Wellbeing on a Budget

Budget 2019 Preview

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- Finance Minister Grant Robertson delivers his much vaunted "Wellbeing Budget" next week.
- The accompanying array of Budget documents will cover a much broader range of topics than usual.
- The fiscal accounts are likely to show the Government is running out of wiggle room. The weaker than expected starting point for the economy will be weighing on the Treasury's revenue projections, and the recent run of surprisingly strong tax revenues has come to an end.
- We expect little additional spending to be announced in next week's Budget although we could see some reprioritisation of spending. Despite this, the Government is still likely to need to borrow a bit more.
- Beyond 2021/22 the Government has given itself some extra headroom by softening its net debt to GDP target. That could leave room for more of a spend-up in future years.

The much vaunted Wellbeing Budget will finally be unveiled by Finance Minister Grant Robertson next week. Well over a year in the planning, the Wellbeing Budget aims to broaden the definition of success beyond traditional financial metrics, and report on a broader range of indicators which measure the things that impact the lives of New Zealanders.

The Government's five priorities for the Budget are:

- Creating opportunities for productive businesses, regions, iwi and others to transition to a sustainable and low-emissions economy
- Supporting a thriving nation in the digital age through innovation, social and economic opportunities
- Lifting Māori and Pacific incomes, skills and opportunities
- Reducing child poverty and improving child wellbeing, including addressing family violence
- Supporting mental wellbeing for all New Zealanders, with a special focus on under 24-year-olds.

In line with this, pre-Budget announcements to date have included additional funding for addressing homelessness, programmes aimed at reducing the reoffending rate of Māori prisoners and an investment in family and sexual violence and support services.

While the broader focus of the Budget documents is a welcome development, it will come in addition to information on the more traditional economic and financial measurement of the Government's performance. Details of the Crown accounts and fiscal projections will continue to form a core part of the Budget. Here the Government will be facing a few challenges.

The tightrope the Minister of Finance is walking between revenue (i.e. the tax take) and spending has gotten a bit thinner since December's Half Year Economic Update. Granted, the 2018/19 surplus is looking a little healthier than expected. But that's largely down to a positive surprise on non-tax revenue. In contrast, the tax take has been a little lower than forecast, concluding the recent run of positive revenue surprises from this source.

Beyond 2019, the picture is likely to look a bit less rosy. GDP growth was notably softer than the Treasury had expected over the second half of 2018. Furthermore, recent indicators suggest lacklustre growth continued in the first half of 2019.

This weaker starting point will weigh on revenue forecasts. And although the Treasury, like us, may well still expect the pace of growth to pick up beyond 2019, this won't fully offset the weaker starting point. The upshot is that the Government will have about $6 billion less in the kitty over the next 5 years than they had been expecting at the time of the December HYEFU.

This is likely to mean the Government needs to borrow more in the coming years than it was previously projecting. However, it's not all one way traffic. As we've noted previously, the Government has struggled to lift investment as much as it would like to in recent years due to capacity constraints. Next week's Budget is likely to show a capital underspend of about $1 billion this fiscal year. While allocated spending is still likely to happen, it will now occur later than previously envisioned, temporarily improving the Government's net debt to GDP position.

With revenue likely to surprise on the downside, we expect the Government will need to increase its borrowing by about $4 billion over the next 5 years. Most of this is likely to occur post 2021/22 where the Government has allowed itself some extra headroom by relaxing its net debt to GDP target.

The other reason we expect capital spending plans to be pushed out into the later years of the forecast is the softer approach the Government has taken on their Budget Responsibility Rules. While we still expect the net debt to GDP ratio to squeak under 20% of GDP in 2021/22, beyond this the Minister of Finance has signalled the Government will take a more flexible approach.

Instead of continuing with a target net debt cap of 20% of GDP, beyond 2021/22 the Government has signalled it will be comfortable allowing net debt to GDP fluctuate between 15-25%. While this is in theory a symmetrical band around the current target, in reality only the upper end of the range will be binding. The pressure is always on for Governments to spend more rather than less. Lifting the self-imposed ceiling on debt gives the Government more leeway to maintain spending or capital investment plans despite weaker growth projections.

However, we are cautious about the aging population. New Zealand fiscal position is strong right now, and even if net debt hits 25% of GDP at some point, it's still low by international standards. But in the future the ballooning cost of national superannuation and health care will severely strain the Government's finances. It would not be particularly prudent to increase debt faster than GDP growth just before the demographic time bomb goes off. Some might argue that the Government should take advantage of opportunities to invest, but building the economy depends far more on the quality of spending than the quantity.

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	Actual	Treasury HYEFU forecasts					Likely direction of changes
June years	2018	2019	2020	2021	2022	2023	
OBEGAL $bn	5,534	1,724	4,113	5,084	7,562	8,438	Smaller surpluses likely.
Net debt (% of GDP)	20.0	20.9	20.7	20.1	19.0	17.4	Likely to increase relative to HYEFU, but should still be below 20% by 2022.
Bond programme ($bn)	7	8	8	8	7	6	Higher debt to spur increase in bond issuance in later years.
Real GDP (ann avg % change)	2.7	2.9	3.1	2.7	2.5	2.3	Weaker near term activity to be reflected in slower growth forecasts.
CPI (ann % change)	1.5	2.0	2.0	2.0	2.0	2.0	Lower in the near term reflecting weaker stating point.
10-year Government bond yield	2.8	3.0	3.4	4.0	4.3	4.4	To be revised lower following following global long term rates.

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