ANZ Research

NZ Pre-election Economic & Fiscal Update Preview

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Deja-PREFU

Summary

- Pushing out the election date has provided the Treasury time to incorporate renewed lockdown measures into the economic and fiscal forecasts. This will dampen the rebound from the first lockdown, as it has in our economic outlook.
- However, there's a lot more than that for the Treasury to incorporate into the outlook since the May Budget, including fiscal and monetary policy decisions, the economy's vigorous rebound out of the first lockdown, a weaker global economy, and likely a reassessment of the Treasury's medium-term economic assumptions (that were largely unchanged at Budget and sitting on the optimistic side of things).
- Overall, we expect to see a stronger starting point for the economy and some fiscal indicators, but more than likely a slightly slower recovery.
- Pre-election Updates are intended to inform the public and the incoming Government about the state of the books ahead of the election. They are not a platform for fiscal policy announcements. Accordingly, we don't expect any.
- Changes to New Zealand Debt Management's (NZDM) bond issuance guidance should be relatively minor. The Budget Update forecasts showed the Treasury is expected to hold a substantial buffer of financial assets over the forecast horizon. We think it would be premature for NZDM to conclude that it won't be needed.

Key points

The Treasury will open up the Government's books on 16 September ahead of the General Election (scheduled for 17 October), with the publication of the Pre-election Economic and Fiscal Update (PREFU).

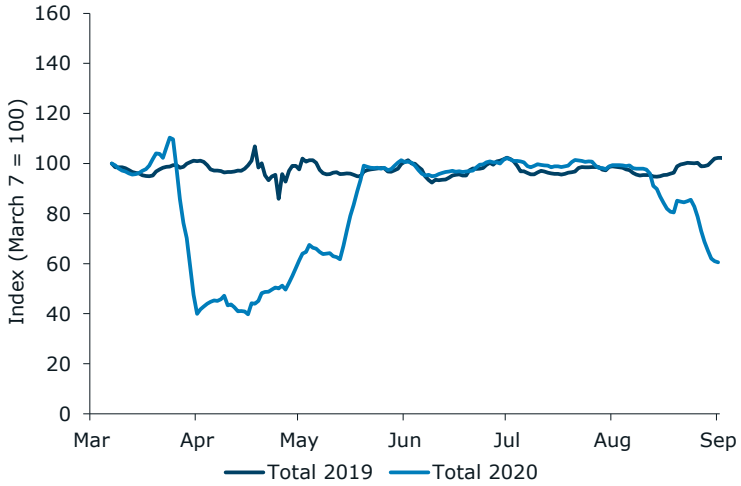
The PREFU will outline the Treasury's take on the economic and fiscal situation, and how they expect this to unfold over the next four years or so. Pushing out the election has given the Treasury the chance to review its economic and fiscal forecasts in light of renewed lockdown restrictions.

While the election result could bring changes to policy settings, the Treasury's forecasts will assume that Government decisions taken at the time of forecast finalisation will be carried through the forecast period. Any changes to policy after the election will be included in December's Half-Year Update.

A stronger starting point, but more than likely a slower recovery

Reflecting the vigorous rebound in the timely data following the first lockdown, we expect the Treasury to upgrade its forecast for Q2 GDP (-23.5% q/q at Budget). And they won't have to wait long to see if they're right. These data are published the following day at 10:45am. But as figure 1 shows, renewed lockdown measures are going to hamper the Q3 rebound.

Figure 1. ANZ card spending



Source: ANZ

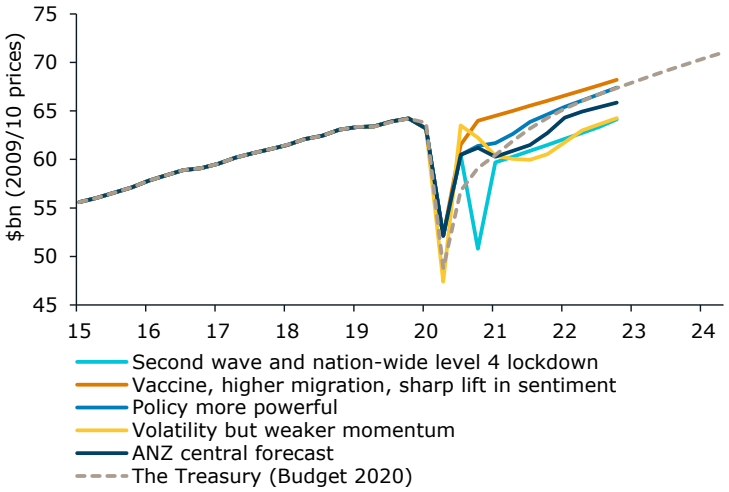
But there is a lot more for the Treasury to incorporate into the outlook than renewed lockdown restrictions:

- There are fiscal and monetary policy developments, which have both landed on the more stimulatory side versus what was assumed in the May Budget Update's central outlook.
- Conversely, there's likely to be a number of assumption changes that could weigh on the medium-term outlook, such as the length of time our borders remain closed, and the speed limit of the economy (potential GDP), given very weak business investment and low net migration.
- Then there's the fact that the global slowdown is looking worse than previously assumed. Although New Zealand's commodity prices are proving relatively resilient so far, this will weigh on expected domestic incomes, investment and sentiment more broadly.

Overall, we think the stronger starting point for GDP will be met with a slightly weaker medium-term outlook, but perhaps not significant enough to see a material deterioration in the fiscal outlook compared to the Budget Update.

However, it's worth noting that in this extremely uncertain environment, all forecasts will be wrong to some degree. The Treasury will once again communicate this clearly and lean on its scenarios (possibly not too dissimilar to our own, figure 2) to demonstrate how things could evolve from here.

Figure 2. GDP forecasts and ANZ scenarios

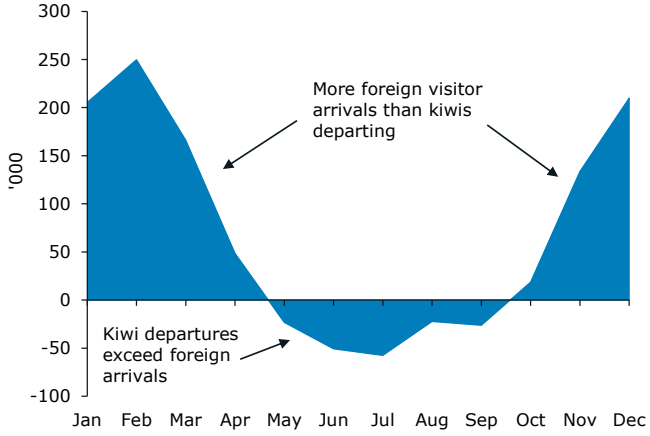


Source: Stats NZ, ANZ Research

Near term, the data is going to be volatile and subject to significant revisions. But it's the medium-term implications of this crisis that really matter – especially from a fiscal and monetary policy perspective. While some of the timely data has surprised a number of forecasters (including us and the Treasury) on the upside, it's worth remembering that there's a long way to go.

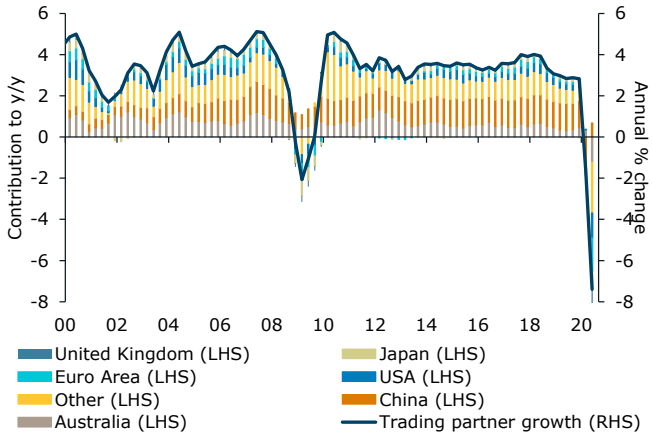
The initial lockdown (and now, renewed measures) is just one part of this shock. There's still the persistent impacts of a closed border (which will be felt much more acutely in the months ahead when net visitor arrivals would normally be lifting rapidly, figure 3), and the very sharp and synchronised global slowdown (figure 4) that will impact export earnings, investment and confidence more broadly. So far we've primarily experienced the impacts of the initial lockdown, but unfortunately the strong bounce out of that doesn't mean we've dodged the looming significant national income shock. International tourism was as big a foreign exchange earner as the dairy industry. And it's gone up in smoke.

Figure 3. Average net visitor arrivals to NZ, 2016-2019



Source: Stats NZ, ANZ Research

Figure 4. Trading partner growth



Source: Stats NZ, Macrobond, ANZ Research

Combined with the fact that the economy is yet to be weaned off an unprecedented amount of temporary support measures (such as the wage subsidy and mortgage relief), we think the Treasury are likely to conclude – as we do – that recovery over the medium term will be a little slower than assumed in May's Budget Update.

A few tweaks to the fiscal outlook

The starting point for the Government's books will be a little stronger than expected at the Budget Update, but it hasn't been one-way traffic for the Government's key fiscal indicators.

In the 11 months to May, core Crown tax revenue was almost $1.5bn ahead of forecast, consistent with a sharper-than-expected bounce in activity from lockdown. Expenses were tracking very close to forecast, despite the Budget forecasts being finalised before a number of decisions were taken. An OBEGAL deficit of $16bn was $1.6bn narrower than forecast. But at $78.7bn, net core Crown debt was $1.3bn higher than forecast, owing mostly to higher-than-forecast repurchase losses on the RBNZ's Large Scale Asset Purchase programme (LSAP). Broadly speaking, the RBNZ's LSAP is expected to cause an initial increase in net debt, but that's expected to unwind over time.

Like the broader economic outlook, there is a lot of information to incorporate into the fiscal outlook since the Budget figures were finalised in May. But we expect most of this will be around timing and allocation rather than wholesale changes to the fiscal stance. Forecast net core Crown debt is likely to peak close to 55% of GDP once again, with an OBEGAL deficit close to 10% of GDP in the 2021 fiscal year, with narrowing deficits thereafter.

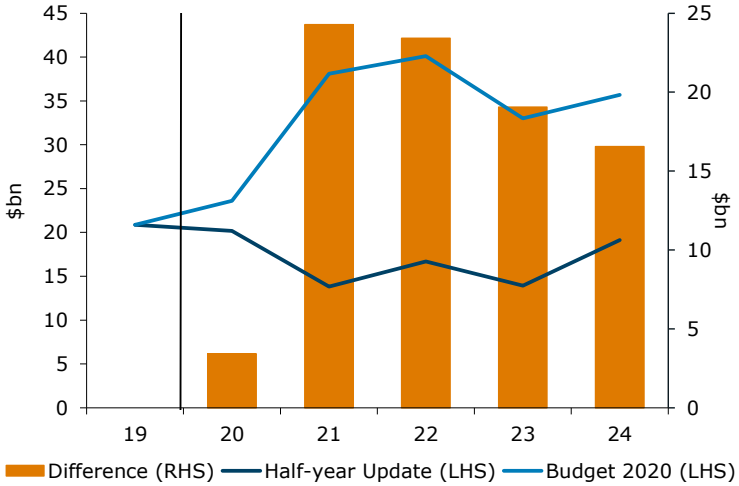
The $14bn unallocated portion of the COVID Response and Recovery Fund (CRRF) is likely to be treated like it was at the Budget, as operational spending. It would be premature to take it out now, given uncertainty around the outlook for both the virus and the economy. In our view, this money (and possibly more) will be needed to facilitate the recovery even if virus risks are contained in a relatively timely manner.

On the spending and tax side, we don't expect any new policy announcements. The PREFU is a Treasury document (not the Government of the day's) and is not intended as a platform for the incumbent Government to electioneer from. Rather, the PREFU is about informing the voter about the state of the books ahead of the election and ensuring that the incoming Government isn't met with any major surprises when they take office after the election.

Little change to the bond programme

Before the recent virus flare-up, we would have said risks were skewed towards a small downgrade to issuance guidance. NZ Debt Management has had a little more cash come in the door via syndication than expected, the forecast buffer of financial assets held by the Treasury at Budget was suitably large (figure 5), and tax revenues have been a touch better than expected.

Figure 5. Financial assets held by the Treasury



Source: The Treasury

However, the return of COVID in the community is a good reminder that this crisis is very unpredictable. We think NZDM will conclude that the prudent thing to do is maintain issuance guidance broadly in line with that signalled at the Budget Update until there is more clarity around the economic and fiscal outlook. They'll also want to be ready for any possible changes to policy settings after the election. Indeed, NZDM have a preference for stability in their guidance, and will want to avoid flip-flopping at this early stage.

Table 1. Bond issuance guidance

	Jun-21	Jun-22	Jun-23	Jun-24	Total
Budget Update	60	40	35	30	165

We don't expect a materially lower bond programme, but against the backdrop of the RBNZ upsizing the LSAP and moving to a tactical approach to bond purchases, the outlook for bonds is better. And while the RBNZ hasn't taken the liberty of flexing the pace of weekly purchases in recent weeks by as much as it did in April, we do expect the RBNZ's ongoing commitment to do what it takes and its "least regrets" approach to ultimately succeed in driving the NZGB curve lower. Some further flattening is likely in coming weeks as global bond yields decline on the prospect of easier policy elsewhere too. In 2021, we expect the OCR to fall below zero. And as we approach that OCR cut in April, we would expect the NZGB curve to bull-steepen as short bonds gravitate towards the OCR, outperforming longer bonds. To be clear, we expect longer bond yields to fall – but for the magnitude of the fall to be less.

All up, the PREFU should come and go with little fanfare, and changes to the forecasts are likely to be immaterial compared to the degree of forecast uncertainty that surrounds them.

Other than providing a near-term distraction, the election doesn't change our view of how fiscal settings are likely to evolve at a macro level from here (regardless of what the Government looks like on the other side). There will come a time when the very expensive temporary support measures are withdrawn (or expire) and the Government's focus becomes more about facilitating the economic recovery than limiting the initial damage caused by lockdowns. But to really get bang for buck on the recovery front, virus risks will first need to be contained.

Then of course there are the politically charged questions of who will pay for all this, how, and when. That's a discussion that's going to continue well after the next electoral term expires, and it'll take some pretty brave politicians to tackle issues like NZ Super affordability, and other intergenerational inequality issues. Indeed, fiscal consolidation is a story for another day but a story that we think will be told eventually. And it'll be a ripping yarn with plenty of drama and some gripping battles.

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