PRUDENCE, PROMISES AND PRAGMATISM

IN SHORT: A pragmatic balance between aspirational goals and fiscal prudence.

KEY POINTS

- As expected, the Government’s first Budget emphasised prudence over promises. Operating surpluses are projected to grow and net core Crown debt to fall below 20% of GDP by 2022 – 19.1%, in fact.

- Underpinning this outlook is another upbeat set of nominal GDP growth projections. That said, the real activity outlook has been downgraded for 2018 and 2019.

- Both revenues and expenses are higher, with OBEGL surpluses little changed. On the opex side, health and education gobbled up most of the cash available, as they tend to do. Meanwhile, core Crown tax revenues got a $5.7bn cumulative bump, owing to persistence in the stronger starting point, policy tweaks and a stronger nominal GDP outlook.

- On the funding side, NZDMO’s bond issuance guidance has been lifted by $1bn to $8bn in the 2019, 2020 and 2021 fiscal years, while 2018 and 2022 are unchanged at $7bn. Over the five years to June 2022, total bonds issued are expected to be $38bn compared to $35bn at the Half Year Update. However, two thirds of the increase is owing to a reduction in short-term funding through Treasury bills. In terms of off-balance sheet funding, there was little to report, which we view as a good thing.

- The fiscal stance is a little more expansionary than previously forecast, with the core Crown fiscal impulse averaging 0.4% of GDP over the next five years, compared to 0.1% forecast in the Half Year Update. Overall, we think this change is immaterial for monetary policy.

- All up, we think there was headroom for a little more spending on infrastructure in this Budget, given the significant deficit in this area resulting from years of strong population growth and underspending. This will no doubt be debated anew next year. But prudence is the order of the day, taking precedence over promises. And given how quickly the world can change, it is hard to take a firm line that this is a mistake.

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<tr>
<td>Real GDP (ann. ave. % chg.)</td>
<td>2.8 (2.9)</td>
<td>3.3 (3.6)</td>
<td>3.4 (3.0)</td>
<td>2.7 (2.6)</td>
<td>2.5 (2.1)</td>
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<td>Nominal GDP (ann. ave. % chg.)</td>
<td>6.1 (5.0)</td>
<td>4.7 (5.3)</td>
<td>5.0 (5.0)</td>
<td>4.6 (4.8)</td>
<td>4.5 (4.2)</td>
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<td>Current account deficit (% of GDP)</td>
<td>-2.6 (-2.1)</td>
<td>-3.1 (-2.3)</td>
<td>-3.0 (-2.7)</td>
<td>-3.0 (-3.3)</td>
<td>-3.1 (-3.9)</td>
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<td>Unemployment rate (March qtr, %)</td>
<td>4.5 (4.6)</td>
<td>4.2 (4.4)</td>
<td>4.1 (4.2)</td>
<td>4.1 (4.0)</td>
<td>4.2 (4.1)</td>
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<tr>
<td>CPI (ann. % chg.)</td>
<td>1.4 (2.0)</td>
<td>1.5 (1.9)</td>
<td>1.8 (2.1)</td>
<td>1.9 (2.2)</td>
<td>2.0 (2.2)</td>
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<tr>
<td>OBEGL - % of GDP</td>
<td>1.1 (0.9)</td>
<td>1.2 (0.9)</td>
<td>1.7 (1.6)</td>
<td>1.7 (2.0)</td>
<td>2.1 (2.5)</td>
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<tr>
<td>Core Crown Residual Cash - % of GDP</td>
<td>-0.4 (-0.9)</td>
<td>-1.3 (-1.5)</td>
<td>-0.5 (-0.8)</td>
<td>-0.6 (0.1)</td>
<td>0.2 (0.7)</td>
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<tr>
<td>Net Core Crown Debt - % of GDP</td>
<td>20.8 (21.7)</td>
<td>21.1 (22.2)</td>
<td>20.6 (21.9)</td>
<td>20.2 (20.8)</td>
<td>19.1 (19.3)</td>
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<tr>
<td>Bond Programme (gross, NZ$bn)</td>
<td>7.0 (7.0)</td>
<td>8.0 (7.0)</td>
<td>8.0 (7.0)</td>
<td>8.0 (7.0)</td>
<td>7.0 (7.0)</td>
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THE DETAILS

As expected, the Government’s first Budget emphasised prudence over promises. The broad message is that the fiscal books are in good shape. Operating surpluses are projected to grow and net core Crown debt to fall below 20% of GDP by 2022 – 19.1%, in fact. Minister of Finance Grant Robertson said debt below 20% of GDP was justified given uncertainties around spending pressures (using Mycoplasma Bovis as an example) and the need for fiscal prudence.

Figure 1: Treasury net core Crown debt forecasts

The lower starting point for net core Crown debt persists across the forecasts, but it declines more gradually to a similar end point. Core Crown cash flows remain in deficit one year longer than forecast in November, and do not reach surplus until 2022. Accordingly, the nominal value of net debt does not begin to decline until 2022 (previously 2021).

Operating balance before gains and losses (OBEGAL) surpluses are projected to rise from $3.1bn (1.1% of GDP) in the current fiscal year to $7.3bn (2.1% of GDP) by June 2022. With the exception of the 2019 fiscal year, the OBEGAL profile is broadly similar.

Figure 2: Treasury OBEGAL forecasts

Core Crown expenses are higher than forecast in the Half Year Update across the board, with the difference widening over the forecast period. As a share of GDP these are expected to remain broadly stable below 29% of GDP.

Figure 3: Core Crown expenses

Total capital spending is broadly unchanged at $42bn over the next five years. However, capital allowances have been lifted $0.4bn this year and $0.3bn in each of the following years. This increase partially reflects some large projects being pushed outside the forecast period and some reprioritisation. The KiwiBuild capital injection has been pushed out, with the impetus to residential investment halved from a cumulative $5.4bn to $2.5bn over the next five years. We suspect this may speak to the lack of capacity in the sector.
As expected, **operating allowances are higher**, up from $2.6bn to $2.8bn this year, and up $0.5bn to $2.4bn in following years. On top of new operating expenses, significant reprioritisation also enabled more spending, with health and education getting the largest boost.

**Figure 4: Future operating allowances**

![Future operating allowances chart](chart.png)

Source: Treasury, ANZ Research

As expected, **core Crown tax revenues got a $5.7bn cumulative bump**, owing to persistence in the stronger starting point, policy tweaks and a stronger nominal GDP outlook. Nominal GDP has been revised higher by a cumulative $46bn, nearly all of which is due to the starting point.

**Figure 5: Change in forecast core Crown tax revenue**

![Change in forecast core Crown tax revenue chart](chart.png)

Source: Treasury, ANZ Research

On the funding side, **NZDMO’s bond issuance guidance has been lifted by $1bn to $8bn in the 2019, 2020 and 2021 fiscal years**, while 2018 and 2022 are unchanged at $7bn. Over the five years to June 2022, total bonds issued are expected to be $38bn compared to $35bn at the Half Year Update. However, two thirds of the increase is owing to a reduction in short-term funding through Treasury bills, which are expected to be cumulatively $2bn lower over the next 5 years. This means net funding (bonds plus T-bills) is just $1bn higher on a cumulative basis.

**Figure 7: Bond tender program**

![Bond tender program chart](chart.png)

Source: Treasury, ANZ Research

In terms of off-balance sheet funding, there was little to report other than the inclusion of total Crown borrowings, which includes Crown entities and State owned Enterprises. The key takeout here was that Crown entity borrowing is forecast to rise over the forecast horizon, reflecting the PPPs entered into by NZTA, and Housing New Zealand bond issuance. While this borrowing sits outside of net core Crown debt (the Government’s strategy measure), it is being treated very transparently by the Treasury.
The fiscal stance is a little more expansionary than previously forecast, with the core Crown fiscal impulse averaging 0.4% of GDP over the next five years, compared to 0.1% forecast in the Half Year Update. Overall, we think this change is immaterial for monetary policy.

Figure 8: Fiscal impulse

Other key points of note: the Government is consulting on the establishment of an independent fiscal institution for policy costings, similar to the US. There was also a nod towards next year’s Well-being Budget that will report against wider set of indicators, including Treasury’s Living Standards Framework. Further details will follow in the 2019 Budget Policy Statement.

OUR ASSESSMENT
Overall, there were no big surprises today.

New Zealand’s fiscal accounts are in a strong position relative to many international peers and that provides options should economic risks materialise – as they tend to do eventually. However, as things stand, we would have liked to see a bit more capital spending. There is a clear infrastructure deficit, and done well, infrastructure investment pays for itself. But it is a balancing act. The Government needs to ensure their spending doesn’t compete with and crowd out private activity. This is why the focus should be on a long, relatively smooth forward-looking pipeline of prioritised infrastructure spending, with the option to ramp up if economic activity were to soften.

Given the pressures we’re seeing on infrastructure and the likely balance of risks around Treasury’s economic outlook, we suspect the debate on loosening fiscal targets is not over. But for Budget 2018, prudent pragmatism is the order of the day.

KEY NEW SPENDING INITIATIVES
- **Health**: $4bn, including $2.3bn for DHBs, $750m for urgent hospital building, free doctor visits for under 14s.
- **Education**: $1.9bn, including $395m for new schools and classrooms, $370m for 1500 more teachers, and $590m for early childhood services.
- **Housing**: $1bn for public/affordable housing (on top of Kiwibuild), including 6400 more state houses.
- **Justice**: Waikeria prison on hold, replaced by 600 “rapid build modular units”. 1800 new police officers.
- **Immigration**: more money for labour inspectors and screening staff.
- **Biosecurity**: peanuts in light of the Mycoplasma bovis outbreak.
- **Environment**: $100m green investment fund to encourage private sector investment in low emissions.
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