25 May 2017

Government Budget Has A Lot to Do With Pressure

- A responsibly expansive Budget
- A net stimulus for RBNZ (and us) to add to forecasts
- Treasury's macro forecasts not overdone…nominally
- DMO tweaks bond program; sets gross debt minimum
- Markets unmoved as fiscal stimulus largely confirmed
- Rating agencies should be encouraged

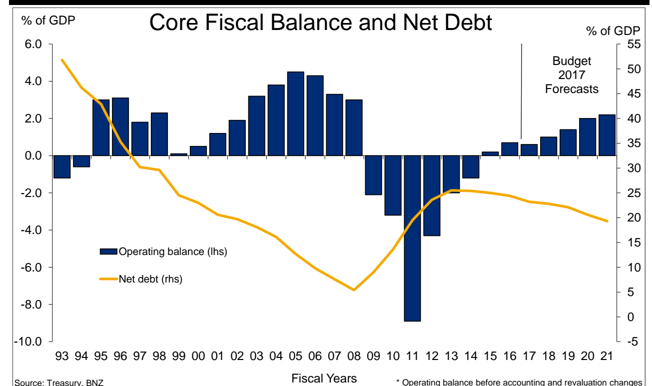
Today’s Budget had a lot to do with pressure. Pressure to funnel some of surpluses back into the economy (in an election year); the pressure this will put on the economy’s resources, especially construction; all amid the ongoing pressure from a strongly growing population.

Even with extra spending and transfers that the government confirmed today, the projections of increasing operating surpluses and declining net debt looked broadly similar to those of December’s Half-year Economic and Fiscal update (HYEFU). This has been afforded by robust economic growth, boosting tax revenue. It’s an enviable fiscal story New Zealand thus has. Still. And with the buffers that are being built, there remain further options should they be needed.

But before we go through the niceties of the fiscal numbers, we should mention the Treasury’s macro-economic forecasts upon which they are founded. While they looked a bit ambitious, in real terms, they seemed much more achievable when looked at on a nominal basis.

The number that first jumped out at us was Treasury’s forecast of 3.8% real GDP growth for the year to June 2019. We expect 2.6%. However, Treasury’s nominal GDP forecasts for the year to June 2017, and year to June 2018, are slower than ours, before largely averaging out over the outer years. We thought this might be owing to Treasury having a not-so-strong track on the terms of trade. However, this is not obviously different to ours. Whatever the explanatory price factor is, the fact is that Treasury’s nominal GDP forecasts don’t look overdone to us.

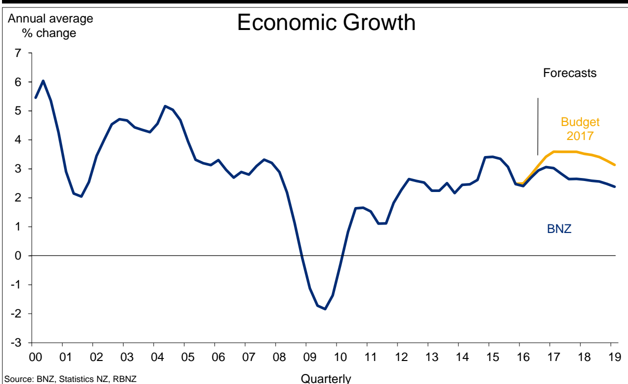
Still Good



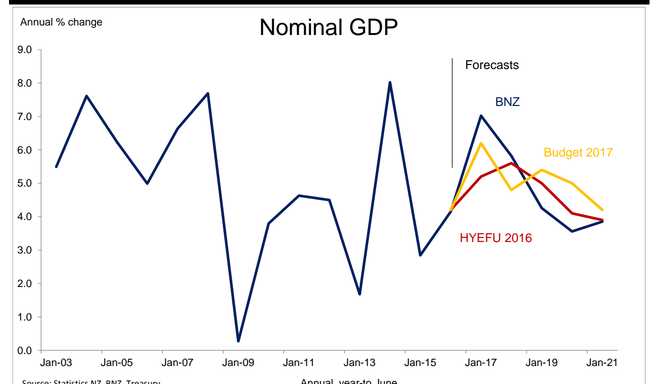
But we do take issue with Treasury’s view that the economy still has a degree of spare capacity as a starting basis (which we don’t). Even the RBNZ admits the output gap is closed now (albeit not turning as positive as it previously expected). Implicit to this is our warning that the economy will encounter capacity constraint sooner, and more obviously, than is implied by Treasury’s output gap projections.

With this in mind, it is worth noting that Treasury forecasts a slowdown in annual CPI inflation over the coming year, similar to what the Reserve Bank anticipates, and (yet?) a clear pick up in annual wage inflation over the

Really?



Achievable



coming year (to 2.6% in terms of QES average hourly earnings). For what it's worth Treasury also infers the Official Cash Rate will be starting to rise next year, with a 90-bank bill yield forecast of 2.7% by June 2018 on its way to 3.9% by mid-2021. This looks more likely than the RBNZ's latest projection of no change over this horizon.

Also to note is that Treasury's macro forecasts are predicated on only a very gradual abatement in net inward migration, from recent record highs, along with sustained strength in house prices (involving 7.8% inflation for the year to June 2018). This despite the clear construction response that was touted by Finance Minister, Steven Joyce, at today's Budget lockup.

In perhaps the worst kept secret of the 2017 Budget, tax thresholds will be going up. Not soon, but not that far away either, on 1 April 2018. Finance Minister Joyce did mention there was discussion about earlier implementation, but that it would have been practically difficult for IRD to implement at such a short time frame.

The starting band will reach up to $22,000, currently $14,000, in respect to 10.5 cents in the dollar. The top of the 17.5 per cent band will edge up to $52,000, from $48,000 presently, while the 30 cent bracket still ends at $70,000k. Above this, 33 cents in the dollar takes over, as is the case now.

Not to be forgotten (in an election year especially), students will get more in the way of accommodation supplements. The average superannuitant will supposedly be better off by $29 dollars per week, as a result of the Family Incomes Package (FIP) announced in today's Budget.

All up, the fiscal cost of the FIP gets to about $2b at an annual rate. This averages out to about $20 per week, per worker – very roughly speaking. It's more than double that for low income families with young children, a deliberate skew on the part of the government.

In terms of household income we also need to mention the pay-equity settlement that was finalized a couple of months ago, worth around $4b over the coming four years. But also that this cost was largely provided for in the Half-year Economic and Fiscal Update.

Some the shine to household income was taken off by the announcement that the Earthquake Commission (EQC) levy will, come 1 November, rise from 15 cents to 20 cents per $100 of cover. This will equate to a rise in the annual premium of up to $69 for the average homeowner. This is designed to accelerate recovery in the EQC fund, which has been largely drained by the Kaikoura quake, having been on the road to replenishing itself after the massive hit from the Canterbury quakes.

Then there was all the money doled out to various government departments. While these, like the FIP, are no small amounts they merely reiterate what was formally "leaked" in the run up to today's Budget.

There is also the substantive "below the line" stimulus that the government confirmed today, in respect to capital expenditure. It's difficult to isolate how much of this is genuinely new expenditure, compared to the HYEFU. But even if it is only a top up, it affirms a very strong public CAPEX track in absolute terms – one which has really ramped up since about 2014 and won't really peak, growth wise, until another couple of years.

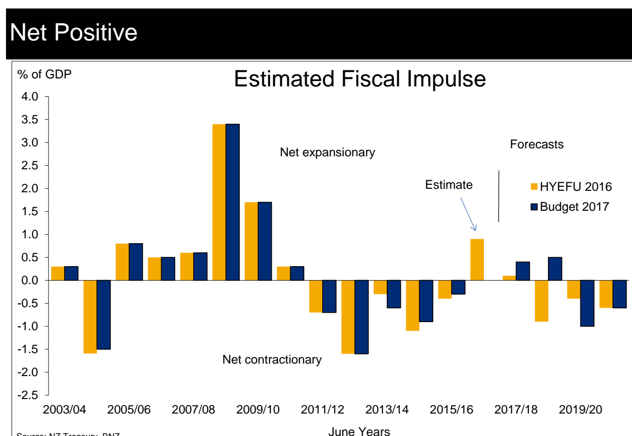
But, as Steven Joyce mentioned, think of the CAPEX program as being funded by the operating surpluses that are in the Budget projections. Thus it is no cause for net borrowing.

Accordingly, it was little surprise to learn that the government's bond program is largely unchanged, albeit with a $1b bump up to the 2019/20 schedule, taking it to $7b. Of more immediate interest was the announcement by the Debt Management Office (DMO) that it would be issuing a new 20 April 2029 nominal bond, expected to be launched, via syndication, before 31 December 2017.

There was also news from the DMO in that the government "intends to maintain levels of NZGBs on issue at not less than 20 per cent of GDP over time." This is to recognize "the importance of maintaining a sustainable NZGB market." This has come into focus, with the forecasts of falling net debt, to a now lower target of between 10 to 15% of GDP over the longer term, to be achieved by 2025. DMO's announcement should thus be seen as giving assurance to markets that there will be a line in the sand on gross debt proportions.

For those interested in the bottom line numbers, the core (OBEGAL) operating surplus is seen to be 0.6% of GDP in this present fiscal year (2016/17) – in spite of the now-included costs of the Kaikoura quake – rising gradually to 2.2% of GDP by 2020/21. Net core Crown debt, having peaked at 25.5% of GDP back in 2012/13, continues its moderating path, getting down to 19.3% by 2020/21. Including the NZ Superannuation Fund it is supposed to get down to 5.4%, close to its low just before the 2008 recession and GFC.

Net Positive



But we really need to finish the way we started, by highlighting the economic stimulus that today's Budget confirms. While there is always debate about fiscal impulse metrics, the Treasury's own version signifies a move into stimulus territory for the next couple of year – and absolutely so, not just in terms of marginal effect. This is something that the Reserve Bank will have to factor into its forecasts. We will have to work through the implications for our forecasts as well, with a view to upgrading them.

The markets, meanwhile, have taken today's Budget largely in their stride. While the document confirmed a fair degree of net stimulus, this has been well telegraphed by all and sundry.

In relation to this, we also await any comment by the rating agencies. They might well be busy taking a closer look at other countries' ratings – Australia and China included as recent examples. However, we can imagine they will have an easy job affirming New Zealand's government rating and outlook (even looking to upgrade for those not currently attributing a triple-A, if we could be so bold?).

Budget 2017	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
	actual	actual	actual	actual	actual	f/cast	f/cast	f/cast	f/cast	f/cast
(June years, % of GDP)										
Core Crown Revenue	28.1	29.2	28.4	29.7	30.1	30.0	29.7	29.5	29.7	29.8
Core Crown Expenses	32.0	32.0	30.1	29.8	29.2	28.8	28.6	28.1	27.7	27.5
OBEGAL	-4.3	-2.0	-1.2	0.2	0.7	0.6	1.0	1.4	2.0	2.2
Gross Sovereign Issued Debt (excl settlement	39.1	38.5	37.5	38.3	36.9	35.4	32.2	30.7	29.0	26.3
Net Core Crown Debt	23.6	25.5	25.4	25.0	24.4	23.2	22.8	22.1	20.6	19.3
Domestic Bond Programme ($NZm)	15,000	14,000	8,000	8,000	8,000	8000	7000	7000	7000	6000
(June years)										
Real GDP (annual average % change)	2.7	2.2	2.5	3.3	2.7	3.1	3.5	3.8	2.9	2.4
Consumer Price Index (annual % change)	1.0	0.7	1.6	0.4	0.4	1.8	1.6	2.1	2.2	2.1
Unemployment rate (June qtr)	6.3	6.0	5.2	5.5	5.0	5.0	5.0	4.6	4.3	4.3
90-day Bank Bill Yield (March qtr. av.)	2.6	2.6	3.4	3.5	2.4	2.0	2.0	2.7	3.4	3.9
Trade Weighted Index (March qtr. av.)	72.4	76.3	81.5	76.2	73.6	76.1	76.6	76.9	76.7	74.7

Budget - HYEFU 2016	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
	actual	actual	actual	actual	actual	f/cast	f/cast	f/cast	f/cast	f/cast
(June years, % of GDP)										
Core Crown Revenue	0.0	0.0	-0.1	-0.2	-0.1	-0.4	-0.4	-0.6	-0.6	-0.8
Core Crown Expenses	0.0	0.0	-0.2	-0.2	-0.2	-0.8	-0.1	0.0	-0.2	-0.2
OBEGAL	0.0	0.0	0.0	0.0	0.0	0.4	-0.2	-0.4	-0.2	-0.5
Gross Sovereign Issued Debt (excl settlement	0.0	0.0	-0.1	-0.3	-0.2	-1.4	-1.7	0.1	0.2	0.4
Net Core Crown Debt	0.1	0.0	-0.1	-0.1	-0.2	-1.1	-1.0	-0.1	0.3	0.5
Domestic Bond Programme ($NZm)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1000.0	0.0
(June years)										
Real GDP (annual average % change)	-0.1	-0.1	-0.5	0.0	-0.1	-0.5	0.0	0.9	0.5	0.1
Consumer Price Index (annual % change)	0.0	0.0	0.0	0.0	0.0	0.3	-0.4	0.0	0.2	0.0
Unemployment rate (June qtr)	0.0	0.0	0.0	0.0	0.0	0.2	0.4	0.4	0.0	0.0
90-day Bank Bill Yield (June qtr. av.)	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.4	0.2	0.0
Trade Weighted Index (June qtr. av.)	0.0	0.0	0.0	0.0	0.1	-0.4	1.7	1.9	2.2	2.1

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