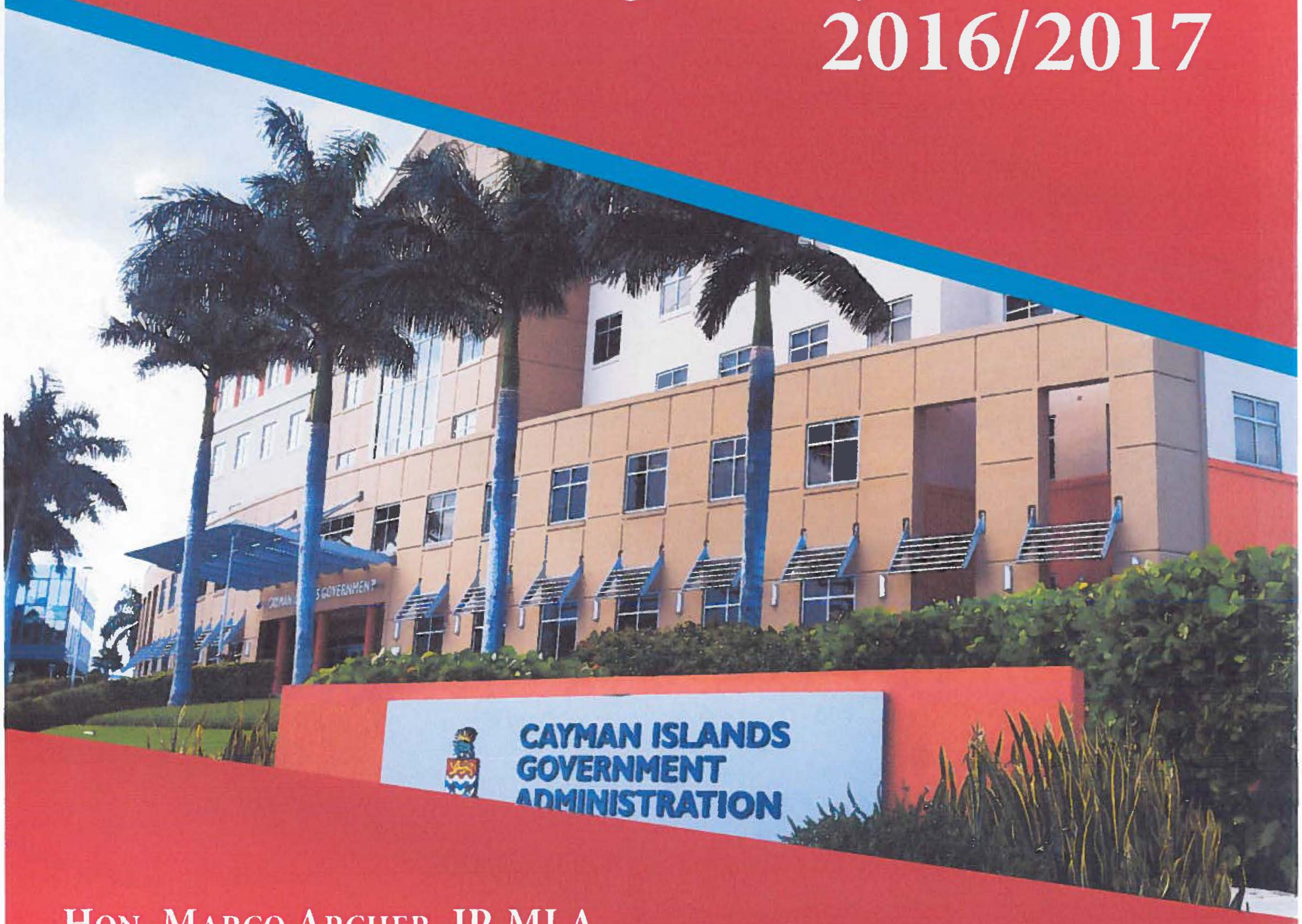
CAYMAN ISLANDS
GOVERNMENT

Strategic Policy Statement 2016/2017



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Introduction

Madam Speaker. The Government's 2016/17 Strategic Policy Statement or SPS, which has just been tabled, outlines the Government's fiscal plans, policy priorities and broad strategic outcomes for the next three financial years which will cover the period 1 July 2016 to 31 December 2019 and also guide the development of the detailed 2016/17 Budget.

This SPS is unique in that it sets out the Government's financial targets for the next three financial periods (that being 18 months for 2016/17; 12 months for 2018; and 12 months for 2019) and establishes the framework within which the detailed 2016/17 18-month Budget will be prepared.

Madam Speaker this SPS is the third one produced by this administration and will be the last SPS before the next General Election scheduled for May 2017.

Prudent fiscal management has and continues to be the central guiding principle of this Government's fiscal management strategy and this SPS lays out a financial management plan which will ensure that the Cayman Islands remains on a stable and fiscally sustainable path which will enable the Government to support the continued economic and social development needs of these Islands, ensuring a bright future for all Caymanians. We have a responsibility to ensure that our precious and limited resources are managed in such a way that we do not deprive future generations of the benefits and opportunities that have been bestowed upon us.

The main elements of the Government's fiscal strategy are:

1. **Maintain Compliance with the Public Management and Finance Law (the "PMFL"), which now includes the Framework for Fiscal Responsibility (the "FFR");**
2. **Promote Sustainable Economic Growth;**
3. **Reducing the Tax Burden;**
4. **Aggressively Managing Expenditure and Capital Investments;**
5. **Active Debt Management; and**
6. **Improve Cash Balances.**

The economic and financial forecasts set out in the SPS document now before Honourable Members support all aspects of the fiscal strategy just mentioned. The Government is forecasting stable economic growth supported by firm, sustainable financial operations for the Government.

Under the terms of the FFR the Government is required to present the SPS to the United Kingdom's Foreign and Commonwealth Office for its review and agreement prior to the SPS being presented to this Honourable House. This SPS is the third time that we have had to follow this process and I am very happy to report that the Honourable James Duddridge, MP, Minister for Africa, the Overseas Territories and the Caribbean granted unconditional agreement in writing to this 2016/17 SPS.

Madam Speaker, the short timeframe within which we have received such agreement is a real testament to the quality of our forecasts and the increased levels of confidence that the United Kingdom has in our ability to deliver on our promises of financial reform. On behalf of Government, I wish to thank the Foreign & Commonwealth Office for its timely and efficient review of the SPS.

Economic Forecasts

Concerning the economy, over the past couple of years the Cayman Islands has experienced slow but steady economic recovery. The Government has been working over the past two and a half years to support sustainable economic growth through careful policy interventions such as: reduced import duties; lower business licensing fees; development concessions; extended support to small businesses and other initiatives geared towards achieving greater economic diversification and increased employment opportunities for our people.

Over the next three financial years the Economics and Statistics Office is forecasting that our economy will grow steadily in-line with forecasts for the world's major economies, or the source markets for our major economic pillars.

Economic growth as measured by the Real Gross Domestic Product (GDP) is expected to grow steadily by 1.7 % during 2016; 1.8% in 2017; 2.2% in 2018; and 2.5% in 2019. These forecasts are underpinned by the assumption that the three key sectors of the Cayman Islands economy: Financial Services; Tourism; and Business services will all continue to evolve and maintain their global competiveness.

In addition, economic growth will be directly influenced by several large construction projects from both the private and public sectors including: the completion and opening of the new Kimpton Seafire Hotel and Condominiums; redevelopment and expansion of the terminal at the Owen Roberts International Airport; redevelopment of the former Hyatt Hotel; development of the new St. James Point hotel and condominiums in Beach Bay, Bodden Town; the development of a new hotel at Camana Bay; upgrades to road infrastructure as part of the revitalization of George Town and the redevelopment of the George Town Cargo and Cruise Berthing port.

This diverse mix of projects from both the public and private sectors helps to bolster the economy by diversifying the sources of investment and by creating new opportunities for wealth creation.

The forecast economic growth will create additional jobs which is expected to reduce the unemployment rate to 5.1% in 2016; 5% in 2017; 4.7% in 2018 and further to 4.5% in 2019.

With economic growth and increased levels of employment, consumption of goods and services will increase, putting upward pressure on the rate of inflation (as measured by changes in the Consumer Price Index) which is expected to increase by 1.5% in 2016; 1.7% in 2017; 2.2% in 2018; and 2.4% in 2019.

Controlling inflation is of particular concern and interest to the Government as it impacts the lives of everyone by affecting the cost of doing business and the cost of living. Given our Islands' high dependence on imported goods we are particularly vulnerable to inflation caused by external factors. As a Government we will continue to exercise the interventions available to us to manage domestic inflation.

We have already lowered the import duty on diesel used by CUC by $0.50 per gallon (effective 1 January 2016) and reduced the import duty on consumer goods from 22% down to 20%. Neither have we introduced any new revenue measures to increase the cost of doing business and cost of living.

Financial Forecasts

Madam Speaker, I will now move on to highlight the financial forecasts which are contained in the SPS document. However, before I do so, I need to spend a few moments to explain how the numbers in the SPS are different than those of previous SPS documents and the current 2015/16 Budget.

Honourable Members will recall that just last month on the 15 October, the Public Management and Finance (Amendment) Law, 2015 was passed by this House. Those Amendments were the first phase of a series of legislative changes aimed at strengthening our financial management framework.

One of the most significant amendments to the PMFL was to change the Government's financial year from 1 July – 30 June, to the 1 January – 31 December.

In practical terms this amendment means that in order to transition to this new financial year, our next financial period will be for an 18–month duration from 1 July 2016 – 31 December 2017. As a result, Honourable Members need to bear in mind that the numbers in the financial forecasts for the 2016/17 financial period are not directly comparable to those of other financial years which cover just a 12–month period.

The change to the financial year also impacts the year-end cash balances reported in the financial statements as now they will be reported at 31 December, which is historically the point when the Government experiences its lowest cash balances of the year.

The amounts reported as Revenues are also impacted as there is a seasonality factor whereby a higher proportion of Government's revenue is received and booked in the January to March period and the 2016/17 financial period only covers one January to March period thereby making revenues appear proportionately lower.

Operating Revenue Forecasts

The Government's main revenue streams are directly tied to the level of consumption and rate of economic growth; as the economy grows so do revenues. Consistent with our objectives to keep the tax burden low, and reduce pressures on the cost of living, the Government does not plan to introduce any major new revenue measures during the next three financial years.

Instead we are focusing our efforts on improving the enforcement and rate of collection on the existing suite of revenue measures. We are also forecasting to leave in place the import duty reductions on fuel imported by Caribbean Utilities Company (CUC) for the generation of electricity. This important policy measure has a direct impact across the economy by reducing the cost of electricity for residential and commercial customers – a basic necessity of modern life – thereby lowering the cost of living for households and also reducing the cost of doing business for businesses which in turn will further help to reduce the cost of living.

Madam Speaker, as the economy grows the SPS forecasts that the Government's revenues will be approximately $896.4 million in 2016/17; $683.5 million in 2018 and $688.1 million in 2019.

Operating Expenditure Forecast and Targets

In tandem with achieving enhanced revenue collection, Madam Speaker, the Government is focused on achieving sustainable reductions to public sector expenditure without sacrificing the effective delivery of much needed public services. Our fundamental responsibility as a Government is to ensure that every dollar is well spent, and that all available resources are used in a responsible manner to best serve our people.

Operating expenses are forecast to be $851.5 million in 2016/17; $572.7 million in 2018; and $569 million in 2019.

When we set about establishing our operating expenditure targets our goal was to ensure that any growth in expenditure was not more than the expected economic growth rate for the year. However, we have had to adjust our targets to take account of specific one-off items such as the conduct of the 2017 General Election as well as the specific policy priorities of the Government.

For 2016/17, the operating expenditure forecast of $851.5 million represents a modest 2.4% annualized increase over the current 2015/16 budget and will be used to fund various initiatives including:

1. Enhancements to Public Education Services through the implementation of recommendations emanating from the recent independent review of the Cayman Islands Public Education System and also a series of baseline school inspection reports;

2. Improvements to the regulatory services provided by the Cayman Islands Monetary Authority to the vital financial services industry in order to keep pace with ever-evolving international regulatory requirements and to prepare for the upcoming IMF and FATF assessments in 2017;

3. The May 2017 General Election;

4. Implementation of various public sector reforms under the umbrella of Project Future;

5. The creation of an Office of Public Ombudsman;

6. A review of Civil Service remuneration to address pay stagnation and competitiveness for certain employees but especially teachers and those in the uniform and law enforcement branches;

7. Additional resources for the Needs Assessment Unit and the Department of Children and Family Services to improve services to the most vulnerable and at risk persons in our society; and

8. The implementation of a Conditional Release Programme to better enable prisoners to successfully reintegrate into society as productive citizens following release from incarceration and to lower the rates of recidivism.

These all totaled approximately $14.4 million. If removed from the figures, the actual growth in expenditure for the 18 – month period is less than 1% (0.68%) and below the 1.7% forecast GDP growth. In other words, Madam Speaker, the increases in expenditure are targeted at those areas in which we have identified the greatest need and where we hope to have the greatest impact.

The 2016/17 Operating Expenditure targets set out in this SPS for Ministries, Portfolios and Offices were established after rigorous rounds of consultations over the past several weeks with Cabinet. Agencies are required to strictly adhere to these targets when they prepare their detailed 2016/17 Budgets. Any increases to the expenditure targets will only be considered where exceptional circumstances warrant and the Cabinet has made a policy decision to do so.

We have taken this approach in order to further streamline the budget process and to allow Agencies to focus their efforts on preparing themselves to deliver their services within the resources they have been allocated. As a result we are expecting the substantive 2016/17 Budget process to operate more smoothly.

Compliance with Principles of Responsible Financial Management

Madam Speaker, the current 2015/16 financial year is critical for the Government's compliance with the Principles of Responsible Financial Management since 30th June 2016 is the deadline for compliance as set out in the PMFL and the FFR.

Today I can happily report that we are well on-track to achieve compliance at the 30th June 2016 deadline. This is a major achievement for the Government as this is the first time that the Government has been able to achieve compliance with the revised Principles since the FFR came into effect on 16th November 2012.

The importance of this achievement cannot be overstated. It did not come easily and is the direct result of this Government's focused policy of practicing fiscal prudence and ensuring that we take the time necessary to follow the established business processes; to ensure that we are maximizing value for money and making fiscally sustainable decisions, whilst at the same time, increasing expenditure in those areas where it really matters; and reducing the tax burden on society to help reduce the cost of doing business and the cost of living for everyone, residents and visitors alike.

This meant that we were not able to do everything that we would have liked to do in the time we may have wanted to do so but it means that we have achieved financial stability; something which, if managed properly, will eventually allow for everything necessary to be done and pay enormous dividends for future generations of Caymanians.

For the next three financial years we are forecasting that the Government will maintain compliance with the main Principles of Responsible Financial Management with a one-off non-compliance in 2019, which I will explain shortly.

Operating Surplus: The PMFL requires that the Government maintain a positive Operating Surplus. Over the next three years, the Core Government is forecast to remain in compliance with this requirement. Operating Surplus is forecast to be $44.9 million in 2016/17, increasing to $110.7 million in 2018 and $119 million in 2019.

The operating surplus is to pay off the principal on our debt balances annually, fund capital expenditure and equity investments in the Statutory Authority, and Government Companies (since we cannot borrow) and to put aside money in our Reserves for the upcoming CI$261.3 million Bullet Bond due in November 2019.

Debt Service Ratio: Robust Debt Management is a critical component of the Government's fiscal strategy and it is focused on:

1. The repayment of existing debt;

2. Where possible, the refinancing of non-amortizing debt into amortizing debt instruments; and

3. Effectively zero restricted borrowings for both Core Government and Statutory Authorities and Government Owned Companies;

The PMFL requires that the Entire Public Sector debt service costs (interest and principal) not be greater than 10% of Core Government Revenues. Forecasts indicate that the Debt Service ratio will be 9.7% in 2016/17; and 9.6% in 2018. In 2019, the Government will technically breach compliance with this ratio when it is expected to spike to 48.5%.

However, it is important to note that this "non-compliance" is a direct result of the planned full repayment of the 2009 Bullet Bond of US$312 million / CI$261.3 million that matures in November 2019. This is a one-off event and the Debt Service is expected to fall to approximately 8% in 2020.

We will hold discussions with the Foreign and Commonwealth Office in order to ensure that this technical breach is not viewed as an actual breach. In fact, the appropriate assessment should be conducted on the basis of debt servicing expenditure other than the amount required to retire the CI$261.3 million Bullet Bond in November 2019.

Net Debt Ratio: The PMFL requires that the Government's Net Debt not exceed 80 per cent of Core Government's Operating Revenues. Net Debt is calculated as the total amount of outstanding Core Government Debt plus the risk-weighted debt of Statutory Authorities and Government Companies (SAGC's) less the liquid assets of Core Government. The Government is forecast to be in full compliance with this requirement over the next three financial years, with the Net Debt Ratio forecast to be 43.3% in 2016/17; 27% 2018; and 10.1% in 2019. This trend places Government well below the maximum allowed limit of 80%, and is consistent with the Government's overall strategy of debt reduction.

Cash Reserves: The PMFL requires that the Government have liquid cash reserves of not less than 90 days of estimated executive expenses.

This ratio is calculated at the point in the financial year when Government's liquid cash reserves are expected to be at their lowest, typically the 31st December each year.

Over the forecast period, the Government is forecast to maintain full compliance with this Principle as allowable liquid cash reserves – for the purposes of the ratio calculation – are expected to be $209.7 million (or 140.2 days) in 2016/17; $271.9 million (or 177.2 days) in 2018; and then be $145.0 million (or 95.1 days) by 31 December 2019.

Capital Investment Forecasts

Madam Speaker, the Government's capital investment plans over the next three financial years will be consistent with our established fiscal policy stance over the past two and a half years of not borrowing and instead funding Capital Investments from cash generated from Operating Surpluses.

Over the SPS forecast period, planned capital investments are forecast to be $94.7 million during 2016/17 which is an eighteen (18) month period; $50.9 million in 2018 and $42.9 million in 2019. These investments will be directed to support debt servicing obligations of SAGC's as well as the development of key pieces of infrastructure items by the Core Government such as:

1. the continued development of the new John Gray High School;

2. the redevelopment and expansion of the passenger Terminal at the Owen Roberts International Airport;

3. improved waste handling facilities;

4. revitalization of central George Town; and

5. Upgrades to our road network.

Conclusion

In conclusion, Madam Speaker, this SPS presents a financial plan which firmly demonstrates this Government's overarching commitment to prudent financial management.

The forecasts indicate that the economy and Government's finances are on solid footing. Economically speaking, the country is forecast to experience stable economic growth, with contained inflation and decreasing unemployment. The Government's finances are firmly on a sustainable track with stable operating surpluses, increasing cash balances and reducing debt balances in order to maintain compliance with the Principles of Responsible Financial Management as set out in the PMFL.

This Administration has delivered on its commitment to improve the finances of the Cayman Islands and increased job prospects through stable economic growth, a tremendous achievement that will benefit this country for many years to come. Further and importantly, we see the FCO's agreement to this SPS and those in the past, as an independent attestation of the Government's fiscal achievements. This SPS provides a guide that, if followed, will ensure continued prosperity for our people.

Thank you, Madam Speaker.