No major surprises

Budget 2018 First Impressions

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June years	2018	2019	2020	2021	2022
OBEGAL ($bn)	3.1	3.7	5.4	5.7	7.3
Change since HYEFU	0.6	0.9	0.4	-0.8	-1.5
Net debt (% of GDP)	20.8	21.1	20.6	20.2	19.1
Change since HYEFU	-0.9	-1.1	-1.3	-0.6	-0.2
Bond programme ($bn)	7	8	8	8	7
Change since HYEFU	0	1	1	1	0

There were no major surprises in today's unveiling of the 2018 Budget. That was somewhat inevitable, given that this Budget was shaped by the new Government's self-imposed fiscal responsibility rules and was well signalled in advance.

The Budget featured both higher revenue and higher spending, relative to last December's Half-Year Fiscal and Economic Update (HYEFU). Tax revenue has again surprised to the upside in the current fiscal year, and this upside surprise is assumed to persist. That seems a reasonable assumption, as the surprise mostly reflects the fact that, after last year's GDP revisions, the economy is larger than the Treasury believed when it prepared the HYEFU forecasts.

Against this, the Budget provides for a substantial increase in operational spending allowances, particularly in the later years. The net result is a slightly smaller cumulative surplus over five years, but with larger surpluses in the near term and smaller surpluses in later years.

As signalled during the election campaign, the greatest share of new spending has gone towards health and education, receiving $3.2bn and $1.6bn respectively over the next four years. There were substantial spending increases across a range of portfolios, but there was no one initiative on the scale of the Families Package and the year of free tertiary study that were already announced in December.

For businesses, the only significant announcement in the Budget was the R&D tax credit that had previously been signalled. However, with the incentive limited to firms who spend more than $100,000 per year on R&D, the benefit is likely to accrue primarily to a few large firms rather than a larger number of small to medium sized businesses.

There was some additional funding for biosecurity in the Budget, but the relatively small amount slated to deal with the Mycoplasma bovis outbreak is noted as a risk by the Treasury. More will undoubtedly be required over the coming year.

There was no increase in projected capital spending over the next four years, although there was a modest increase in the allowance for capital spending for future Budgets. This recognises that there is already a full pipeline of infrastructure spending, which will be difficult to deliver in the face of capacity constraints.

A higher level of GDP, and larger surpluses in the near term, mean that net core Crown debt is well on track to fall below 20% of GDP in the projections. By the June 2022 fiscal year, net debt is expected to decline to 19.1% of GDP.

The Government's overall borrowing programme for the next four years has been increased by $1bn compared to the HYEFU. However, this consists of $3bn of additional bond issuance, partly offset by a $2bn run-down in the level of short-term Treasury bills outstanding. In addition, Housing NZ is expected to borrow up to $2.9bn in its own name to invest in more social housing. At the margin, this will put a little more upward pressure on the long end of the yield curve, which is already being dragged higher by overseas trends.

The economic forecasts that underpin the Budget assume a reasonably strong economy, with average GDP growth of around 3% over the next five years. We still think that this is on the high side, but the gap between our view and the Treasury has been narrowing over time. The projected pickup in growth is later than previously assumed, partly because the Treasury has heavily revised its assumption of how quickly the KiwiBuild programme will lead to a lift in homebuilding.

Today's Budget was largely a business as usual document for a new Government balancing election promises, support partners and its Budget Responsibility rules early in its term. Next year's Budget could be a different beast, once the Living Standards Framework is integrated and the working groups on tax, education and social welfare report back with policy ideas.

Market reaction

There was no reaction in the NZ dollar to the Budget.

However, the yield on longer term government bonds rose on the increase in bond supply.

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