Sticking to the script

Bottom line

- Next week’s Half-Year Update is expected to show the Government’s books remaining in good shape over the next five years.
- Underpinned by a solid economic outlook and strong starting point, there should be room for the Government to squeeze a little more spending in and still comply with its Budget Responsibility Rules.

Key points

We expect the vibe of next week’s Half-Year Economic and Fiscal Update (HYEFU) and Budget Policy Statement (BPS) to be broadly unchanged from May’s Budget Update and Fiscal Strategy Report. An increased emphasis on well-being is likely to feature, but this is more of a lens through which to assess the Government’s priorities than something that will impact the aggregate numbers. Overall, the stronger starting point for the Government’s books provides a little wiggle room on the spending side, but we expect this to be relatively modest given the Government will be sticking to its five Budget Responsibility Rules:

1. **Deliver a sustainable operating surplus across an economic cycle.**
   From 2017/18’s solid starting point (a larger-than-forecast $5.5bn surplus in the year ended June 2018), we wouldn’t be surprised to see the forecast OBEGAL turn south in 2018/19, partly as the 2017/18 underspend is pushed into 18/19 and any additional (but small) windfall is put to use. Thereafter, we see surpluses lifting across the latter forecast years as revenues grow alongside the nominal economy and expenditure growth remains relatively contained.

   In terms of **sustainable surpluses across the cycle**, the cyclically-adjusted balance is likely to show slightly smaller surpluses over the forecast horizon (given we expect Treasury’s view is that the economy is currently running faster than is sustainable). However, this potentially undercooks the revenue windfall associated with strong migration-led population growth, which we see as output gap neutral and a source of revenue growth that can hardly be defined as **sustainable**.

2. **Reduce the level of net core Crown debt to 20% of GDP within five years of taking office.**
   This is perhaps the most focused on – and therefore binding – aspect of the Government’s BRRs. “Within five years of taking office” implies the net debt forecasts will land at or below 20% of GDP by the year ended June 2022. We suspect it will drift a little lower in the additional forecast year to June 2023.

3. **Prioritise investments to address the long-term financial and sustainability challenges facing New Zealand.**
   Restarting contributions the New Zealand Super Fund and the Provincial Growth Fund are likely to get a mention here. However, that’s not to say there isn’t room for a little more infrastructure investment, or at least planning of a few spade-ready projects the Government could swoop in with should the economy take a turn for the worse. Such a time would be optimal for the Government to loosen the purse strings, provided the books are in good order and economic capacity (particularly labour) is idle. Addressing the infrastructure
deficit is perhaps one of the most obvious long-term challenges from an economic outlook perspective, given future economic expansion depends on it. Climate change is another challenge the New Zealand (and global) economy faces in the long-term. And like many long-term issues, the sooner we begin the transition the easier it will be (though not necessarily from a political perspective).

4. **Take a prudent approach to ensure expenditure is phased, controlled, and directed to maximise its benefits. The Government will maintain its expenditure to within the recent historical range of spending to GDP ratio.** Translation: expect core Crown spending to remain below 30% of GDP. Building business cycle considerations into the fiscal strategy (i.e., the interaction between fiscal and monetary policy) would be a nice touch, but is not something we expect to see explicitly spelled out at HYEFU.

5. **Ensure a progressive taxation system that is fair, balanced, and promotes the long-term sustainability and productivity of the economy.** This essentially sums up the Tax Working Group’s mandate.

Underpinning the above ambitions, we think the Treasury’s economic forecasts will remain relatively upbeat. On the one hand, its assessment of near-term economic momentum is likely to be a little more optimistic than our own, reflecting the solid starting point for GDP (up 1.0% q/q in Q2) and the strong labour market (Q3 unemployment rate of 3.9%). However, we would be surprised if the recent softening in export prices, moderating global growth (and outlook downgrade), cooling housing market, and shrinking impetus to growth from easing net migration inflows don’t trim the peak off its previous (optimistic) growth outlook.

**Real GDP forecasts**

Source: Stats NZ, The Treasury, ANZ

But even if the outlook for the real economy gets a downgrade, the stronger starting point for CPI inflation (and output gap) should provide at least a partial offset to the nominal side, and see forecast tax revenues remain relatively healthy. It’s unlikely there will be any big announcements around tax settings given the Tax Working Group’s final recommendations are not due until February 2019, and if the Treasury’s outlook accommodates any additional spending (which we suspect it will) this is likely to be minor and operational. Public sector wage settlements are one possibility. However, the fiscal forecasts are likely to continue to exclude any changes on that front so long as negotiations remain open.
The Treasury’s assessment of the risks to the outlook will be key from a fiscal strategy perspective, and on that front we expect a skew to the downside, with the US/China tariff war and Brexit uncertainty, wobbly global equity markets, and debt risks in China all on the radar. The Minister of Finance should be spoilt for choice regarding risks he can hitch his wagon to as he walks the path of fiscal prudence and reiterates the need to keep the Government’s books in good shape for the inevitable rainy day.

Regarding Debt Management’s bond issuance guidance, we’re not expecting much (if any) change from the Budget Update in May, and think the additional forecast year (2023) will be steady as she goes at $7bn. This assumes only small changes to the Government’s net spending profile, and by our estimates will keep forecast NZGBs on issue above 20% of GDP. That said, we continue to see upside risks to the issuance profile. On the one hand, upside risks to nominal GDP could see the Government’s commitment to maintain NZGBs on issue above 20% of GDP become binding, with 2021 and 2023 being the years most at risk. On the other hand, downside risks to the economic outlook could push Government revenues below forecast and expenses above. However, it’s important to note these are ‘tail end’ risks and there’s likely to be some flexibility around the Treasury’s central projections.

Treasury bills outstanding were at $3.8bn as at November 2018, above the Budget Update guidance of $2bn for the year ended June 2019. In part, this appears timing-related, with bills outstanding likely to trend lower as the 2019 fiscal year progresses. However, it’s possible that the strong start to 2019 reflects a more persistent near-term funding requirement and that T-bill guidance for 2019 gets a bump (perhaps +$1bn to $3bn).

Given the array of economic risks out there, and the pressures we’re seeing on New Zealand’s infrastructure, we haven’t abandoned the possibility of fiscal targets being loosened in time. Indeed, this debate is likely to ramp up as we approach the next election. But for now, we expect the Government to stick to the fiscal prudence script.
This document is intended for ANZ’s institutional, professional or wholesale clients, and not for individuals or retail persons. 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 updates to the information contained within this document, which may be applicable to your particular situation.

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. If trading strategies or recommendations are included in this document, they are solely for the information of ‘wholesale clients’ (as defined in section 761G of the Corporations Act 2001 Cth).

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.
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

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

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).

New Zealand. This document is intended to be 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 any financial services in Oman. In the context of the DFSA, 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 other financial instruments may be consummated. 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, 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. In addition, ANZ has a representative office (ANZ Representative Office) in Abu Dhabi regulated by the Central Bank of the UAE. The ANZ Representative Office is not permitted by the Central Bank of the UAE to provide any banking services to clients in the UAE.

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 ANZ 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 9160 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