ANZ Research

NZ Pre-election Economic & Fiscal Update

16 September 2020

ANZ

This is not personal advice. It does not consider your objectives or circumstances. Please refer to the Important Notice.

Contact

Miles Workman for more details.

Big picture unchanged: colossal shock, colossal deficits

Summary

- As expected, the Treasury has dovetailed a stronger starting point for the economy into a weaker medium-term view.
- At a high level, changes to the fiscal outlook are immaterial. Substantial (but narrowing) deficits are forecast over the next four years and net core Crown debt as a share of the economy is expected to peak a little higher (but with the level pretty close to Budget forecasts).
- New Zealand Debt Management have downgraded their bond issuance guidance slightly, with a near-term downgrade more than offsetting expectations for higher issuance in the 2024 fiscal year.

Key points

The Treasury's Pre-election Economic and Fiscal Update shows the Government's books are expected to be a in pretty similar shape to the picture outlined in the May Budget, but the near term is a touch stronger and the final forecast year (2024) a touch weaker. This is underpinned by an economic outlook that isn't too dissimilar to our own. Importantly, given the degree of uncertainty around virus developments, the fiscal policy response, and the economic outlook more broadly, we'd classify these forecast changes as more cosmetic than meaningful. The absolute story remains unchanged: a colossal deterioration in the fiscal position is underway and economic headwinds will be with us for a long while yet.

A better starting point for the economic outlook, but a downgrade to the medium term

As expected, the Treasury has dovetailed a stronger starting point for the economy into a slightly weaker medium-term outlook.

Q2 GDP will be published tomorrow at 10:45am. The Treasury's outlook has a 16% contraction pencilled in – a significant improvement from -23.5% at Budget, and not too far from our expectation of -12%. But Q2 is old news. More importantly, the Treasury have updated a number of forecast assumptions, downgrading their expectation for potential GDP, reflecting a lower capital stock (owing to weak business investment), a smaller labour force (reflecting weaker net migration and displaced worker effects) and weaker productivity. A weaker outlook for the global economy has also weighed. These are all sensible adjustments in our view, and have seen the Treasury's central forecast land pretty close to ours on average (figure 1, over).

The Treasury have now incorporated more persistent impacts of this crisis on the labour market, with a higher unemployment rate over the medium term than expected at Budget time. The Treasury expect the unemployment rate to peak a little lower than we do (figure 2), but on the other hand expect it to remain higher for longer. Set against the degree of forecast uncertainty currently (and measurement issues that made the signal in Q2's very optimistic unemployment read of 4.0% virtually meaningless), this is neither here nor there. We know these data are far from perfect.

Figure 1. GDP

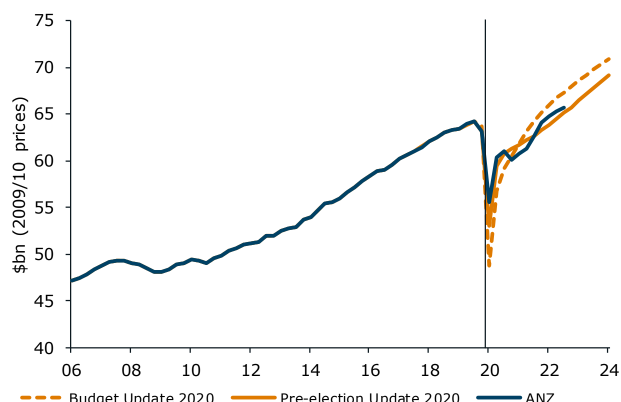


Figure 2. Unemployment rate

Source: The Treasury, Stats NZ ANZ Research

The Treasury's 90-day rate outlook implies they expect the OCR will be taken to broadly zero. This is at odds with our view that the RBNZ will cut the OCR by 50bp to -0.25% in April 2021. CPI inflation is expected to remain below the RBNZ's 2% target midpoint over the entire forecast horizon, but it gets close (1.9%) in the 2024 fiscal year.

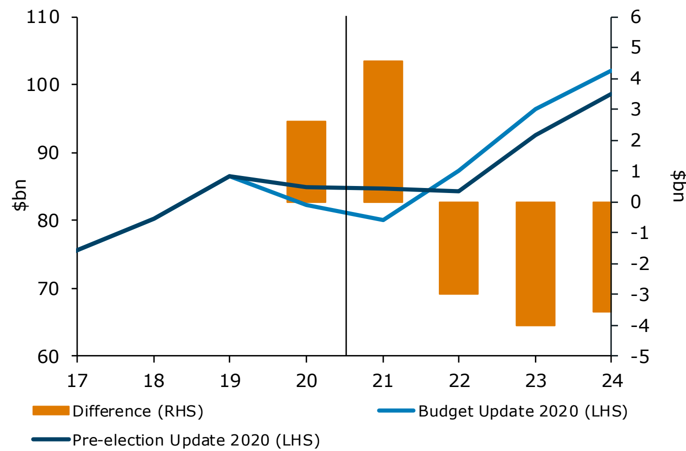
An outlook for weaker activity and subdued price pressures has seen the Treasury's outlook for nominal GDP downgraded by $13 billion over the forecast horizon – and that implies a weaker tax take.

Overall, we think the Treasury's central forecasts are well within the range of plausible outcomes. The initial lockdown (and now, renewed measures) is just one part of this shock. There are 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), and the very sharp and synchronised global slowdown that will impact export earnings, investment and confidence more broadly. Combine this 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), and the downgrade to the Treasury's medium-term outlook appear quite justified. Given the seasonality of the New Zealand economy (high activity in the summer months though both international tourism and housing) the real test for New Zealand's economic resilience is fast approaching.

Fiscal outlook much the same, but a few timing changes

The Treasury has been able to incorporate more detail into the fiscals since the May Budget, but the aggregate debt and deficit forecasts aren't all that different. While the expected cost associated with the COVID response has been downgraded (by $4bn overall) the downgrade to the medium-term economic outlook is expected to keep the pressure on the Government's books. Overall, changes to the fiscal outlook are immaterial compared to the degree of forecast uncertainty that surrounds them.

Figure 3. Change in core Crown tax revenue



Source: The Treasury

The weaker medium-term economic outlook sees core Crown tax revenue lower by around $6bn over the forecast horizon compared to Budget (figure 3). However, spending is also expected to be lower overall (figure 4), providing an offset. As expected, the $14bn unallocated portion of the COVID Response and Recovery Fund (CRRF) is assumed to be fully allocated over the forecast horizon.

Figure 4. Core Crown expenses

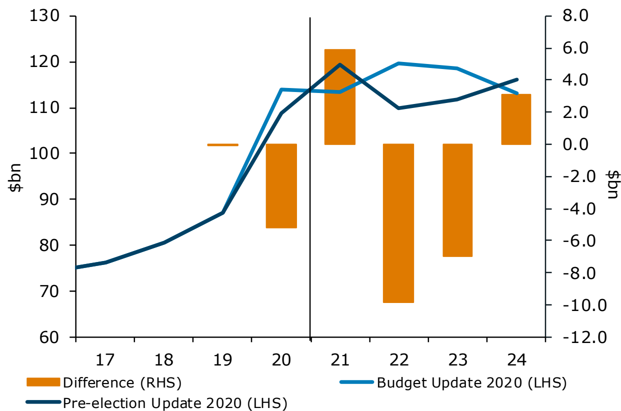
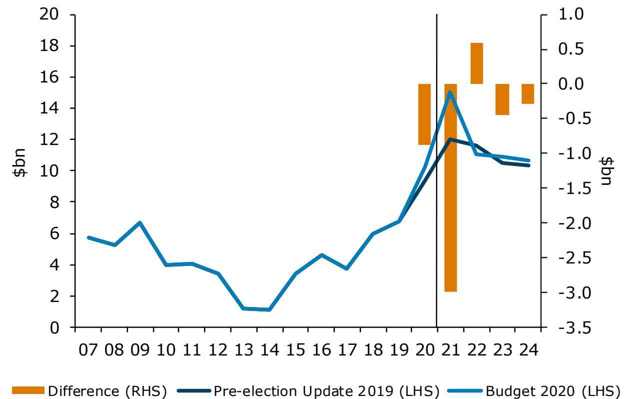


Figure 5. Net core Crown capital cash flows



Source: The Treasury

Forecast OBEGAL deficits are expected to be a little narrower as a share of the economy in the near term, but wider by the 2024 fiscal year (figure 6). Net core Crown debt is forecast to peak at 55.3% of GDP in the 2024 fiscal year (figure 7), versus 53.6% in 2024 in the Budget. This forecast tweak is immaterial in our view given what's yet to come to pass over the next four years.

Figure 6. Total Crown OBEGAL

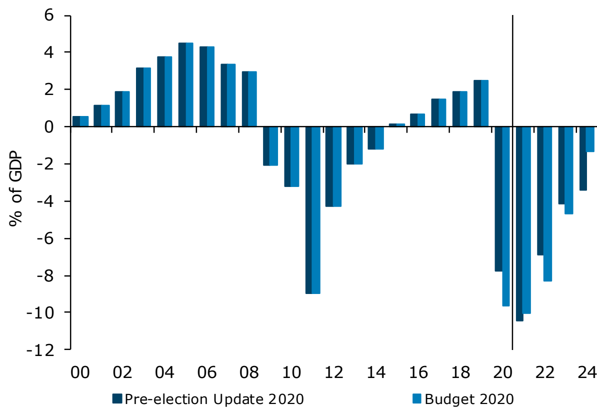
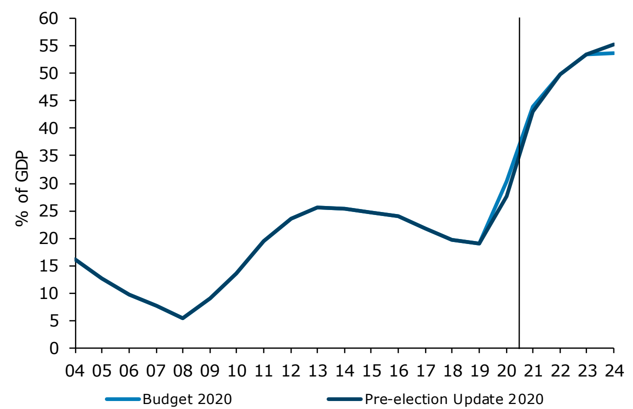


Figure 7. Net core Crown debt



Source: The Treasury

Total borrowings are forecast to grow from $110.2 billion in 2019 to $286.6 billion in 2024 (a decent downgrade versus $317.3 billion in 2024 at Budget). Total borrowings aren't part of the Government's suite of fiscal strategy indicators, but it's a very important metric from both the taxpayers' and rating agencies' perspectives. That's because it captures decisions made outside of the core Crown accounts for which the taxpayer is still potentially on the hook. The Government can improve its net core Crown debt outlook by funding outside of the core accounts (such as via Housing New Zealand), but interest costs are generally higher than the counterfactual (ie. funding through NZ Debt Management).

A few tweaks to the bond programme

New Zealand Debt Management (NZDM) have downgraded their bond issuance guidance by $10 billion over the 4-year forecast horizon, with near-term guidance downgraded (2021 fiscal year down $10b to $50bn, and 2022 down $5bn to $35bn) and a small upgrade to the 2024 fiscal year (up $5bn to $35bn).

This new profile reflects a number of factors, including lower-than-expected COVID-related costs incurred to date and more success in earlier syndications than previously expected, a small downgrade to funding requirements over the next four years as a whole, lower expected interest rates over the forecast horizon, and at the margin, a shift towards longer-dated issuance (requiring less debt to be rolled over during the forecast period). The Treasury still expects to hold a suitably large financial buffer over the forecast horizon, which at first blush appears largely unchanged from the Budget. T-bill issuance guidance is unchanged from Budget.

Table 1. Bond issuance guidance

	Jun-20 (actual)	Jun-21	Jun-22	Jun-23	Jun-24	Forecast total
Budget Update	25	60	40	35	30	165
Pre-election Update	29	50	35	35	35	155

The $10bn reduction in this year's bond tender programme was well received by the market and the prospect of less issuance in coming quarters is likely to drive the curve lower and flatter in coming days. We assume there will be 37 more tenders over the remainder of the fiscal year beyond this month, and the $10bn reduction in supply equates to around $270m less issuance per week. However, NZDM have also flagged an intention to offer a May 2028 bond before the end of the year. If that was, say, a $5bn issue and that week's tender is cancelled as per normal protocol, that would reduce the weekly required run rate of issuance by just over $400m, paving the way for tenders

of closer to $600m than $1bn like we have been seeing. We think that's worth more than the 1-2bps we have seen so far, especially at the long end. NZDM's projections now also show an intention to issue just $12.5bn of 2024s before they mature, down from $15.4bn at the Budget. The 2023s line is expected to reach $15.7bn before maturity, which means next month is likely to be the last month of issuance for it, as we have flagged in earlier research. In a nutshell then, this is good news for the bond market.

A long road ahead

All up, the Treasury's PREFU contained few surprises – which is how these things should be. Now, the focus turns squarely on the upcoming election. But other than providing a near-term distraction, we don't think the election result will lead to a material change in fiscal settings at a macro level (regardless of what the Government looks like on the other side). The incoming Government will be constrained by some notion of an upper limit for the debt ratio, and of course will face difficulties implementing the already lengthy list of initiatives currently in the pipeline (particularly on the infrastructure side).

Previous communications from the Treasury suggest the appropriate "upper limit" for net core Crown debt is around 50-60% of GDP when responding to a significant crisis (and around 30% of GDP during good times). The Treasury's latest forecasts show net core Crown debt comfortably within this range (lifting to 55.3% of GDP by 2024). That's a level that many advanced economies would be over the moon about, but there are some very good reasons why New Zealand governments should maintain relatively low government debt on average (such as relatively high private sector debt and our vulnerability to national disasters).

While not so much a story for the here and now (there is a crisis to deal with first), fiscal consolidation will be needed to return debt to prudent levels at some point. Growing the economy out of the debt position will naturally become part of the consolidation strategy, and the more the Government does today to boost the productive capacity of the economy tomorrow, the easier that will be (eg by addressing the infrastructure deficit). But this won't be sufficient to see debt returned to prudent levels over a reasonable time horizon (ie before the next big economic shock comes along). Higher taxes or fewer government services than otherwise are also likely to be required at some point. And the debate over who should cover this cost is only poised to intensify over the years ahead.

But now is not the time for austerity. If there are good (targeted, temporary, and timely) policy options available, this crisis justifies their pursuit. Changes to regulatory settings (such as RMA and labour market regulation reform) could also go a long way, providing a powerful boost to activity while limiting the fiscal burden on future tax payers. There's certainly scope in the PREFU forecasts and on the regulatory front for fiscal policy to go further in supporting the recovery. But for fiscal stimulus to really be effective, virus risks must first be contained.

Contact us

Meet the team

We welcome your questions and feedback. Click here for more information about our team.

Sharon Zollner
Chief Economist

Follow Sharon on Twitter
@sharon_zollner

Telephone: +64 27 664 3554
Email: sharon.zollner@anz.com

General enquiries:
research@anz.com

Follow ANZ Research
@ANZ_Research (global)

David Croy
Senior Strategist

Market developments, interest rates, FX, unconventional monetary policy, liaison with market participants.

Telephone: +64 27 432 2769
Email: david.croy@anz.com

Susan Kilsby
Agricultural Economist

Primary industry developments and outlook, structural change and regulation, liaison with industry.

Telephone: +64 21 633 469
Email: susan.kilsby@anz.com

Liz Kendall
Senior Economist

Research co-ordinator, publication strategy, property market analysis, monetary and prudential policy.

Telephone: +64 27 240 9969
Email: elizabeth.kendall@anz.com

Miles Workman
Senior Economist

Macroeconomic forecast co-ordinator, fiscal policy, economic risk assessment and credit developments.

Telephone: +64 21 661 792
Email: miles.workman@anz.com

Kyle Uerata
Economic Statistician

Economic statistics, ANZ proprietary data (including ANZ Business Outlook), data capability and infrastructure.

Telephone: +64 21 633 894
Email: kyle.uerata@anz.com

Natalie Denne
PA / Desktop Publisher

Business management, general enquiries, mailing lists, publications, chief economist's diary.

Telephone: +64 21 253 6808
Email: natalie.denne@anz.com

Important notice

This document is intended for ANZ's Institutional, Markets and Private Banking clients. It should not be forwarded, copied or distributed. The information in this document is general in nature, and does not constitute personal financial product advice or take into account your objectives, financial situation or needs.

This document may be restricted by law in certain jurisdictions. Persons who receive this document must inform themselves about and observe all relevant restrictions.

Disclaimer for all jurisdictions: This document is prepared and distributed in your country/region by either: Australia and New Zealand Banking Group Limited (ABN11 005 357 522) (**ANZ**); or its relevant subsidiary or branch (each, an **Affiliate**), as appropriate or as set out below.

This document is distributed on the basis that it is only for the information of the specified recipient or permitted user of the relevant website (**recipients**).

This document is solely for informational purposes and nothing contained within is intended to be an invitation, solicitation or offer by ANZ to sell, or buy, receive or provide any product or service, or to participate in a particular trading strategy.

Distribution of this document to you is only as may be permissible by the laws of your jurisdiction, and is not directed to or intended for distribution or use by recipients resident or located in jurisdictions where its use or distribution would be contrary to those laws or regulations, or in jurisdictions where ANZ would be subject to additional licensing or registration requirements. Further, the products and services mentioned in this document may not be available in all countries.

ANZ in no way provides any financial, legal, taxation or investment advice to you in connection with any product or service discussed in this document. Before making any investment decision, recipients should seek independent financial, legal, tax and other relevant advice having regard to their particular circumstances.

Whilst care has been taken in the preparation of this document and the information contained within is believed to be accurate, ANZ does not represent or warrant the accuracy or completeness of the information Further, ANZ does not accept any responsibility to inform you of any matter that subsequently comes to its notice, which may affect the accuracy of the information in this document.

Preparation of this document and the opinions expressed in it may involve material elements of subjective judgement and analysis. Unless specifically stated otherwise: they are current on the date of this document and are subject to change without notice; and, all price information is indicative only. Any opinions expressed in this document are subject to change at any time without notice.

ANZ does not guarantee the performance of any product mentioned in this document. All investments entail a risk and may result in both profits and losses. Past performance is not necessarily an indicator of future performance. The products and services described in this document may not be suitable for all investors, and transacting in these products or services may be considered risky.

ANZ expressly disclaims any responsibility and shall not be liable for any loss, damage, claim, liability, proceedings, cost or expense (Liability) arising directly or indirectly and whether in tort (including negligence), contract, equity or otherwise out of or in connection with this document to the extent permissible under relevant law. Please note, the contents of this document have not been reviewed by any regulatory body or authority in any jurisdiction.

ANZ and its Affiliates may have an interest in the subject matter of this document. They may receive fees from customers for dealing in the products or services described in this document, and their staff and introducers of business may share in such fees or remuneration that may be influenced by total sales, at all times received and/or apportioned in accordance with local regulatory requirements. Further, they or their customers may have or have had interests or long or short positions in the products or services described in this document, and may at any time make purchases and/or sales in them as principal or agent, as well as act (or have acted) as a market maker in such products. This document is published in accordance with ANZ's policies on conflicts of interest and ANZ maintains appropriate information barriers to control the flow of information between businesses within it and its Affiliates.

Your ANZ point of contact can assist with any questions about this document including for further information on these disclosures of interest.

Country/region specific information: Unless stated otherwise, this document is distributed by Australia and New Zealand Banking Group Limited (**ANZ**).

Australia. ANZ holds an Australian Financial Services licence no. 234527. For a copy of ANZ's Financial Services Guide please click here or request from your ANZ point of contact.

Brazil, Brunei, India, Japan, Kuwait, Malaysia, Switzerland, Taiwan. This document is distributed in each of these jurisdictions by ANZ on a cross-border basis.

Cambodia. This document is distributed in Cambodia by ANZ Royal Bank (Cambodia) Limited (**ANZ Royal Bank**). The recipient acknowledges that although ANZ Royal Bank is a subsidiary of ANZ, it is a separate entity to ANZ and the obligations of ANZ Royal Bank do not constitute deposits or other liabilities of ANZ and ANZ is not required to meet the obligations of ANZ Royal Bank.

European Economic Area (EEA): *United Kingdom.* ANZ is authorised in the United Kingdom by the Prudential Regulation Authority (**PRA**) and is subject to regulation by the Financial Conduct Authority (**FCA**) and limited regulation by the PRA. Details about the extent of our regulation by the PRA are available from us on request. This document is distributed in the United Kingdom by Australia and New Zealand Banking Group Limited ANZ solely for the information of persons who would come within the FCA definition of "eligible counterparty" or "professional client". It is not intended for and must not be distributed to any person who would come within the FCA definition of "retail client". Nothing here excludes or restricts any duty or liability to a customer which ANZ may have under the UK Financial Services and Markets Act 2000 or under the regulatory system as defined in the Rules of the Prudential Regulation Authority (**PRA**) and the FCA. ANZ is authorised in the United Kingdom by the PRA and is subject to regulation by the FCA and limited regulation by the PRA. Details about the extent of our regulation by the PRA are available from us on request.

Fiji. For Fiji regulatory purposes, this document and any views and recommendations are not to be deemed as investment advice. Fiji investors must seek licensed professional advice should they wish to make any investment in relation to this document.

Hong Kong. This publication is issued or distributed in Hong Kong by the Hong Kong branch of ANZ, which is registered at the Hong Kong Monetary Authority to conduct Type 1 (dealing in securities), Type 4 (advising on securities) and Type 6 (advising on corporate finance) regulated activities. The contents of this publication have not been reviewed by any regulatory authority in Hong Kong.

India. If this document is received in India, only you (the specified recipient) may print it provided that before doing so, you specify on it your name and place of printing.

Myanmar. This publication is intended to be general and part of ANZ's customer service and marketing activities when implementing its functions as a licensed bank. This publication is not Securities Investment Advice (as that term is defined in the Myanmar Securities Transaction Law 2013).

Important notice

New Zealand. This document is intended to be of a general nature, does not take into account your financial situation or goals, and is not a personalised adviser service under the Financial Advisers Act 2008 (**FAA**).

Oman. ANZ neither has a registered business presence nor a representative office in Oman and does not undertake banking business or provide financial services in Oman. Consequently ANZ is not regulated by either the Central Bank of Oman or Oman's Capital Market Authority. The information contained in this document is for discussion purposes only and neither constitutes an offer of securities in Oman as contemplated by the Commercial Companies Law of Oman (Royal Decree 4/74) or the Capital Market Law of Oman (Royal Decree 80/98), nor does it constitute an offer to sell, or the solicitation of any offer to buy non-Omani securities in Oman as contemplated by Article 139 of the Executive Regulations to the Capital Market Law (issued vide CMA Decision 1/2009). ANZ does not solicit business in Oman and the only circumstances in which ANZ sends information or material describing financial products or financial services to recipients in Oman, is where such information or material has been requested from ANZ and the recipient understands, acknowledges and agrees that this document has not been approved by the CBO, the CMA or any other regulatory body or authority in Oman. ANZ does not market, offer, sell or distribute any financial or investment products or services in Oman and no subscription to any securities, products or financial services may or will be consummated within Oman. Nothing contained in this document is intended to constitute Omani investment, legal, tax, accounting or other professional advice.

People's Republic of China (PRC). This document may be distributed by either ANZ or Australia and New Zealand Bank (China) Company Limited (**ANZ China**). Recipients must comply with all applicable laws and regulations of PRC, including any prohibitions on speculative transactions and CNY/CNH arbitrage trading. If this document is distributed by ANZ or an Affiliate (other than ANZ China), the following statement and the text below is applicable: No action has been taken by ANZ or any affiliate which would permit a public offering of any products or services of such an entity or distribution or re-distribution of this document in the PRC. Accordingly, the products and services of such entities are not being offered or sold within the PRC by means of this document or any other document. This document may not be distributed, re-distributed or published in the PRC, except under circumstances that will result in compliance with any applicable laws and regulations. If and when the material accompanying this document relates to the products and/or services of ANZ China, the following statement and the text below is applicable: This document is distributed by ANZ China in the Mainland of the PRC.

Qatar. This document has not been, and will not be:

- lodged or registered with, or reviewed or approved by, the Qatar Central Bank (**QCB**), the Qatar Financial Centre (**QFC**) Authority, QFC Regulatory Authority or any other authority in the State of Qatar (**Qatar**); or
- authorised or licensed for distribution in Qatar,

and the information contained in this document does not, and is not intended to, constitute a public offer or other invitation in respect of securities in Qatar or the QFC. The financial products or services described in this document have not been, and will not be:

- registered with the QCB, QFC Authority, QFC Regulatory Authority or any other governmental authority in Qatar; or
- authorised or licensed for offering, marketing, issue or sale, directly or indirectly, in Qatar.

Accordingly, the financial products or services described in this document are not being, and will not be, offered, issued or sold in Qatar, and this document is not being, and will not be, distributed in Qatar. The offering, marketing, issue and sale of the financial products or services described in this document and distribution of this document is being made in, and is subject to the laws, regulations and rules of, jurisdictions outside of Qatar and the QFC. Recipients of this document must abide by this restriction and not distribute this document in breach of this restriction. This document is being sent/issued to a limited number of institutional and/or sophisticated investors (i) upon their request and confirmation that they understand the statements above; and (ii) on the condition that it will not be provided to any person other than the original recipient, and is not for general circulation and may not be reproduced or used for any other purpose.

Singapore. This document is distributed in Singapore by the Singapore branch of ANZ solely for the information of "accredited investors", "expert investors" or (as the case may be) "institutional investors" (each term as defined in the Securities and Futures Act Cap. 289 of Singapore). ANZ is licensed in Singapore under the Banking Act Cap. 19 of Singapore and is exempted from holding a financial adviser's licence under Section 23(1)(a) of the Financial Advisers Act Cap. 100 of Singapore.

United Arab Emirates (UAE). This document is distributed in the UAE or the Dubai International Financial Centre (**DIFC**) (as applicable) by ANZ. This document does not, and is not intended to constitute: (a) an offer of securities anywhere in the UAE; (b) the carrying on or engagement in banking, financial and/or investment consultation business in the UAE under the rules and regulations made by the Central Bank of the UAE, the Emirates Securities and Commodities Authority or the UAE Ministry of Economy; (c) an offer of securities within the meaning of the Dubai International Financial Centre Markets Law (DIFCML) No. 12 of 2004; and (d) a financial promotion, as defined under the DIFCML No. 1 of 200. ANZ DIFC Branch is regulated by the Dubai Financial Services Authority (**DFSA**) ANZ DIFC Branch is regulated by the Dubai Financial Services Authority (**DFSA**). The financial products or services described in this document are only available to persons who qualify as "Professional Clients" or "Market Counterparty" in accordance with the provisions of the DFSA rules.

United States. Except where this is a FX- related document, this document is distributed in the United States by ANZ Securities, Inc. (**ANZ SI**) which is a member of the Financial Regulatory Authority (**FINRA**) (www.finra.org) and registered with the SEC. ANZSI's address is 277 Park Avenue, 31st Floor, New York, NY 10172, USA (Tel: +1 212 801 9160 Fax: +1 212 801 9163). ANZSI accepts responsibility for its content. Information on any securities referred to in this document may be obtained from ANZSI upon request. This document or material is intended for institutional use only – not retail. If you are an institutional customer wishing to effect transactions in any securities referred to in this document you must contact ANZSI, not its affiliates. ANZSI is authorised as a broker-dealer only for institutional customers, not for US Persons (as "US person" is defined in Regulation S under the US Securities Act of 1933, as amended) who are individuals. If you have registered to use this website or have otherwise received this document and are a US Person who is an individual: to avoid loss, you should cease to use this website by unsubscribing or should notify the sender and you should not act on the contents of this document in any way. Non-U.S. analysts: Non-U.S. analysts may not be associated persons of ANZSI and therefore may not be subject to FINRA Rule 2242 restrictions on communications with the subject company, public appearances and trading securities held by the analysts. Where this is an FX-related document, it is distributed in the United States by ANZ's New York Branch, which is also located at 277 Park Avenue, 31st Floor, New York, NY 10172, USA (Tel: +1 212 801 916 0 Fax: +1 212 801 9163).

Vietnam. This document is distributed in Vietnam by ANZ or ANZ Bank (Vietnam) Limited, a subsidiary of ANZ.

This document has been prepared by ANZ Bank New Zealand Limited, Level 26, 23-29 Albert Street, Auckland 1010, New Zealand,
Ph 64-9-357 4094, e-mail nzeconomics@anz.com, http://www.anz.co.nz