9 October 2018

Robertson Rightly Plays Down Fiscal Fillips

- **2017/18 fiscal surplus lifts to 1.9% of GDP**
- **Net debt dips below 20% "target"**
- **But on spending delays rather than tax**
- **Govt. books running close to Budget, at heart**
- **Treasury's GDP forecasts for 2019 vulnerable**
- **But its inflation forecasts have cause to lift**

Hat's off. This afternoon's Crown financial accounts were pretty good; certainly a chunk better than we figured on. But not quite as good as the headlines portrayed. Finance Minister, Grant Robertson, made this clear in his press release in stating that;

"The headline results today are ahead of the Treasury forecasts in Budget 2018. This was largely due to timing issues with Crown expenses, which will reverse out as planned spending occurs early in the 2018/19 year. This means Budget 2018 spending and investment plans are on track."

He reiterated this point in his address at the lunch-time lock-up, as part of an underlying caution that was most becoming of the Finance Minister. The gatekeeper of the government accounts. Charges from lock-up attendees that we "were flush with cash" and actually going "below target on debt", so why not spend up large, were met with a strong sense of responsibility regarding the medium term, and risk. And fair enough too.

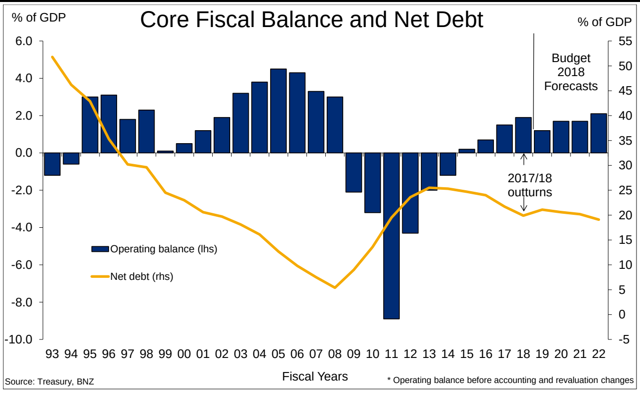
So let's not get ahead of ourselves…from the fact the year to June 2018 core operating surplus beat May's Budget expectation by a whopping $2.4b. This meant for an outright surplus of $5.5b, equivalent to 1.9% of GDP, when 1.1% was anticipated.

That this essentially occurred on the basis of one month's worth of information, added to the eleven months to May we already knew about, along with end-year accounting methods, did reek of something transitory.

Nor, then, should we read too much into net core debt jagging down to $57.5b, when $60.4b was anticipated. The trends are not necessarily our friends.

Still, these are pretty strong results taken at face value. It's worth noting, in particular, that it puts net debt down at 19.9% of GDP. Strictly speaking, this achieves the

Timing Issues



government's stated intention to have it at around 20% within five years of taking office.

However, Robertson was once again bridled with his enthusiasm, pointing out that 20% is a medium term debt target, and the actual results may fluctuate around this from year to year, over the interim.

It was a similar story with the government expenses, which came in at 27.9% of GDP for the year to June 2018. The government has talked about 30%. Robertson was quick to describe this as a guideline, not a target, and how many things could throw this about over the coming years (including an insufficient denominator, namely nominal GDP).

And to elaborate on the timing issues involved in the 2017/18 Crown accounts, Treasury went on to note in its documents that;

"the lower than forecast (result for core Crown expenses) was largely owing to changes in demand for services (e.g. lower than forecast expenses across the education sector and lower than expected year-end family tax credit claims); one-off factors such as lower than forecast impairments; and timing delays with expenditure now expected to be spent in the 2018/19 fiscal year (e.g., Provincial Growth Fund and social housing expenses).

With perceptions from some quarters that Labour-centric governments are wont to spend too much, the issue is more one of not being able to spend enough. The potential for catch-up is something to bear in mind for expenditure GDP hence.

It's not as though the fiscal surfeit is coming from tax revenue. To be sure, the tax take is growing strongly – something like 6.1% over 2017/18 as a whole. But it was only 0.6% ahead of Budget.

And, much depends on economic growth continuing to defy business confidence, in order that the Budget's tax forecasts come to pass. To be sure, Treasury was bold to have maintained strong GDP growth forecasts in the face of collapsed business confidence. And it can probably feel vindicated in this, at least for now.

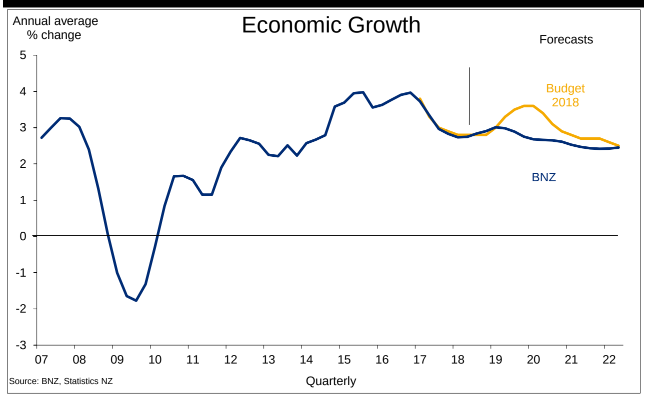
The starting point on real GDP Treasury assesses as roughly in line with Budget. While Q2 GDP growth was above expectations, remember that Q1 GDP (published after the Budget) undershot.

Also, we think Budget expectations for GDP growth over the second half of 2018 are achievable. At 0.8% for Q3 and 1.0% for Q4, they are not too different to our forecasts of 0.8% and 0.8% respectively.

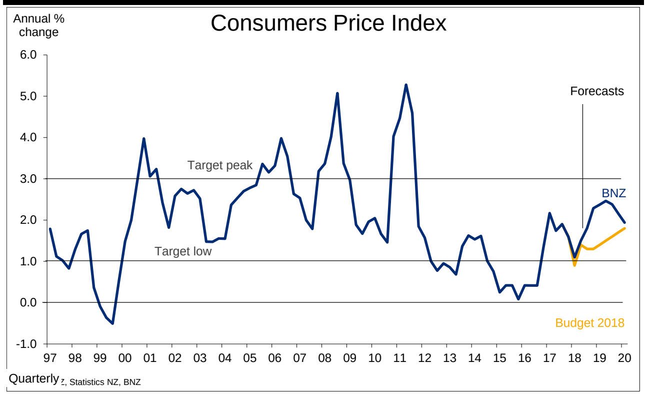
However, after this we go our separate ways. The Budget expected GDP growth to ramp up to 3.6% for calendar 2019 and glide long at 2.9% for 2020. We project 2.8% and 2.6% respectively, a cumulative difference of 1.1%. Use our numbers for tax revenue and we suspect the trajectories on surplus and debt would not look so pretty.

But it's not just Treasury's GDP forecasts that bear thinking about. As much as these might face some downside risk further down the track, Treasury's inflation forecasts arguably face upside surprise. And not just as a medium term phenomenon, or because of the lower than anticipated exchange rate. The Budget looks to have undercooked near-term CPI inflation.

Really?



An Offset?



We expect this to become clear as soon as the Q3 CPI release, set for Tuesday next week. If so, we wonder how Treasury might be feeling about the OCR hikes that were already inferred in the Budget, to begin by early 2019. Or will reservations on the GDP growth front offer a strong counterpoint?

Our forecasts of CPI and wage inflation are certainly stronger than those of the Budget.

How potentially slower real GDP growth, versus stronger inflation nonetheless, balances out in terms of nominal GDP will be important to think through. The latter is what ultimately drives tax revenue, and elements of government expenditure.

We should also be mindful of public investment. Grant Robertson was as upbeat on this as he was cautious on the non-CAPEX spending lines that run through the operating surplus. In many ways these are separate issues. However, the government's CAPEX still will wash through to the cash requirement all the same and, hence, the debt programme.

All of this brings into focus the Half-year Economic and Fiscal Update (HYEFU). This is due to be published around mid-December. To our mind, it's still shaping up to be a difficult balancing act, conscious of the fact the 2017/18 accounts were not quite as buffed as they looked.

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