Give and take

Key points

- As expected, the Treasury’s Half-Year Update showed the Government’s books are expected to remain in good shape over the next five years.

- A stronger starting point has not convinced the Government that now is a good time to increase spending.

- The Minister of Finance continues to walk the path of fiscal prudence. While there appears to be a little wiggle room based on the net debt forecasts, he reiterated that given global uncertainties, now isn’t a good time to push the limits of the debt constraint.

- Accordingly, net core Crown debt is forecast to moderate from 20.9% of GDP in the year to June 2019, to 19.0% in 2021/22.

- Debt Management’s bond guidance was unchanged from the Budget Update, with $6bn pencilled in for the additional forecast year (2022/23). There is little in here that should engender a market reaction.

- Once again, the Treasury’s economic outlook underpinning the fiscal forecasts is more optimistic than our own, but this has been downgraded. On our growth numbers the books would still improve over the years ahead, but it would take a little longer to meet the debt target, and/or require cost savings further down the track.

- The Government’s Budget Policy Statement included five new well-being priorities that will guide spending decisions in the 2019 Budget. There were no changes to the five Budget Responsibility Rules.

- The next big event on the fiscal side will be the Tax Working Group recommendations in February.

<table>
<thead>
<tr>
<th>Economic (June years)</th>
<th>2018/19</th>
<th>2019/20</th>
<th>2020/21</th>
<th>2021/22</th>
<th>2022/23</th>
</tr>
</thead>
</table>
| Real GDP (ann. ave. % chg.) | 2.9 (3.3) | 3.1 (3.4) | 2.7 (2.7) | 2.5 (2.5) | 2.3 (--)
| Nominal GDP (ann. ave. % chg.) | 4.3 (4.7) | 5.6 (5.0) | 5.1 (4.6) | 4.7 (4.5) | 4.5 (--)
| Current account deficit (% of GDP) | -3.5 (-3.1 ) | -3.6 (-3.0 ) | -3.6 (-3.0 ) | -3.6 (-3.1 ) | -3.7 (--)
| Unemployment rate (March qtr, %) | 4.1 (4.2) | 3.9 (4.1) | 4.0 (4.1) | 4.1 (4.2) | 4.1 (--)
| CPI (ann. % chg.) | 2.0 (1.5) | 2.0 (1.8) | 2.0 (1.9) | 2.0 (2.0) | 2.0 (--)
| Fiscal (June years) | 2018/19 | 2019/20 | 2020/21 | 2021/22 | 2022/23 |
| OBEGAL - % of GDP | 0.6 (1.2) | 1.3 (1.7) | 1.5 (1.7) | 2.2 (2.1) | 2.3 (--)
| Core Crown Residual Cash - % of GDP | -1.7 (-1.3) | -0.8 (-0.5) | -0.3 (-0.6) | 0.3 (0.2) | 0.8 (--)
| Net Core Crown Debt - % of GDP | 20.9 (21.1) | 20.7 (20.6) | 20.1 (20.2) | 19.0 (19.1) | 17.4 (--)
| Bond Programme (gross, NZ$b) | 8.0 (8.0) | 8.0 (8.0) | 8.0 (8.0) | 7.0 (7.0) | 6.0 (--)|
Details and assessment

We weren’t expecting any big surprises in today’s Half-Year Economic Update, and we didn’t get any. The general message was that the Government’s books are in good shape and are expected to remain that way so long as the Government sticks to its Budget Responsibility Rules and the Treasury’s central economic outlook broadly materialises.

The most binding of the Government’s self-imposed budget rules is the intention to reduce the level of net core Crown debt to 20% of GDP within five years of taking office. According to the Treasury’s forecasts, the Government is set to slightly overachieve on that front, with net core Crown debt at 19.0% of GDP in the year to June 2022. That said, increased spending and the pushing out of spending that was originally intended for 2017/18 (but didn’t occur) sees net debt lift to 20.9% of GDP in 2018/19 (up from 20.0% in 2017/18). Thereafter, growth in the nominal economy exceeds growth in the level of net debt, pushing the ratio down to 17.4% by 2022/23. The nominal level of core Crown net debt is forecast grow from $62.7bn in 2018/19 to $66.9bn in 2020/21, before declining to $63.5bn by the end of the forecast period. Accordingly, core Crown residual cash is forecast to remain in deficit until 2020/21, turning to surpluses thereafter.

Figure 1. Core Crown net debt

Source: The Treasury

At a surplus of $5.5bn in the year ended June 2018, the starting point for the total Crown operating balance before gains and losses (OBEGAL) was well above that forecast in the Budget Update. However, the OBEGAL surplus is forecast to narrow to $1.7bn in 2018/19 and gradually widen thereafter, reaching $8.4bn by 2022/23.

Figure 2. Total Crown OBEGAL

Source: The Treasury
As expected, the forecast cyclically adjusted OBEGAL is a touch softer than the headline measure. This reflects Treasury’s judgement that some of the strength in forecast tax revenues (and muted expenses, particularly welfare) is owing to the cyclically strong position of the economy. At face value the adjusted OBEGAL suggests the Government is delivering on its ambition to deliver sustainable surpluses across the economic cycle.

There is little change on the spending side. Cumulative capital spending of $41.6bn over the next five years is unchanged from the Budget Update. However, the introduction of the multi-year capital envelope means the Government has more flexibility in how it allocates the remaining $9bn over the next few years. Operating allowances are also unchanged from the Budget.

However, the pushing out of spending from 2017/18 into 2018/19 and a few other small timing-related tweaks that shift the profile mean that cumulative spending over the next five years is higher than that forecast in May. Compared to the Budget Update, core Crown expenses are $4.7bn higher on a cumulative basis by 2021/22 (the last forecast year in the Budget Update).

Overall, core Crown expenses are forecast to grow from $88.7bn in 2018/19 to $103.2bn by 2022/23, but as a share of GDP they are expected to remain below 30%, declining from 29.5% in 2018/19 to 28.3% by 2022/23.

We still feel there’s a case to loosen the purse strings and address New Zealand’s infrastructure deficit faster. The key caveat is that it doesn’t significantly crowd out/compete with private investment – and that’s a tricky nut to crack, with demand for private investment not a particularly easy thing to accurately anticipate.

A stronger starting point for core Crown tax revenue is carried through the entire forecast period, lifting from $84.3bn in 2018/19 to $105.3bn by 2022/23. This is despite the fact that Treasury’s forecast for nominal GDP is below that in the Budget Update. However, the forecast composition of nominal growth is expected to be more “tax rich” than previously, reflecting a solid outlook for household incomes through a tight labour market and solid wage growth, which boosts compensation of employees and source deductions.
In part, the weaker nominal GDP forecast reflects a downgrade to the outlook for real activity. Compared to our own outlook it’s still on the optimistic side. Indeed, next week’s Q3 GDP release could see Treasury’s outlook already softer than reality, with a 0.7% q/q lift baked into the half-Year Update compared to our expectations for a 0.5% rise.

One of the drivers underpinning this outlook is a stimulatory fiscal stance in the near term. That said, the fiscal impulse in 2017/18 is estimated to have been less expansionary than previously anticipated (reflecting the previously announced under-spend) but consequently stronger in 2018/19 in what is a pure timing effect. Thereafter, fiscal settings are expected to exert a mildly negative (or broadly neutral) impact on growth.
While our own central economic outlook is a little softer than the Treasury’s, we also see the Government’s books improving over time. That said, if the economy evolves as we expect it could take a little longer for the Government to reach its debt target, and/or it could result in the Government having to find cost savings further down the line – or loosen its debt targets.

So what does it all mean for funding? In the grand scheme of things, not a lot. Debt Management’s bond issuance guidance was unchanged over the next four fiscal years to 2021/22. Guidance for the additional forecast year (2022/23) is at $6bn, $1bn softer than we had pencilled in.

![Figure 7. Bond tender program](source: The Treasury)

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, which would be a nice problem to have. On the other hand, downside risks to the economic outlook could push Government revenues below forecast and expenses above.

Treasury bills outstanding were at $3.8bn as at November 2018, above the Budget Update guidance of $2bn for the year ended June 2019. With guidance unchanged, this is purely timing-related and likely reflects a seasonal lift in short-term funding requirements: Government receipts (cash inflow) generally dry up over the holiday season, while outgoings remain relatively constant.

As expected, the Government’s Budget Policy Statement contained substantial emphasis on well-being, including a well-being outlook and five Budget Priorities for Budget 2019 that will guide how funding is allocated in May’s Budget. These include:

- Creating opportunities for productive businesses, regions, iwi and others to transition to a sustainable and low-emissions economy
- Supporting a thriving nation in the digital age through innovation, social and economic opportunities
- Lifting Māori and Pacific incomes, skills and opportunities
- Reducing child poverty and improving child wellbeing, including addressing family violence
- Supporting mental wellbeing for all New Zealanders, with a special focus on under 24-year-olds.

All up, given the array of economic risks out there, and the pressures we’re seeing on New Zealand’s infrastructure, we still see a very real 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, the Government remains content to stick to the ‘fiscal prudence’ script.
The next Economic and Fiscal Update will be in May next year and it’s set to be a doozy. First, it’s going to be the Government’s long-awaited first ‘Wellbeing Budget’, meaning spending decisions will be made through the lens of the Wellbeing Budget Process outlined in the Budget Policy Statement. But more importantly, it will come after the Tax Working Group’s recommendations have been made (due February), and could include changes to revenue settings. But with regards to the elephant in the room, a capital gains tax, the Government has made it clear that the next election will effectively be a referendum on the topic, should it be recommended.
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 material change to the opinion or information contained within it that 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 warrant 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.

Europe. This document is distributed in your country/region by either: Australia and New Zealand Banking Group Limited (ANZ); or its relevant subsidiary or branch (each, an Affiliate), as appropriate or as set out below.

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

This document is distributed in your country/region by either: Australia and New Zealand Banking Group Limited (ANZ); or its relevant subsidiary or branch (each, an Affiliate), as appropriate or as set out below.

Important notice
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).

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 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, 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 27 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 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 nzecconomics@anz.com, http://www.anz.co.nz