

2017 BUDGET PREVIEW

18 May 2017

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HEAD AND SHOULDERS

- **The Budget will print some rosy fiscal numbers with rising surpluses and declining debt. Solid growth is a key driver.**
- **The Government is in the enviable position of being able offer tax (bracket) cuts, lift infrastructure spending, pay down debt and throw the normal Budget lollies around.**
- **However, the spirit will be “steady as she goes”.**
- **The bond tender program is expected to be broadly unchanged.**
- **We expect a slightly more expansionary fiscal stance than was presented in the Half-year Update but not enough to influence the stance of monetary policy.**

KEY POINTS

- **Next week’s Budget will paint a rosy picture of the fiscal outlook.** Growth is solid, inflation a tad higher, and spending restraint continues. Larger projected surpluses and lower debt levels will provide the Government with plenty of options.
- **Since the December Update, the fiscal numbers have been tracking extremely well.** Tax revenue is running around 1% ahead of forecasts and over 7% above the same period last year; 7% tax growth in itself is saying something about the economy. That gap will likely to be maintained through the projection period, with Treasury’s economic forecasts consistent with an ongoing solid growth backdrop (and reasonable rates of nominal GDP growth). While near-term real GDP growth numbers may be revised a touch lower, growth will still be projected to average around 3% over the forecast period, and together with higher inflation, could perhaps see the level of nominal GDP around \$6bn above Half-year Update forecasts at the end of the projection period. At the same time, core Crown expenses have been below forecast, and while that reflects technicalities around the fiscal costs of the Kaikoura earthquake more than anything, even those have been revised a little lower of late. In the nine months to March, the OBEGAL was \$1.3bn ahead of forecast.
- **We don’t believe this positive backdrop will entice the Government into significantly changing its approach.** The Minister of Finance’s pre-Budget speech mentioned the word “resilience” ten times, giving a clear impression that the Government’s mind-set (even with some key changes in leadership) has not shifted from a prudent approach to spending and a building up of its rainy-day coffers. The announcement of a new 10-15% net debt target by 2025 reinforces this further (even given the fact that this is outside the scope of the Budget forecasts).
- **The usual flag-bearers of growing a strong economy – better public services (including social investment) and responsible fiscal management – will no doubt remain entrenched. On top of this we expect housing initiatives to come more to the fore as a theme.**

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- A solid fiscal backdrop provides options, and some of these will be exercised.** There have already been announcements with regards to new infrastructure spending (which we believe will be heavily skewed towards housing), and also additional spending for social initiatives. Health and education will get the usual large bump up in Budget initiative spending. Personal tax cuts also continue to be mooted (“when we have room to do so”) and we wouldn’t rule out those being pencilled in (perhaps through tax bracket changes) this fiscal year or next – this may be explicit or through a lift in the operating allowance for Budget 2018 from \$1.5bn currently. We’ve seen the usual pre-Budget announcements in areas such as tourism already. Stepping back we still expect Crown expenses to be projected to fall as a share of the economy.
- In terms of the numbers themselves, we expect a 2016/17 OBEGAL surplus of around 0.7% of GDP, with this projected to grow towards 3%.** The core Crown residual cash position could also be in surplus this fiscal year, which would be the first time since 2008. However, we wouldn’t be surprised if the cash balance is forecast to fall back into deficit, albeit temporarily, given the timing of various capital payments. Larger capital spending overall is also likely to mean that despite higher tax revenue, the bond issuance programme will be left largely unchanged. The starting point for net debt will be lower, and projected to fall towards 18% of GDP by 2020/21 (lower than in the Half-year Update), highlighting that it is well on track to meet its new 2025 target.
- We are not expecting the Budget to contain much in the way of implications for monetary policy, at least not in the near-term.** The RBNZ has made it quite clear that it is going to take some significant developments to sway it from its neutral stance. However, the fiscal impulse is turning more neutral after being a drag of around 1% of GDP on average since 2012. So all else equal, it adds to the case that the downside risks surrounding the OCR outlook continue to ease.
- With the fiscal accounts in surplus, the Government has runs on the board and wickets to play with – and it’s happened without upping taxes.** Potential challenges remain. The business cycle tends to turn every 10 years so you need to allow for the risk of a downturn. There will be the usual demands for more spending. Fixing New Zealand’s housing challenges is going to cost a lot more. And wage inflation demands will become more of a focal point. Even allowing for such developments, the position to absorb such challenges is a strong one.

ANZ expectations of Budget 2017 forecasts (HYEFU 2016 forecasts in brackets)					
June Years	2016/17	2017/18	2018/19	2019/20	2020/21
Real GDP (ann. ave. % chg.)	3.1 (3.6)	3.6 (3.5)	3.2 (2.9)	2.6 (2.4)	2.5 (2.3)
Nominal GDP (ann. ave. % chg.)	5.8 (5.2)	5.6 (5.6)	5.2 (5.0)	4.4 (4.1)	4.2 (3.9)
Current account deficit (% of GDP)	-2.6 (-3.0)	-3.0 (-3.8)	-3.4 (-4.1)	-3.6 (-4.4)	-4.0 (-4.4)
Unemployment rate (March qtr, %)	4.8 (4.8)	4.6 (4.6)	4.3 (4.2)	4.3 (4.3)	4.3 (4.3)
CPI (ann. % chg.)	2.0 (1.5)	2.1 (2.0)	2.0 (2.1)	2.0 (2.0)	2.0 (2.1)
June Years	2016/17	2017/18	2018/19	2019/20	2020/21
OBEGAL - % of GDP	0.7 (0.2)	1.3 (1.2)	2.0 (1.8)	2.5 (2.2)	3.0 (2.7)
Core Crown Residual Cash - % of GDP	0.0 (-0.8)	-1.0 (-0.7)	0.4 (0.5)	1.1 (1.0)	1.7 (0.8)
Net Core Crown Debt - % of GDP	23.1 (24.3)	22.9 (23.8)	21.3 (22.2)	19.3 (20.3)	17.5 (18.8)
Bond Programme (gross, NZ\$bn)	8.0 (8.0)	7.0 (7.0)	7.0 (7.0)	6.0 (6.0)	6.0 (6.0)

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