ANZ Research

NZ Insight: Election 2023

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Confused by acronyms or jargon? See a glossary here.

Post-election macroeconomic musings

Summary

- While special votes are yet to be counted, and Port Waikato's byelection is yet to come, it's looking pretty clear that New Zealand will have a new Government. But it could be weeks (or months) before we have certainty over the make-up of the Government and the policy platform.
- This note discusses possible macroeconomic implications of a change in Government. It is not a review of individual party policies. Rather, we discuss big-picture impacts and what these might mean for aggregate demand, inflation pressures, and interest rates.
- Based on National's fiscal plan, the direct macroeconomic impacts of the fiscal position appear similar to the outlook signalled at the Pre-election Update. Tax cuts are expected to be meaningfully offset by lower government spending and new revenue initiatives. Same-sized milkshake, different flavour.
- Despite increasing pressure on expenses from inflation, an aging population and higher interest rates, there appears to be scope to reduce government spending by more than National has signalled, while maintaining key services at a similar level to before the pandemic. It's not yet clear if that will be a bottom line for ACT.
- Looser housing-related policy could add a bit of momentum to the housing market, and thereby possibly inflation and interest rates. But meaningful headwinds (high mortgage rates, affordability constraints) cap the upside.
- The Government's fiscal strategy will be key for assessing risks to the fiscal outlook. The previous Government loosened their strategy after COVID. We suspect a National-led Government will adopt something tighter, meaning less scope for positive spending surprises.
- Changes to the RBNZ's remit are unlikely to impact monetary policy settings but are likely to alter the RBNZ's communications somewhat.
- The direct implications of the election outcome for markets and bond supply appear immaterial at this stage.

Macroeconomic implications of a change in fiscal settings

New Zealand's preliminary General Election results are in, and suggest New Zealand is likely in for a change in Government once coalition agreements have been finalised. However, it could be a few weeks before we have certainty. Special votes are yet to be counted, coalition agreements concluded, and the results of the Port Waikato byelection are about a month away. While nothing is set in stone yet, it's still worth asking what a change in Government might mean for the macroeconomy and the RBNZ.

Following Budget 2023's meaningful increase in Government spending (and all that came before it), a new Government is going to inherit a very stimulatory fiscal position in the near term (ie for the remainder of the current fiscal year to June 2024). This additional demand is adding upward pressure to inflation pressure and therefore interest rates. While that's undesirable, particularly for anybody with a home loan, and is perhaps something a National-led Government will have less tolerance for, there probably isn't a lot of scope to alter it – especially if coalition negotiations take a while to conclude.

The majority of any change to broad fiscal settings is likely to occur from the 2024/25 fiscal year. The full details will be announced in May's Budget, with a taster in December's Half-Year Update. The long and short of it is, a change in Government won't represent an instant turning off of the fiscal stimulus taps. That means fiscal policy settings are unlikely to have immediate implications for monetary policy settings.

Beyond the near term, there is of course scope for fiscal settings to vary more meaningfully from those signalled in the Pre-election Update. Again, this probably isn't a game changer for monetary policy, but it could certainly change the risk profile. There's quite a lot to unpack here, so we break it into the following sections:

- What's your counterfactual?
- The fiscal policy mix: same-sized milkshake, different flavour.
- The Government's fiscal strategy: implications for fiscal policy risks.

What's your counterfactual?

On paper, there appears to be very little difference between National and Labour's fiscal outlook. Ahead of the election, both signalled a return to surplus in the 2026/27 fiscal year, albeit with National signalling their eventual surplus will be wider by a whisker. This broad comparison suggests there is very little between the two major parties when it comes to the interaction between fiscal and monetary policy.

However, as we discuss in the fiscal strategy section, the temptation to increase spending in the future may vary meaningfully between the major parties. As we noted in our Review of the Pre-election Update, the previous Government had a tendency to increase government spending despite there being no economic capacity to accommodate it, with the forecast return to surplus being pushed out on more than one occasion.

In short, the on-paper difference in the fiscal stance between political parties isn't the end of it. The balance of risks around how spending could vary in practice matters too. As we will discuss later, the Government's broad fiscal strategy will be important when it comes to assessing the risks around whether the Government will stick to its signalled profile for fiscal settings.

A change to the fiscal policy mix: Same sized milkshake, different flavour

Digging into the 'on paper' comparisons, a change in government doesn't suggest aggregate demand will be meaningfully different going forward. Rather, there will be less demand from Government, and more from the private sector.

National's proposal to cut taxes (income tax in particular) and fund this via spending cuts and new revenue initiatives (such as the foreign buyer tax) attracted a lot of media attention. But in terms of the macroeconomic implications, it got more attention than it probably deserved. Based on the costings provided by National (noting the Treasury's estimates could end up a bit different in December's Half-Year Update), there is perhaps a smidgen more stimulus under National's fiscal plan than meets the eye, but it's very small in the scheme of things.

Over the four years to June 2028, National's numbers indicate tax relief will cost a total of $14.6bn (about 0.7-0.8% of GDP per year, which is relatively small compared to the 1.4% increase in government spending announced in Budget 2023 for the current fiscal year). A healthy chunk of that (income tax indexation, FamilyBoost etc) will go straight to households. Struggling households are likely to spend 100% of the income gain (adding to aggregate demand and CPI inflation pressures), while other households might save some or all of it.

Government spending will be cut to help pay for this, and that will reduce the impact on aggregate demand and inflation pressures. When it comes to government spending, the composition is important. For convenience, and given the degree of uncertainty around estimating fiscal multipliers,[1] we assume every $1 in tax relief that is offset by $1 in reduced spending is neutral from an aggregate demand perspective. You can poke holes in this assumption, but in big-picture terms, this is well within rounding error territory.

On the spending front, National expects to cut $8.5bn over the next four years compared to the spending signalled in the Pre-election Update, leaving $6bn or so of the 'fully funded' tax break to come from new revenue initiatives. And it's here where there might be a little more stimulus than meets the eye. That's because revenue generated from foreign sources won't be sucked out of domestic demand for goods and services, meaning the $3bn that National have said will be generated by the foreign buyer tax over the next few years should probably be stripped out when assessing the implications for monetary policy. But at about 0.15% of GDP per year, this is miniscule.

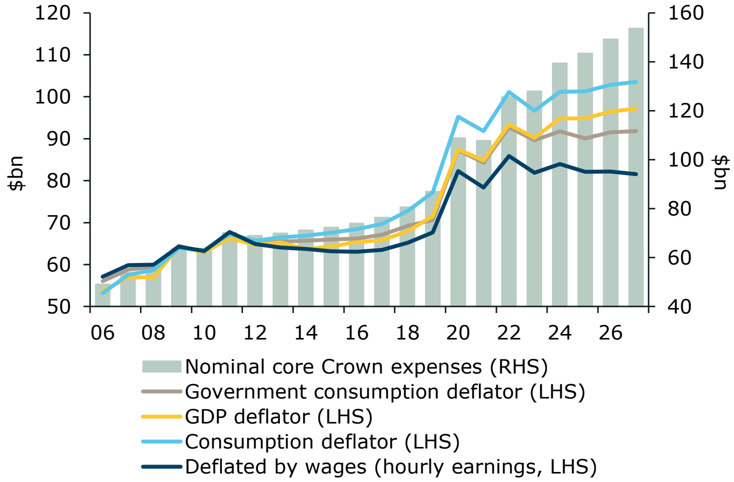
All up, while National's fiscal plan might have a smidgen more stimulus in the details, this is inconsequential compared to other key economic drivers, such as export prices, the weather, net migration, and the housing market (more on the latter on page 7).

Perhaps the bigger unknown regarding the fiscal policy mix is just how much government spending can, and will, get cut once coalition agreements are concluded. The ACT party wants to cut spending by more. Of course, high inflation means the cost of delivering key public services has lifted, and no major party has been advocating for material cuts to core public services such as health and education.

So is there really room to cut spending and continue to deliver key public services? Figure 1 shows that it really doesn't matter which price deflator you use to proxy real government spending, the Treasury's Pre-election Update forecasts show core Crown expenses are expected to remain significantly higher after stripping out price changes compared to pre-pandemic (between 20% and 35% higher by the year to June 2027, depending on your deflator of choice).

[1] For example see this note.

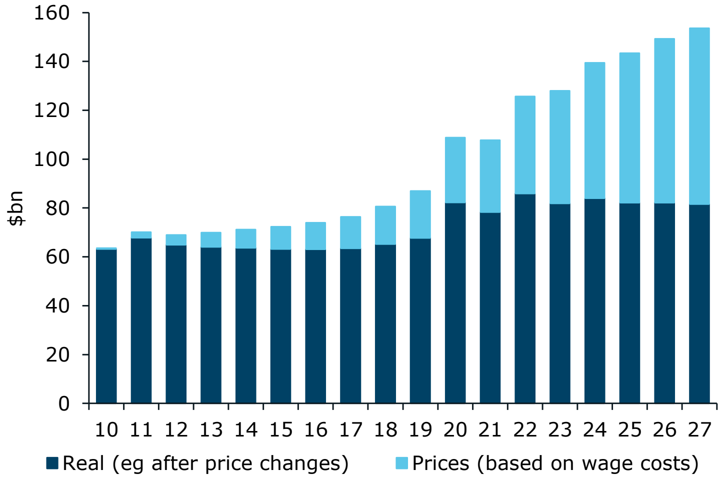
Figure 1. Real (price adjusted) core Crown expenses (2009/10 prices)



Source: The Treasury, Macrobond, ANZ Research

Using the most extreme deflator (wages), figure 2 shows that real core Crown expenses are almost $15bn higher per year over the forecast period compared to pre-pandemic (2019). In other words, between the year to June 2024 and 2027 there's around $60bn more cost-adjusted government spending in the forecast compared to pre-pandemic. Clearly, the post-pandemic rise in Government spending hasn't just been about keeping up with the cost of delivering government services. Using the mildest deflator (the consumption deflator), there's around $80bn more real spending in the forecast versus pre-COVID.

Figure 2. Contributions to core Crown expenses

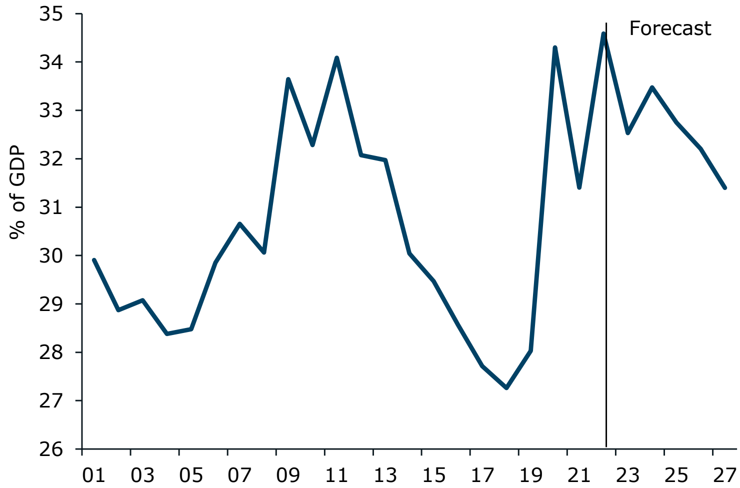


Source: The Treasury, ANZ Research

The next question worth asking is whether 2019 is a good benchmark for a 'normal' level of Government spending. Figure 3 shows that as a share of GDP, expenses were relatively low in 2019. The upside to that was of course that the Government had more ammunition to respond to COVID-19 because it had kept its powder dry, so to speak. But with no crisis in the Treasury's forecast horizon, it would be appropriate to return government spending to a lower share of the economy a little faster than the previous Government intended. The Treasury's pre-election forecasts showed government spending falling to 31.4% of GDP by June 2027. Even a small tweak, to say 31% by 2027 (about the 20-year average), is consistent with around an $8bn reduction in spending over the next four years, similar to National's proposal.

A reduction to 30% by 2027 (still meaningfully higher than 2019) would require around a $26bn reduction in spending over four years.

Figure 3. Core Crown expenses share of GDP



Source: The Treasury, ANZ Research

All up, National's proposed $8.5bn of spending cuts over four years are relatively small in the context of the $60bn (or more) increase in *real* spending to June 2027 vs pre-pandemic. There may be more room to cut Government spending than some realise, but that doesn't mean it'll be easy.

The Government's fiscal strategy: implications for fiscal policy risks

The Public Finance Act requires the Government to specify its fiscal strategy in accordance with the principles of responsible fiscal management. There are no legislated fiscal targets. Rather, the Government formulates its own strategy, putting its reputation as a responsible manager of the Government's books on the line in the process. The new Government's fiscal strategy will be outlined in the upcoming Budget Policy Statement (typically published alongside December's Half-Year Update, but it could be sooner).

From a macroeconomic perspective, separating the policy details from the Government's overarching (and self-imposed) fiscal goals and targets is important, as the latter can determine how much potential flex there is in fiscal policy, which is what ultimately determines the broader risk profile around fiscal settings. For example, relatively loose fiscal targets imply a higher likelihood that government spending is increased over time.

As we noted when the previous Government unveiled its post-COVID fiscal strategy, the removal of a debt target represented a loosening in the fiscal strategy, particularly when it comes to capital expenditure. In terms of the day-to-day running of Government, the rule requiring running surpluses within a band of 0 to 2 percent of GDP (implemented at Budget 2022) wasn't very specific in terms of *when* a surplus will be achieved. As we have noted before, forecasting a surplus is relatively easy: just tell the Treasury you're not going to spend much in the future. In this world (and all else equal), the addition of an extra fiscal year to the Treasury's forecast horizon every December would theoretically allow for both an increase in near-term Government spending, and a projected surplus over the forecast horizon (albeit one year later than previously expected). Achieving a surplus is much harder, as it requires signalling a spending profile and then sticking to it.

While a relatively vague operating balance target might be all the fiscal discipline that's required to prevent an unsustainable blowout in the Government's books, it certainly doesn't guarantee that fiscal settings will deliver value for money to the taxpayer or play nicely with monetary policy.

For an operating balance target to have that, it should probably specify a point in time when a surplus will be achieved (subject to economic conditions of course), and hint at how the Government will respond if the economy (and fiscal position) outperforms the Treasury's expectation. That said, one of the downsides to a point-in-time target is that it can inflict excessive rigidity into fiscal settings, with one historical example being maintaining ACC levies higher than necessary in order to preserve the surplus.

Changes to the Treasury's economic and fiscal outlook are always going to occur, sometimes improving the fiscal outlook, sometimes not. But a fiscal strategy that facilitates the spending of positive revenue surprises, while also adding wiggle room to repeatedly push out the return to surplus, risks fiscal policy running towards the pro-cyclical end of the spectrum, as the last couple of years have demonstrated.

Of course, no one will blame the Government if the economy softens to the point that weaker revenues and higher expenses cause a delay in returning to surplus (that's just automatic stabilisers doing their thing). It's the discretionary side of spending and the discipline to save cyclical revenue windfalls that matters in terms of smoothing out economic outcomes and avoiding economic imbalances such as high inflation, rising interest rates, and wider current account deficits.

To assess the medium-term risks around the fiscal policy outlook we'll be on the lookout for the following when the new Government etches its fiscal strategy in stone:

- A point-in-time target for the operating balance, such as "return the OBEGAL to surplus in 2026/27".
- A comment hinting at what will happen if cyclical revenue or expenses come in better than the Treasury's forecast (eg "or earlier if cyclical revenue and expenses allow"), and
- A comment providing some wiggle room should the economy meaningfully soften (eg "subject to economic conditions")

An operating balance target with all three elements would clearly signal that upside fiscal policy risks (which are also upside risks to aggregate demand and inflation, and thus the OCR), are relatively contained. National's fiscal plan, released in the lead-up to the election, suggested they may already be part of the way there, noting "National will return to surplus in 2026/27 and will deliver sustainable surpluses over the medium term…"

So what about a debt target?

The previous Government did away with a debt target, preferring to frame the Government's debt constraint as a 'ceiling'. If the Government sets a robust operating balance target, a specific debt target may not be needed. That's because operating spending tends to drive the bulk of a sustained deterioration in Government debt, meaning if the operating balance is in surplus, debt should take care of itself over time.

Further, as we learned from the post-GFC era, a core focus on debt may have perverse implications over the long run as it could lead to underinvestment in key infrastructure (which is already straining under rapid migration-led population growth). The focus of capital spending should be on quality rather than quantity, as good capital spending can pay for itself in the longer run. Trying to time capital spending with the business cycle is a mug's game. Government investment requires plenty of planning, meaning turning it on and off again for cyclical or political reasons can be quite wasteful. Rather, ensuring a lengthy (and certain) pipeline of quality projects is about the best thing the Government can hope to achieve.

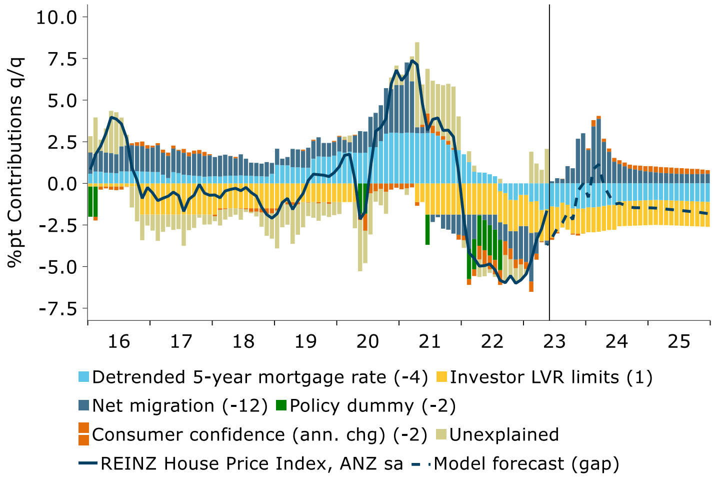
If the new Government does choose to adopt a debt target, they will likely choose to avoid the most recent fiscal strategy 'ceiling' measure of net debt, as this includes NZ Super assets (but not the liabilities!). While these assets make it look a lot lower than the pre-pandemic measure, they are also subject to large valuation changes that are outside the Government's control. The last thing we need is the Government significantly altering fiscal settings according to the ebbs and flows of financial markets.

Housing-related policy

When it comes to macroeconomic drivers, the direct impacts of fiscal policy are one consideration, but housing policy matters in its own right. National plans to loosen the ban on foreign buyers, reinstate interest deductibility on rental properties, and reduce the Bright Line test period from 10 to 2 years. Qualitatively, this is one-way traffic: it'll add to housing demand and therefore prices. But quantifying this is very difficult on top of what's already a very uncertain outlook.

In our June Property Focus, we presented a model that suggested recent changes to a broad suite of policy changes (the introduction of the bright line test, the removal of interest deductibility on investment properties, and CCCFA changes) detracted as much as 3% points from house price inflation. Assuming these impacts are symmetrical, that suggests a small degree of upside risk to our house price forecast. In terms of housing momentum, interest rates, migration and LVR settings tend to be more significant drivers. But all else equal, a temporary 3%pt bump to house price inflation is probably actually a little more inflationary than the 'on paper' change to fiscal settings described previously.

Figure 4. Modelled contributions to quarterly house price inflation



Source: REINZ, Macrobond, ANZ Research

Changes to the RBNZ's remit

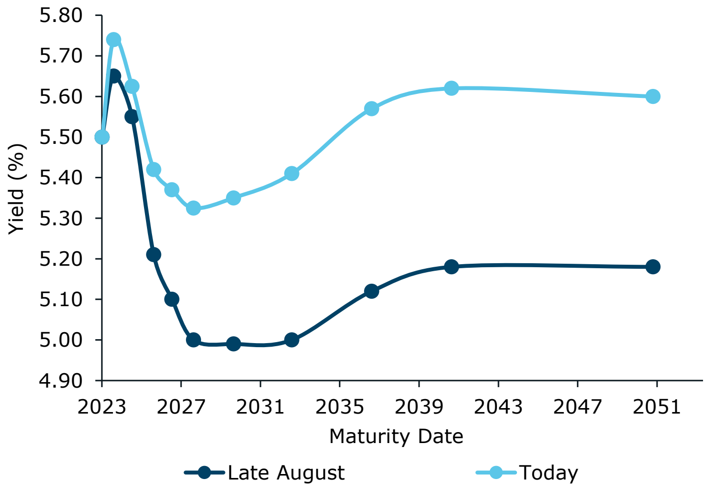
National have signalled they intend to chop the maximum sustainable employment 'target' out of the RBNZ's mandate. In practice, this is likely to make very little difference to how the RBNZ conducts monetary policy. The words provide plenty of wriggle room already ("*supporting* maximum sustainable employment"). And in practice, the forecast of inflation pressures, whether expressed via the 'output gap' or via the deviation of employment from its sustainable level, are more or less the same thing. Getting the labour market where it needs to be has always been the inflation-fighting strategy. We very much doubt that the inclusion of that consideration in the remit has materially impacted any monetary policy decisions. And while changes here (or similarly, to the housing-related additions) will impact the RBNZ's communications strategy, we don't see it influencing policy decisions.

Implications for markets and bond supply

Our base case is that changes to fiscal settings won't have a material impact on NZDM's bond issuance guidance. However, we acknowledge there is a risk that the Treasury estimates a smaller bump to government revenues from National's policies than signalled in their Fiscal Plan. Conversely, we are watching closely to see if spending cuts go a little further than signalled after coalition negotiations. In terms of the broader risks to the 'on paper' fiscal outlook, we think these are more likely to be contained under a National-led Government (but we reserve the right to change our minds after seeing National's fiscal strategy).

Overall, we'd say other economic factors are the larger risk to bond issuance going forward. A material terms of trade shock, or higher term premia on global interest rates are likely to be larger drivers of changes to the bond programme than fiscal policy tweaks. On that front, we've already seen government bond yields push meaningfully higher since the Pre-election Update (figure 5). That's a global trend. Assuming that's a surprise to the Treasury (a fair assumption) we estimate that's up to $3bn less cash in the door for the $129bn face value of bonds NZDM expect to issue over the four years to June 2027. In terms of economic risks, so far the economy appears to be evolving close to the Treasury's 'optimistic' forecast. But as we noted in our preview, if the Treasury's forecast is correct, then its OCR forecast (a peak of 5.5%) is probably a little light.

Figure 5. NZGB curve: current vs August (when MPS and PREFU fiscal forecasts were finalised)



Source: Bloomberg, ANZ Research

On the NZGB front, given lingering uncertainty around the future make-up of government, we remain comfortable with our assumption that we won't see a syndication in November (but we can't completely rule it out). Given NZDM's past practice of notifying the market of syndications no later than the relevant month's tender schedule (in this case, the November schedule – which is due next week), the timing doesn't look like it'll work. To be sure, NZDM is also already broadly on track with its required run rate of issuance, having already done one large syndication this fiscal year.

FX markets have largely ignored the election and are instead more focussed on geopolitics and the outlook for the US economy, with a particular focus on whether the Fed can pull off a soft landing. We think that's logical given the overall result was broadly in line with polling going into the election, even if there were surprises in some electorates, and we don't expect it to be a factor unless there's a major surprise when the final result is announced 3 November.

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