BUDGET 2016/17

Kia Orana,

It gives me great pleasure to present this general guide for the 2016/17 Budget.

The 2016/17 Budget has been developed to invest in our nation, and improve the productive capacity of our economy. As such, we are forecasting significant operating surpluses across coming years. These operating surpluses will be channelled into capital projects that will directly improve the lives of the Cook Islands People and help our economy develop.

We are committed to having a high level of detail in our Budget books to enable national and international scrutiny. The 2016/17 Budget goes much further than previous efforts in an incremental improvement to greater transparency.

We have also outlined some proposed changes to the format of the Budget Appropriation tables to allow the public to have greater visibility on how their money is being spent.

Full details of the 2016/17 Budget are online at www.mfem.gov.ck. Some highlights include:

- $1,350,000 in promotional funds to finance Airline Joint Venture marketing programmes over 3 years.
- $553,858 to increase the Emergency Response Fund to $1.5 million
- $548,000 committed to the implementation of the Family Law Bill and increasing the Destitute and Infirmed payment over 4 years.
- $240,000 committed to the clearance of the backlog of records in the Land Court over 2 years.
- $100,000 to fund a Labour Force Survey in the 2017/18 financial year
- An additional $400,000 for the maintenance of heavy machinery in the Pa Enua over 4 years.
- $588,000 committed to training programmes for teacher and student development over 4 years.
- $344,000 to improve the whole-of-government policy making, cultural policy, and aviation safety over 4 years.

Approximately $80.9 million will be invested in infrastructure for Rarotonga and the Pa Enua, of which, the Cook Islands Government will contribute $36.7 million for 2016/17. From this amount there will be:

- $8 million for the re-sealing of the main road in Rarotonga over 4 years.
- $27.7 million for Renewable Energy projects in the Southern Group over 2 years
- $53.2 million for Te Mato Vai, particularly on works associated with the replacement of ringmains, refurbishment of intakes and provision of storage, filtration and trunk mains which will be done over 4 years.
- $15.1 million for Sanitation upgrades in Rarotonga and Aitutaki over 3 years.
- $11.5 million for Stage 1 of the Tereora College Upgrade over 2 years.
- $15.3 million for the rebuild of the Apii Nikao school over 3 years.
- $4.1 million for strengthening the resilience of island communities over 2 years.
- $2.1 million for bridge upgrades and drainage in Rarotonga over 2 years.
- $4.6 million committed for the stabilisation of the Atiu runway over 2 years.

Kia Manuia,

Hon. Mark Brown
Minister of Finance

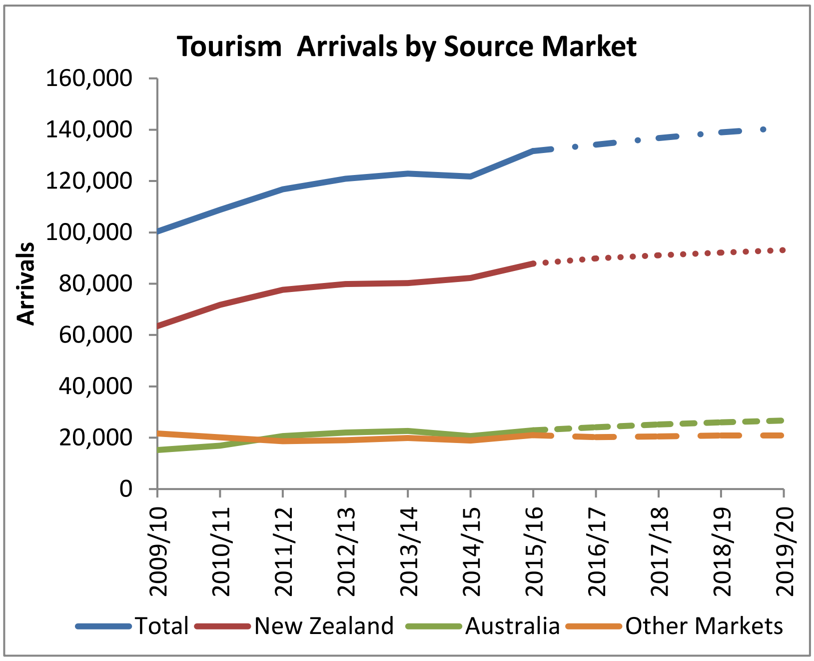
The Economy

The economy performed well above expectations in 2015/16, driven mainly by tourism arrivals.

Visitor arrivals for 2015/16 are projected to total 131,700, a remarkable 8.2 per cent increase from the previous year's negative growth of 0.9 percent.

As a result of improved tourism arrivals, the **total economy (as measured by nominal GDP) is expected to have grown by 5.4 per cent in 2015/16**.

In future years, it is unclear whether arrivals will continue to grow at such high rates. However, increased airline competition and capacity suggest **tourism growth should remain positive**, albeit at a lower rate. In the short term, arrivals are forecast to grow by 2 per cent in 2016/17 and 2017/18.



In terms of total GDP, growth is expected to remain positive, buoyed by continued growth in visitor numbers and capital spending. In 2016/17, nominal GDP is projected to grow by 2.1 per cent.

Key downside risks to growth include a potential reduction in visitor arrivals, external oil price shocks and delays in capital project implementation. Upside risks include stronger arrivals growth due increased airline competition, continued low global inflation, and additional capital projects being added to the capital schedule.

Cook Islands local inflation, as measure by consumer prices, is expected to remain low. Inflation was an estimated 0.4 per cent in 2015/16 – very low by historical standards. Going forward, inflation is expected to be 1.6 per cent in 2016/17 and 1.5 per cent in 2017/18, due to oil prices.

Summary of Key Economic Indicators

	2015/2016 Est.	2016/2017 Est.	2017/2018 Proj	2018/2019 Proj	2019/2020 Proj
Economic Activity					
Nominal GDP ($'000)	418,364	427,310	434,809	446,109	457,107
Percentage change (YOY)	*5.4*	*2.1*	*1.8*	*2.6*	*2.5*
Real GDP (at Constant 2006 Prices, $'000)	421,700	428,471	432,044	436,923	441,443
Percentage change (YOY)	*6.2*	*1.6*	*0.8*	*1.1*	*1.0*
Inflation					
Percentage change (YOY)	*0.4*	*1.6*	*1.5*	*1.6*	*1.4*
Tourism arrivals					
Visitor Arrivals	131,700	134,180	136,735	138,981	140,681
Percentage change (YOY)	*8.2*	*1.9*	*1.9*	*1.6*	*1.2*
Estimated Visitor Expenditures ($'000)	275,872	280,621	290,424	300,081	308,241
External Sector					
Total Trade Surplus ($'000)	126,911	133,428	150,731	166,312	166,556
Financial Sector (at end of financial year)					
Government Net Debt Position ($'000)	50,014	68,244	81,681	66,455	49,778

Budget indicators

Operating Balance (Do today's revenues meet our day-to-day costs?)

A Healthy operating position

In the previous financial year (2015/16) the Budget was in an operating surplus of an estimated $15.9 million (3.8 per cent of GDP). This was largely driven by one-off factors such as a reduced cost of the Air New Zealand underwrite and higher revenue collections. This meant that there was a significant increase in the cash reserves of the government, relative to the 2015/16 HYEFU.

For 2016/17, it is estimated that the operating surplus will be $9.3 million, again reflecting lower costs to the underwrite and increases in estimated revenue.

Fiscal Balance (Do today's revenues meet our day-to-day costs *and* our investment costs?)

A Capital investment Budget

2016/17 is an investment Budget. For 2016/17, the previous savings and operating surpluses will be invested in capital projects over two years. As a result, the fiscal balance in 2016/17 is estimated to be a deficit of $17.3 million.

This deficit will be financed by drawing on cash reserves and using a loan for the Southern Renewable Energy Project.

The fiscal position appears to improve in 2018/19 and 2019/20, as the exact details around major capital projects, such as the submarine cable and measures to address sanitation issues in Muri are yet to be finalised.

Unallocated cash and equivalents (How much cash is not in trust accounts or loan reserves?)

Prudent reserves on hand

Due to healthy operating surpluses in 2015/16 and 2016/17, and a fiscal surplus in 2015/16, unallocated cash reserves are estimated to be $34.9 million in 2016/17. These reserves are kept on hand as insurance in case of a catastrophe.

This cash reserve declines to $13.5 million in 2017/18 due to significant capital investment, but then recovers.

Debt, net of the Loan Reserve (How much does the Government owe, minus any pre-payments?)

Room to invest

The current debt to GDP ratio is estimated to be 23.6 per cent of GDP in 2016/17, with almost all of this debt being held by official creditors (the Asian Development Bank, China, and France) at maturities of around 20 years. The debt ratio declines moving forward, as debt is paid off every year.

This level of debt is similar to a household with an annual income of $50,000 having a mortgage of $11,800

Summary of Key Budget Indicators ($m)

Statement of Financial Performance	**2015/16 Estimate**	**2016/17 Budget**	**2017/18 Projection**	**2018/19 Projection**	**2019/20 Projection**
Total Operating Revenue	**146.5**	**142.8**	**144.9**	**140.8**	**143.5**
Of which: Taxation Revenue	*111.8*	*109.6*	*111.7*	*114.9*	*117.6*
Total Operating Expenditure	**130.6**	**133.5**	**137.1**	**129.1**	**129.0**
Of which: Personnel	*51.1*	*53.3*	*53.1*	*51.6*	*51.6*
Operating Balance	**15.9**	**9.3**	**7.8**	**11.7**	**14.5**
As a percentage of GDP	*3.8*	*2.2*	*1.8*	*2.6*	*3.2*
Cook Islands Government Capital Expenditure	15.1	36.7	34.4	8.5	5.9
Fiscal Balance surplus/deficit ($m) *	**9.7**	**-17.3**	**-15.2**	**14.7**	**20.0**
Percentage of GDP	*2.3*	*-4.1*	*-3.5*	*3.3*	*4.4*
Statement of Financial Position ($m)					
Unallocated Cash & Equivalents ($m)	31.5	34.9	13.5	22.4	33.5
Cash & Equivalents (months coverage)	*3.1*	*3.4*	*1.3*	*2.3*	*3.4*
Statement of Borrowings ($m)					
Net Crown Debt, end of FY ($m)	95.9	100.8	92.6	85.4	79.0
As a percentage of GDP	*22.9*	*23.6*	*21.3*	*19.1*	*17.3*
Loan Repayment Reserves Held ($m)	17.3	18.1	18.1	16.3	15.1
Development Partner Support ($m)					
Grants ($m)	32.5	60.7	31.0	16.4	4.8
As a percentage of GDP	*7.8*	*14.2*	*7.1*	*3.7*	*1.0*

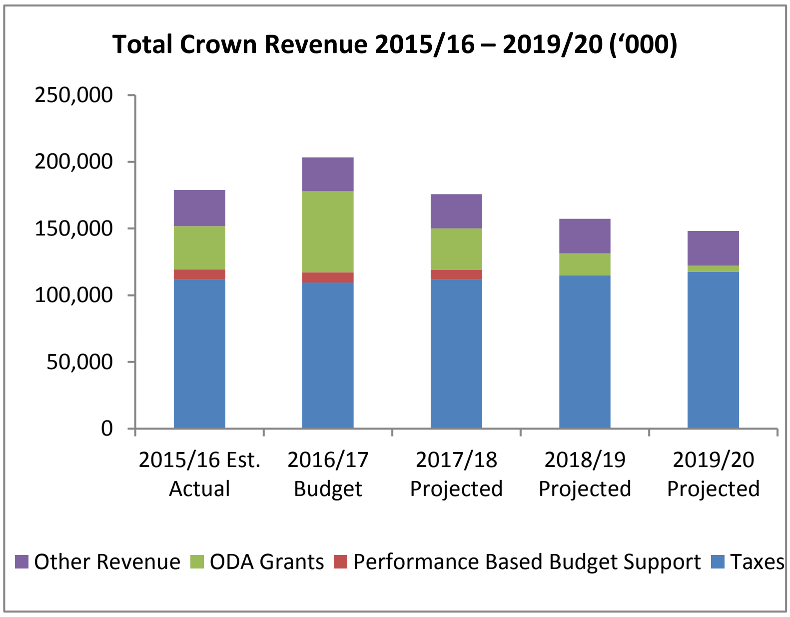
Budget details

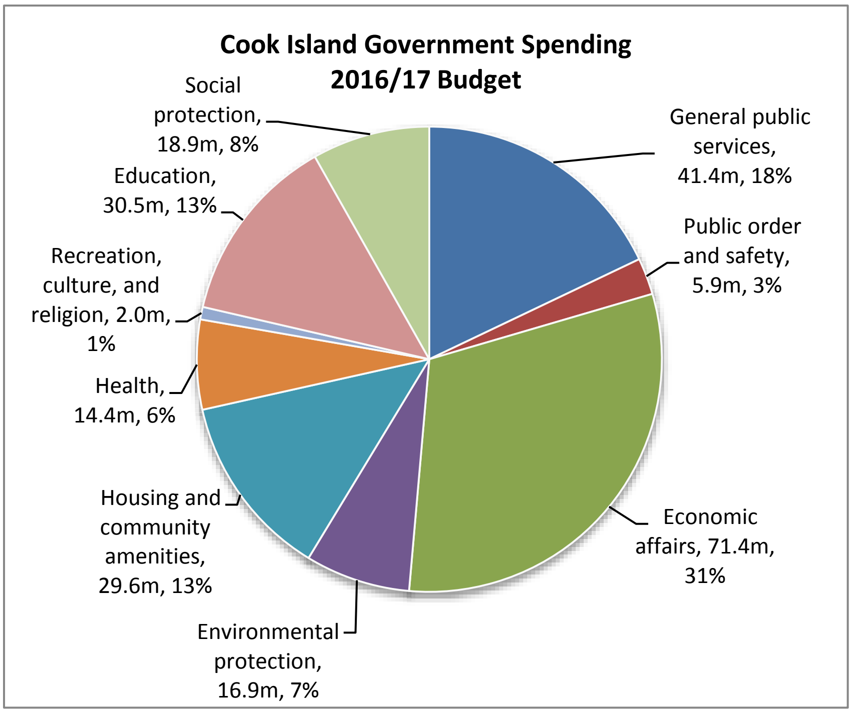
Revenue and grants

Total tax revenue is forecast to be $109.6 million for 2016/17, $55.6 million of which is value added tax, $22.9 million is income tax and $10.2 million is fisheries revenues.

This revenue is complimented by $7.6 million in direct budget support from the New Zealand Government and $60.7 million in other grants.

New Zealand remains the largest development partner, with a contribution of $22.3 million in 2016/17. The European Union and the Global Environment Fund also contribute a significant amount ($12.4 million and $9.4 million, respectively) – most of which is dedicated to the Southern Renewable Energy Project.





Expenditure

Total Government Expenditure is divided across numerous functions of Government. Economic affairs is by far the largest area of total public expenditure at 31 per cent of the total spending, driven by tourism spending through the Cook Islands Government appropriation, and energy infrastructure in the ODA spend.

General public services is next, at around 18 per cent of total public spending, with the Cook Islands Government admin costs being the main driver.

Education is the third largest area of spending at 13 per cent, driven mainly by the Cook Islands Government's own expenditures, but also the construction activity by the Chinese and New Zealand Governments at Apii Nikao and Tereora respectively.

Other major areas of spending are housing and community amenities (which includes general community infrastructure) at 13 per cent, social protection (social welfare) at 8 per cent, and environmental protection at 7 per cent.