



## Reducing the Cost of Borrowing

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## Overview

Loan interest rates in the Cook Islands are high by international standards, as much as 5-7 percentage points higher than comparable products in New Zealand.

Over a number of years there have been three reviews of the commercial banking sector in the Cook Islands, all of which focused on the reasons why commercial banks charge customers high interest rates on loans. In each case there have been justifications given by local banks for a premium above NZ interest rates for home mortgages and commercial loans to business. These include the different risk profiles of assets under the land tenure system(s) in the Cook Islands, lack of economies of scale in a small market and the broader economic environment.

The objective of this project is to identify how the Cook Islands can achieve an outcome of reduced interest rates for business owners and home owners. This may be achieved by allowing our financial system to come under the auspices and jurisdiction of the Reserve Bank of NZ.

Funding for this programme may become available from Cook Islands funding partners however the project is included in the Economic Recovery Roadmap (ERR).

## Context

Interest rates ultimately are the “price” of money, how much extra you have to pay in order to borrow. In the Cook Islands we rely on New Zealand’s currency (\$NZ), due to the strong links between the two economies. We know that implementing a full Cook Islands’ currency is not practicable given the size of our economy and the costs and risks that come with running an independent currency. Because our currencies are the same, we rely on NZ’s monetary policy in terms of the supply of money and the “price” of money, and the rules that are used to set interest rates.

Lending rates by retail and commercial banks are typically based on the centrally set interest rates plus a ‘spread’ which is dictated by various things such as each bank’s own cost of borrowing, their operational overheads, and other risk considerations (often loan specific). Each bank’s own cost of borrowings may be influenced by the deposit interest rates that they pay, or the rates that the bank in turn pays to access funds domestically or overseas.

The primary expected benefits of this project are reduced rate of borrowing for businesses and home owners encouraging growth in construction and private investment through reducing the



associated borrowing costs. Private investment growth is extremely important in stimulating GDP growth and future labour productivity through increasing the capital stock of the Cook Islands.

Lower interest rates may also help to support business competition as it allows potential new businesses to face a lower hurdle to joining the market – which could be a beneficial outcome driving economic growth and diversification.

A further benefit is expected to be a reduced cost of finance for existing loans held by local businesses and home owners and especially with the increased debt taken on over the past two years during the pandemic. Reducing these costs will allow these businesses and homeowners to spend or invest elsewhere in the economy – which may drive further productivity growth or production.

## **Project**

The overall objective is to reduce the cost of borrowing (interest rates) in the Cook Islands to a point where they are much closer to the interest rates in New Zealand. This project is intended to be achieved through the following steps:

1. a report, commissioned by the Reserve Bank of New Zealand (RBNZ) on the drivers of the spread between New Zealand and Cook Island costs of borrowing, and the magnitude of those drivers. The focus on the magnitudes is a key difference from recent reports in this space, as well as recognizing any impact from the pandemic. Expected in early 2022.
2. if supported by the research, the Cook Islands banking sector coming under the purview of the RBNZ's monetary policy framework (and potentially some of its other functions like some (but not all) of RBNZ's prudential or macro-prudential rules) as an extension of the New Zealand system.

## **Engagement**

This project will be led by the Economic Planning Division (EPD) of the Ministry of Finance and Economic Management working with the RBNZ.

No public engagement is presently planned, however representatives of the EPD and RBNZ will engage with the Cook Islands banks.

## **Estimated Cost**

This is expected to have minimal direct costs, but any administrative or unanticipated costs will be funded through the Economic Response Roadmap administered payment managed by MFEM.

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