

NEW ZEALAND ECONOMICS 2016 HALF-YEAR ECONOMIC AND FISCAL UPDATE (HYEFU) AND 2017 BUDGET POLICY STATEMENT (BPS)

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A STRONGER FISCAL WAR-CHEST

KEY POINTS

- All in all today's HYEFU was fairly upbeat and will be taken well by the market, as one would expect given the underlying strength of the economy. It showed stronger growth forecasts, slightly higher surpluses, lower net debt, and acknowledged the impact of the Kaikoura earthquake. But the new 2040 inflation-linked bond ("linker") planned for next year might surprise some.
- The Treasury now sees GDP growth of 3.6% and 3.5% respectively over 2017 and 2018 (up from 2.9% and 3.2% forecast in the May Budget). Tweaks to GDP forecasts further out were minor, with 2019 growth revised up from 2.8% to 2.9% and 2020 revised down 0.1% to 2.4%.
- The Treasury's analysis assumes that the net cost to the Crown of the Kaikoura earthquake will be \$1bn (out of a total cost estimate of \$2-3bn, with the remainder covered by insurances and existing Budget allocations).
- Importantly, nominal GDP is assumed to be a cumulative \$23.7bn higher than assumed in the Budget, courtesy of stronger nominal GDP year-to-date (i.e. a better starting point), stronger real GDP forecasts, and expected higher prices – CPI inflation is forecast to reach 2.0% in 2018 and hold steady thereafter. Collectively, these factors support the collective \$1.1bn improvement in OBEGAL over the forecast period (compared to the Budget), despite absorbing a net \$1bn hit from the Kaikoura earthquakes.
- OBEGAL surpluses were revised up in dollar terms for all future periods except the current year. The net \$1bn hit from Kaikoura slightly outweighed the impact of a stronger starting point and better 2016/17 growth forecasts, leading to a \$0.2bn downward reduction to a current-year surplus of \$0.5bn.
- Owing to stronger growth *and* stronger fiscal outcomes (in percentage of GDP terms), OBEGAL surpluses follow a similar trajectory to the Budget, with a small downgrade (from 0.3% to 0.2%) in 2016/17, a small upgrade (from 0.9% to 1.2%) in 2017/18, and minor tweaks thereafter.
- Net debt is assumed to continue falling (at a slightly more rapid clip than assumed in the Budget), falling to 18.8% of GDP by 2020/21.
- For markets, the "surprise" will be in the detail of the bond programme. Although most (including us) assumed the hit from the Kaikoura quake would lead to an upgrade in current year issuance (duly lifted from \$7bn to \$8bn), the surprise is that the slack will be taken up by planned syndication of a 20 September 2040 linker to be launched via syndication in calendar H1 2017. There was no change to the 2017/18 and 2018/19 bond programmes, but a \$1bn reduction (from \$7bn to \$6bn) in 2019/20.
- Given the Treasury's comment that linkers will account for "up to \$2.5bn" of issuance, assuming a continued pace of \$100m per month of linker issuance, this implies a syndication of \$1.5bn. Linker demand has improved in recent months, but this much longer bond is a surprise, given capacity in existing linker lines. But while we do wonder about linker demand, we do believe issuing ultra-long-term bonds is in NZ's long-term interests, especially given the Crown's commitment to an additional \$2.1bn of capital (infrastructure) spending (see next point).

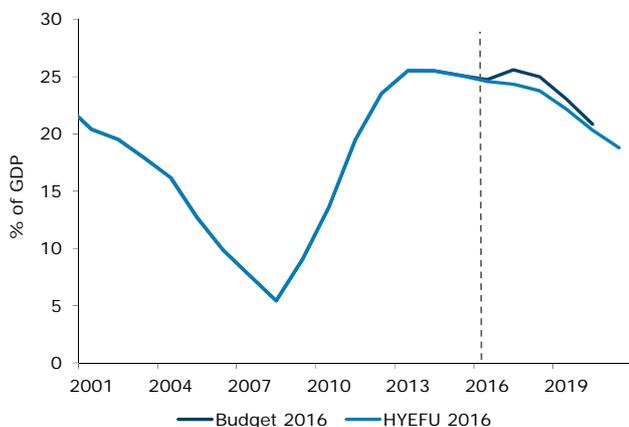
HYEFU 2016/BPS 2017

- While operating allowances remain unchanged at \$1.5bn over the next 4 years, there has been a significant increase in the capital allowance, which has been increased from \$900m to \$3bn in Budget 2017 and to \$2bn in future budgets to provide for investment (mainly infrastructure).
- The fiscal impulse is expected to turn expansionary in 2016/17 and 2017/18, largely thanks to capital spending increases. The fiscal stance was contractionary to the tune of 0.4% of GDP over the 2015/16 year, but it becomes positive to the tune of 0.9% and 0.1% of GDP respectively over 2016/17 and 2017/18 respectively. Beyond that there is “payback”, neutralising the overall fiscal impulse over the next 5 years.
- Risks to the outlook are assumed to be greater than in the Budget, and the HYEFU contains two scenarios. The first assumes slower trading partner growth (especially in China). In this scenario, growth, tax revenue and OBEGAL are all assumed to be lower. The second explores the inflationary impact capacity constraints may have on the economy – potentially leading to faster nominal growth, higher tax revenue and better surpluses.
- Net migration is still expected to decline, but more slowly than in Budget 2016. 150,000 jobs are expected to be created over the next 5 years, and the unemployment rate is expected to fall to 4.6% by 2018, before stabilising around 4¼% in 2019 and beyond.
- On a separate note, Finance Minister Bill English said that if he does become Prime Minister next week, Steven Joyce will be Finance Minister.

HYEFU Forecasts (Budget forecasts in brackets)

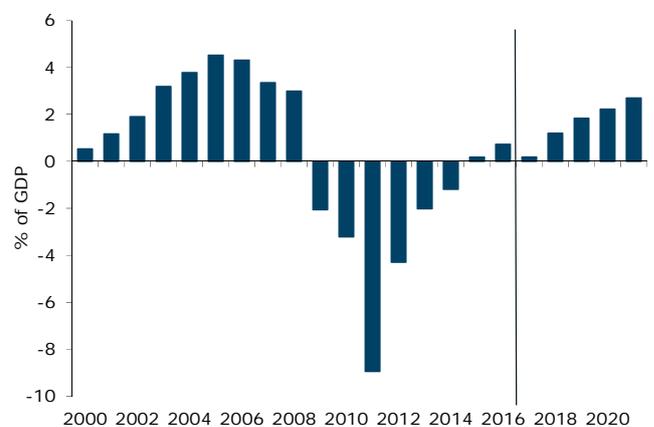
June Years	2016/17	2017/18	2018/19	2019/20	2020/21
Real GDP (ann. ave. % chg.)	3.6 (2.9)	3.5 (3.2)	2.9 (2.8)	2.4 (2.5)	2.3 (na)
Nominal GDP (ann. ave. % chg.)	5.2 (3.6)	5.6 (5.6)	5.0 (5.1)	4.1 (4.1)	3.9 (na)
Current account deficit (% of GDP)	-3.0 (-4.6)	-3.8 (-4.1)	-4.1 (-4.3)	-4.4 (-4.8)	-4.4 (na)
Unemployment rate (March qtr, %)	4.8 (5.6)	4.6 (5.1)	4.2 (4.6)	4.3 (4.6)	4.3 (na)
CPI (ann. % chg.)	1.5 (1.5)	2.0 (2.0)	2.1 (1.9)	2.0 (2.1)	2.1 (na)
June Years	2016/17	2017/18	2018/19	2019/20	2020/21
OBEGAL – % of GDP	0.2 (0.3)	1.2 (0.9)	1.98 (1.7)	2.2 (2.2)	2.7 (na)
Core Crown Residual Cash – % of GDP	-0.8 (-1.6)	-0.7 (-0.8)	0.5 (0.7)	1.0 (1.3)	0.8 (na)
Net Core Crown Debt – % of GDP	24.3 (25.6)	23.8 (25.0)	22.2 (23.1)	20.3 (20.8)	18.8 (na)
Bond Programme (Gross)	8.0 (7.0)	7.0 (7.0)	7.0 (7.0)	6.0 (7.0)	6.0 (na)

FIGURE 1. CORE CROWN NET DEBT



Source: ANZ, The Treasury

FIGURE 2. TREASURY OBEGAL FORECASTS



Source: ANZ, The Treasury

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