23 August 2017

No More Money

- Fiscal revisions will disappoint some
- Recent tax gains seen as temporary
- Potential for more election giveaways reduced
- But an enviable set of accounts, nonetheless
- Treasury more hawkish than RBNZ

Those looking for Treasury to announce that there was money to burn when it presented today's Pre Election Fiscal Update will be very disappointed. There were many who had assumed that the recent windfall gains that were flowing into tax revenues would provide the base for a much stronger future revenue track. They didn't. Consequently, while the fiscal numbers still look very good, especially by international comparison, they will not provide parties lobbying for extra votes the capacity to offer any more giveaways than the previous set of Government accounts allowed.

Sure, the expected core crown operating surplus (OBEGAL) for the year ended June 2017 was revised substantively higher to 1.4% of GDP from the previous estimate of 0.6% but future years have been revised modestly lower.

This year's cash windfall temporary…

The upward revision to the recent past year is, for all intents and purposes, already cooked into the books. And there are two key reasons why this is not expected to feed through into later years:

- The Government has slightly lowered its medium term nominal GDP forecasts which will adversely impact future tax flows; and

- It is believed that a significant portion of the current tax gains are not repeatable. In particular, there had been a significant increase in the tax take associated with the high returns investors had achieved over the last year. In an environment that is becoming less investment friendly (read: interest rates are pushing higher) such high past returns are being seen as one off in nature.

Treasury's fundamental view of the economy has not changed. Without any serious shock this is to be expected given that the Budget was only delivered in May. As is widely accepted, growth is seen to be driven by:

- migration-led population expansion;

- an improving global environment;

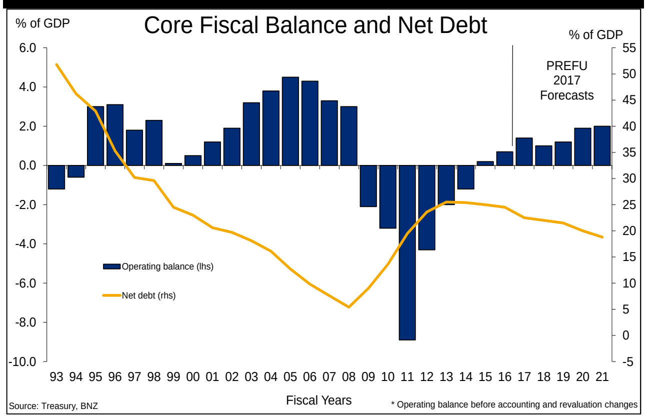
- fiscal stimulus; and

- stimulatory monetary policy.

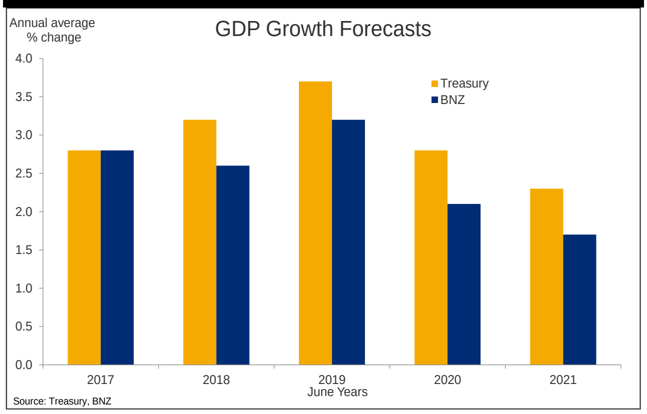
Growth profile edged lower…

Nonetheless, the overall real growth profile has been revised lower to the tune of almost 1.0%, cumulatively, for the five years ended June 2021. In the first instance, this reflects the base effect of recently released GDP figures which have proven to be lower than expected. Additionally, though, there is a nod to the fact that constraints are limiting the economy's ability to expand. Particular reference is made to the residential construction sector where growth expectations have been significantly reduced with Treasury citing labour constraints, the rising costs of construction and tighter financial conditions as the reasons for the downgrade.

Fiscally sound



Growth Forecasts a tad optimistic



National Australia Bank

Putting all this together, Treasury's nominal GDP track is lowered by a total of $2.6bn over the next four years which, in turn, reduces the tax take.

Generally speaking, we see nothing outrageous in Treasury's real GDP or inflation forecasts though we do think the risks lie more to the downside for GDP than the up.

Nothing in it for markets . . .

From a markets' perspective, people may be interested in the fact that Treasury believes the NAIRU for New Zealand is just 4.25%, well below its current level but no different to what it said back in May. Similarly, it reasserts its view that the neutral nominal 90-day interest rate is 4.5%.

For what it's worth, Treasury sees the 90 day bank bill rate averaging 2.6% in the year to June 2019 implying that the cash rate rises by at least 50 basis points during that year – a much more aggressive profile than the central bank.

New Zealand's fiscal position remains the envy of many. If all things turn out as planned the strength in the accounts means that prospective governments can continue to provide fiscal stimulus while still running rising fiscal surpluses and overseeing falling net debt.

What the accounts don't mean, though, is that there is any more money for parties to either expend or reduce taxes with than was originally thought. The prospect of enhanced pre-election "bribes" is now significantly reduced. There is plenty of room for further fiscal laxity down the track as net core crown debt levels trend lower but it is still not until June 2020 that net debt falls to 20% of GDP – a debt target considered worthy by Labour and a stepping stone to 15% by National.

Bond tender programme unchanged . . .

For completeness, we note that the Government Bond tender programme is unchanged, which is hardly surprising under the circumstances.

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PREFU 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	30.4	29.9	29.6	29.8	29.9
Core Crown Expenses	32.0	32.0	30.1	29.8	29.2	28.6	28.7	28.2	27.7	27.7
OBEGAL	-4.3	-2.0	-1.2	0.2	0.7	1.4	1.0	1.2	1.9	2.0
Gross Sovereign Issued Debt (excl settlement	39.1	38.5	37.5	38.3	36.9	34.6	31.7	30.4	29.0	26.2
Net Core Crown Debt	23.6	25.5	25.4	24.9	24.5	22.5	22.0	21.5	20.0	18.8
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)	2.6	2.2	2.5	3.3	2.7	2.8	3.2	3.7	2.8	2.3
Consumer Price Index (annual % change)	1.0	0.7	1.6	0.4	0.4	1.7	1.3	1.9	2.1	2.1
Unemployment rate (June qtr)	6.3	6.0	5.2	5.5	5.0	4.9	4.7	4.4	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	2.6	3.3	3.8
Trade Weighted Index (March qtr. av.)	72.4	76.3	81.5	76.2	73.6	76.5	78.1	78.5	78.7	78.0

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