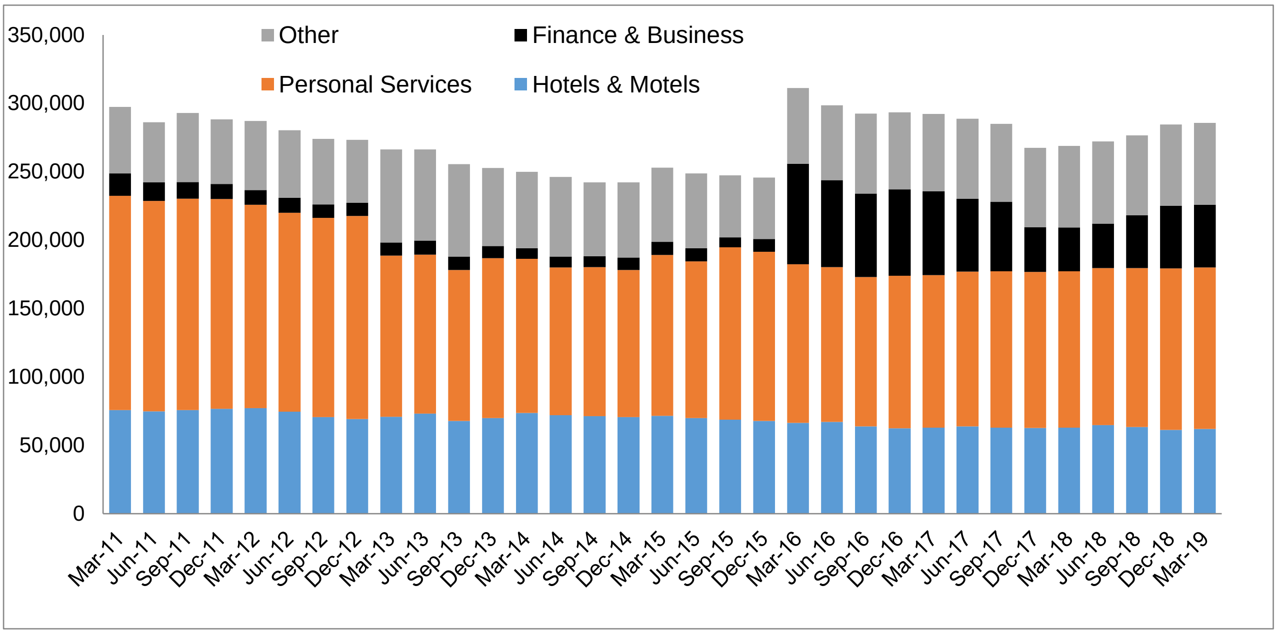
Source: Cook Islands Statistics Office, Miscellaneous Statistics, March Quarter 2019.

Banking

Loans & advances – lending up

Total lending by Cook Islands banks in March 2019 when compared to March 2018 rose by 6 per cent from $269 million to $ 286 million. Agriculture & fishing, Transport & communications, Finance & business and Personal Services categories all recorded increases, more than enough to offset falls in Wholesale and retail trade and Hotels and motels. Personal services loans account for 41 per cent of total lending, followed by Hotels & motels on 22 per cent.

Chart 15: Cook Islands bank loans and advances by industry, March to March ($'000)



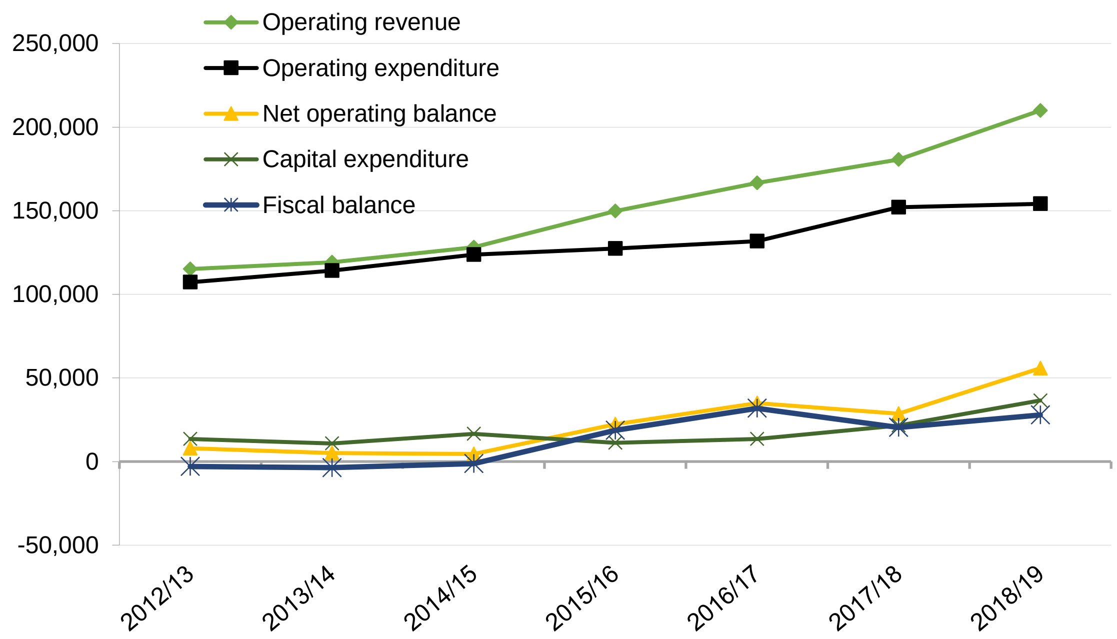
Source: Cook Islands Statistics Office, Miscellaneous Statistics, March Quarter 2018.

Government finance – Cook Islands

Total revenue, expenditure and fiscal balance

Chart 16 shows a time series of government operating revenue, expenditure and net operating balance (the difference between the two) and capital expenditure at the end of June.

Chart 16: Cook Islands Government revenue and expenditure ($'000)



Source: MFEM.

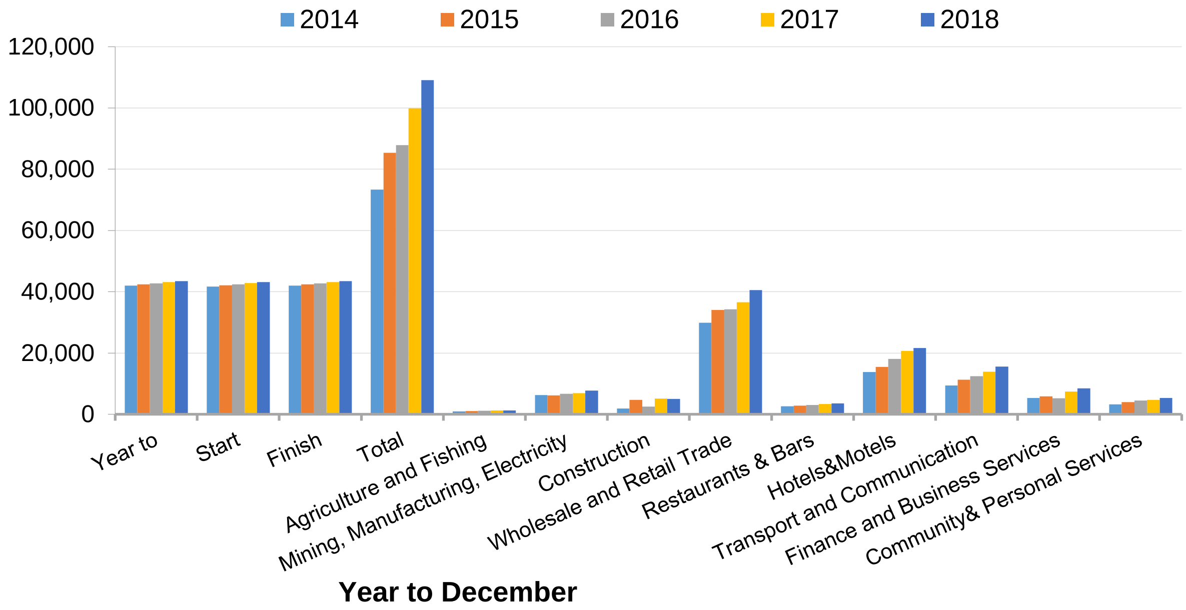
Government revenues have been rising at a faster rate than operating expenditure over the last few years, to the benefit of the net operating balance. In June 2019 the balance was $56 million, 95 per cent higher than the balance of $29 million at the same time the previous year. Total government capital expenditure rose by 69 per cent in June 2019 compared to the previous year, from $22 million to $37 million. This reflects expenditure on a number of large capital projects, such as Te Mato Vai and renewable energy in the Pa Enua. Chart 16 also shows the fiscal balance, which is the net operating balance *minus* capital expenditure *plus* depreciation. The fiscal balance in June 2019 was $28 million, 36 per cent higher than the $20 million balance in June 2018.

VAT revenue — Wholesale & retail trade leads the way

Total value-added tax (VAT) collected by the Cook Islands Government in the year to December 2019 rose by 9 per cent to $109 million from $100 million recorded in the year to December 2017.[1] All industries showed an increase in collections, with the exception of Agriculture & fishing and Construction. The largest contributor to the increase in total VAT was the Wholesale & retail trade, accounting for 43 per cent, followed by Transport & communication with 19 per cent (Chart 17).

[1] Total VAT collected is higher than the net VAT data reported in the Government Financial Reports.

Chart 17: Cook Islands sales and income VAT, by industry, year to December ($'000)



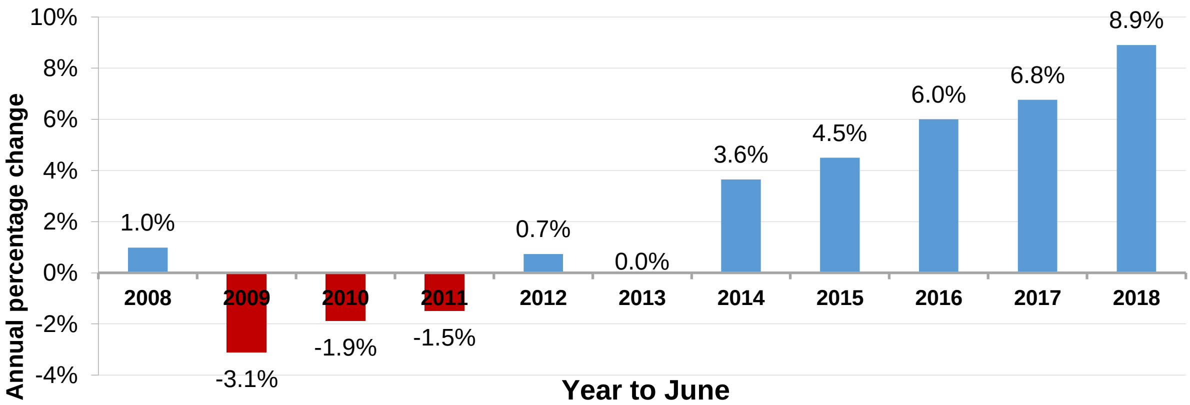
Source: Cook Islands Statistics Office, Taxation Statistics, December Quarter 2018.

Risks

Global financial crisis Mark 2 — what was the impact last time?

The risks of another financial meltdown are high according to numerous economic commentators, including the IMF. The dramatic rise in global debt levels, parts of the financial system remaining unregulated, along with concerns over the Brexit impact and ongoing trade wars, have highlighted concerns about a repeat of the 2007/08 global financial crisis. That crisis, and the global economic slowdown that ensured, had a sobering effect on the Cook Islands economy. Chart 18 shows that the Cook Islands experienced 3 years of recession following the crisis, with growth only re-entering stable positive territory in 2013/14.

Chart 18: Real GDP growth (percentage change)



Source: Cook Islands Statistics Office, National Accounts Statistics, March Quarter 2019; MFEM estimates.

Through sound fiscal management, and guided by the Medium-term Fiscal Strategy, with very low-debt levels, a positive fiscal balance and a Stabilisation Account set up for this scenario, the Government is better placed to respond to a repeat of the 2007/08 crisis.

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