Long-term fiscal statement: Action required

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Confused by acronyms or jargon? See a glossary here.

Can't kick the fiscal can forever

- The Treasury has published its Long-Term Fiscal Statement, identifying key pressures on the fiscal position that are expected to require policy adjustment (assuming we value intergenerational fairness, fiscal sustainability and efficiency, and maintaining enough fiscal firepower to respond to future crises).
- Compared to the 2021 edition, the sense of urgency to address these issues has been dialled up: we're now four more years into intensifying demographic pressures and policy adjustment has been far from rapid.
- There is no single policy lever that can fix this. Managing spending, raising revenue, and improving public sector efficiency are all likely to be part of the mix. The longer we kick the can down the road, the sharper the necessary adjustment will be.
- While these pressures certainty represent an upwards skew in the risk profile for bond issuance over the long run, there are no immediate implications here for the market to sink its teeth into. It's hard to predict how and when policy will adjust. Perhaps the need to get the books into shape following the next inevitable crisis will force the Government's hand.

What's a LTFS?

The Treasury is required to produce a Long-term Fiscal Statement (LTFS) every four years, which includes projections of key fiscal indicators that extend at least 40 years. They are based on a number of macroeconomic assumptions around the long-run trajectory for interest rates, population growth, demographic change, productivity, etc. These assumptions (which are often tested in scenarios) are combined with current fiscal policy settings to reveal pressure points for the fiscal outlook and identify options to adjust fiscal settings.

The LTFS is a Treasury document, meaning it does not have immediate implications for bond issuance (which would require the Government to make changes to fiscal policy settings). However, what the LTFS does show is that in the absence of some kind of course correction (e.g. higher/new taxes and/or lower government spending) current fiscal settings (taxes and the government services we all rely on) can only be maintained by letting Government debt increase (breaching the Treasury's estimate of "sustainable" levels, i.e. introducing vulnerabilities regarding the cost of servicing it as rating agencies and investors start to give New Zealand the side-eye). That is, the LTFS shows that risks to Government debt over the longer run are skewed to the upside. That's not new news of course.

Main conclusions

Unsurprisingly, the main pressures on fiscal policy over coming years are expected to stem from an aging population (NZ superannuation costs and healthcare), climate risk, an increasingly complex global landscape, and defence (and on top of that, New Zealand will experience unforeseeable shocks in the future).

The good news is that the Treasury has identified options to meet these challenges, noting that the sooner action is taken the less costly the likely adjustment will be.

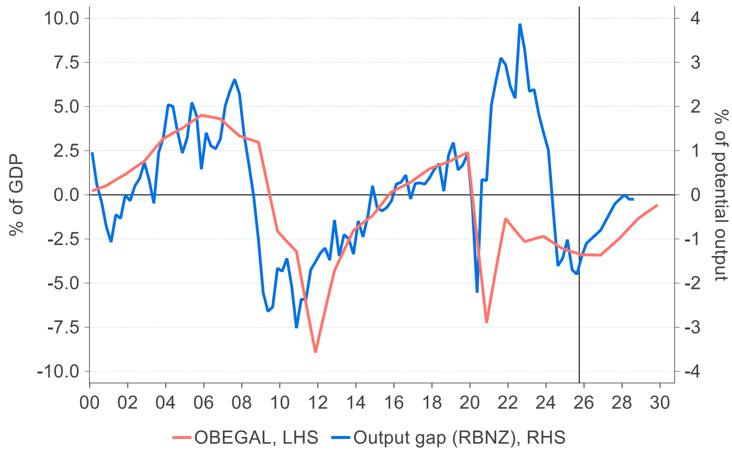
We're not going to rehash every detail of the LTFS here, but we'd definitely put it on our recommended reading list. It is available online here.

Some context: Let the RBNZ handle the cycle, so fiscal policy can focus on the structural stuff

There has been considerable discussion about whether fiscal policy settings are to blame for the current economic weakness in New Zealand. In reality, the economy's subdued cyclical position is largely the result of a post-COVID-boom hangover and past monetary policy decisions, which can impact economic activity with "long and variable" lags (as the economist George Shultz observed, "an economist's lag is a politician's nightmare").

If the Government were doing more to bolster demand right now, interest rates would very likely be higher than otherwise (or inflation pressures would be higher), and that would be limiting scope for the private sector (households and businesses) to grow. Ultimately, the RBNZ will get the economy where they want it to be even if they have to offset fiscal stimulus or contraction to do so (as they did in the wake of the pandemic where persistent fiscal deficits were run despite the economy having no spare economic capacity to accommodate that). Figure 1 shows that New Zealand's strong track record of running surpluses when the economy was running hot, and deficits when the economy needed a helping hand was put to one side following the pandemic: there was help when it was needed in 2020, inflation-fuelling stimulus when it was not needed in 2022 and 2023, and now persistent deficits. Additional monetary easing could easily mop up after fiscal policy in the event that the Government decided to push harder for a surplus, or the RBNZ would have rates higher than otherwise if fiscal policy were to become more stimulatory.

Figure 1. Output gap vs operating balance



Source: New Zealand Treasury, RBNZ, Macrobond, ANZ Research

Our point isn't to dwell on the net costs of past pro-cyclical fiscal policy settings (costs we are still paying), but rather to highlight that fiscal policy will serve us all best in the long run if it focuses on addressing the long-term challenges outlined in today's LTFS, ensuring there are adequate fiscal buffers for when the inevitable next big crisis comes along, and pursuing reforms that enhance the economy's productive capacity over the long run. None of that can be achieved overnight, but blaming the fiscal stance for a monetary policy-induced downturn risks crowding out the debate about the stuff fiscal policy can actually do something about!

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