Government delivers infrastructure boost

- $12 billion increase in infrastructure investment
- Operating expenses to be revised upward at the Budget
- Fiscal deficits to return
- But minimal impact on bond programme or rating agency concerns
- Fiscal stimulus reduces chance of RBNZ cut

Key data

The Government reports an estimated fiscal surplus of 2.4% for the year ended June 2019, substantially greater than the 1.2% estimated at Budget time.

The budget balance will move into deficit this financial year (0.3% of GDP). It is forecast to return to surplus (0.5% of GDP) in the year to June 2022. It rises to 1.5% of GDP by June 2024.

Net core crown debt will rise from 19.0% of GDP to 21.5% in June 2022. It is then forecast to fall to 19.6% of GDP by June 2024.

Treasury forecasts GDP growth of 2.2% for the year ended June 2020. Growth of 2.8%, 2.7%, 2.5% and 2.4% are then expected in the years ended June 2021, 2022, 2023 and 2024 respectively.

The bond tender programme for the three years ended June 2022 is unchanged. An extra $2.0 billion will be issued in 2022/23 raising that year’s offering to $8.0 billion. In 2023/24 the bond tender programme will be $6.0 billion.

Infrastructure investment the primary focus . . .

The focus of today’s Half Year Economic Update was always going to be about the extent and nature of the promised boost to government infrastructure spending.

And, for all intents and purposes the government delivered on that promise in announcing an extra $12.0 billion in capital expenditure.

There was minimal detail but what we did learn was there will be:

- $6.8 billion for new transport projects
- $400 million for schools
- $300 million for regional investment
- $300 million for District Health Boards
- $200 million for public estate decarbonisation and
- $4.0 billion so far unallocated.

The Minister of Finance said the projects have been decided upon but the government is just addressing the finer points before announcing the specifics. Of course, politically, dribbling the announcements out through an election year might be of some appeal too.
The big question that hangs over this is whether there is capacity in the economy for the government to achieve its infrastructure aims. That said, the expenditure is introduced over a long time period with $3.9 billion of the extra spending on hold until after 2025. And almost nothing is deployed until the $1.4 billion allocated for the year ended June 2021.

**Bond tender programme revised modestly . . .**

With such a large amount of expenditure in the pipeline it would have been reasonable to assume that the government’s funding programme would have to increase in step with the extra capex. As it transpired, this was far from the case.

The bond tender programme for the three years ended June 2022 was completely unchanged on the Budget announcement. Only in 2023 does the bond tender programme increase to $8.0 billion from $6.0 billion previously. Additionally, the government will have $1.0 billion of T-bills extra on issue in 2023.

The government also announced that its bond programme for the year ended June 2024 will be $6.0 billion. One can only assume that had this year been forecast at the time of the Budget the amount predicted would have been significantly lower.

There are multiple reasons why the tender programme did not expand significantly:

- Of particular importance to the near term is the fact that the government’s starting point was much better than originally assumed with the core operating balance (OBEGAL) finalised at 2.4% of GDP compared to an initial estimate of just 1.2%;
- $3.9 billion of the capex occurs outside of the time frame for the bond issuance forecasts;
- There will be $1.0 billion extra T-bills on issue;
- Lower interest rates mean that the gross debt issuance can be less to achieve the same cash flow impact;
- The DMO smooths its funding profile and was, effectively, overfunding previously;
- The changed needs is thus reflected in reduced financial assets held by Treasury.

The lower than anticipated bond issuance resulted in a small rally in the bond market but we think this will soon get lost in the wash. Importantly, we believe the eventual bond programme will end up higher than currently postulated. The key here is that the Government today only announced its heightened capex intentions. The next phase will be to announce what it will do to its operating expenditure which will, inevitably, be raised. Indeed, the Minister of Finance Grant Robertson was quite specific in his press conference that there was room to do this in the upcoming Budget especially given that his current targets leave the prospective net debt forecasts well inside the government’s upper limit of 25% of GDP.

The other upside threat to the bond tender programme is the possibility that growth will again come in lower than Treasury’s assumptions. Treasury forecasts GDP growth of 2.2% in the year ended June 2020 followed by 2.8%, 2.7% and 2.5% in the following years. Cumulatively over this period we have a growth profile that is 1.3% lower. That said, we haven’t yet had the chance to build today’s fiscal spending news into our own forecast track.

From a Reserve Bank perspective, the change in the fiscal position is all “good” news. Treasury estimated fiscal impulse in the June year 2020 has risen to 0.9% from 0.0% previously forecast. The following year it’s 0.3% from -0.2%. And this is before the government announces any operating expense increases.
Less reason for RBNZ to ease . . .

The RBNZ will not have these new numbers embedded into its forecasts. Once it does so it must result in a stronger growth path resulting in increased inflationary pressure and more demand for labour. While you can’t say categorically that it will make the RBNZ more hawkish you can say that it won’t in any way shape or form encourage it to cut rates.

Deficits on their way . . .

In all the hype one of the headlines that will tend to be overshadowed is that the government’s books will move into deficit this fiscal year for the first time since 2014. Back in May, when the government released its Wellbeing budget, we headlined our note “Deficits Return in 2020”. We feel vindicated in so doing. Equally, with further downside risk to treasury’s growth forecasts and more operating expenditure yet to be announced, there is now a high chance that deficits are here to stay for a while.

Nonetheless, deficits in and of themselves should be of little concern. The government looks well placed to keep its net debt under its upper target of 25% of GDP which, in turn, should not unduly concern the rating agencies.

As we have said before, the most important thing for the government to ponder is whether the quality of its expenditure is appropriate rather than focusing exclusively on the quantity. It is also important in the investment space that the government does not crowd out the private sector.

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