Economic Bulletin.

13 May 2021

Preview of 2021 Budget, 20 May 2:00pm.

- Budget 2021 will show a dramatic improvement in New Zealand's fiscal position compared to the Half-Year Update.
- Essentially, the Covid hit to the Government's books has been significantly less than anyone feared and particularly so for the Treasury.
- Tax revenue and the operating balance tracks will show large upward revisions, and with a sharply lower debt track, Treasury will pare back bond issuance plans.
- While banking some of this upside surprise, the Government has also indicated that it will dial up its spending and investment plans in Budget 2021.

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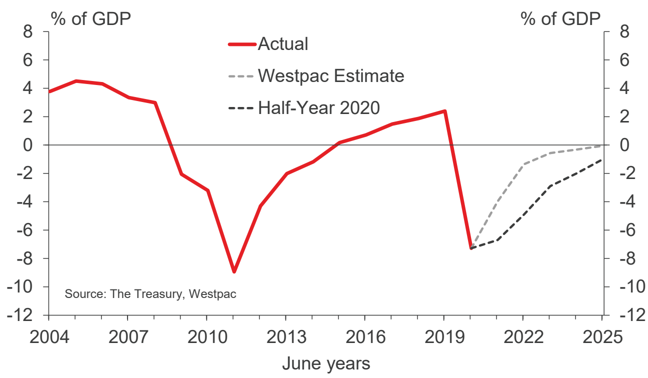
In the good books.

Essentially, the Covid hit to the Government's books has been significantly less than anyone feared. The Government's Covid response has been a resounding success. The benefits of last year's strict lockdown have flowed not only in a health sense, but also economically and financially. And economic policies like the wage subsidy have been similarly effective.

Putting some numbers on the success, we expect this year's operating balance to end up around $8 billion higher than the Treasury forecast back in December. And from there, we anticipate that the deficit will progressively narrow so that the operating balance nears zero by 2025. These kinds of numbers so soon after the pandemic will be the envy of many nations.

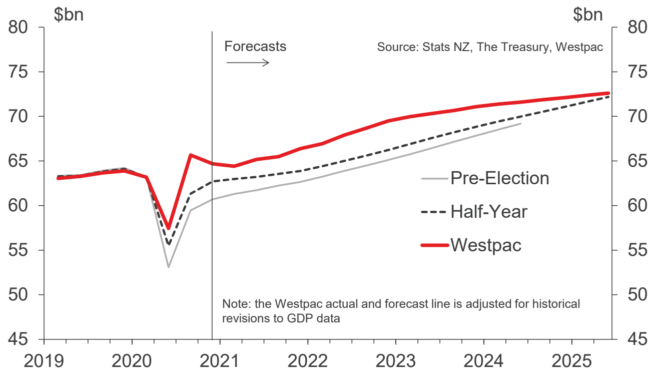
The prospect of an operating balance returning to near surplus should by no means be read as an obsession with balancing the books. On top of this, the Government is planning several billion dollars per year of capital spending (which it will top up further in this Budget). Altogether, it will still be spending much more money than it brings in over the next five years, and still has a significant borrowing requirement.

Operating balance (OBEGAL) as a % of GDP



Some of the improvement in the accounts reflects that the Treasury's economic forecasts were the most pessimistic of the lot. For example, we expect 4.7% growth in the June 2021 year, whereas back at the end of last year the Treasury had projected just 1.5%.

Real GDP level



Treasury's large upward revisions will also ultimately flow through to a significantly smaller bond issuance programme. For 2022 through 2025, we expect just $20 billion of annual bond issuance. That's some $10 billion less than what Treasury previously forecast for 2022 through 2024 and $5 billion less for 2025. 2022 could justifiably go even lower, given overborrowing in 2021, but we think they will look to smooth the path of issuance.

Bond Programme, $bn (June year)

	2021	2022	2023	2024	2025
Westpac estimate	**45**	**20**	**20**	**20**	**20**
Half-year	45	30	30	30	25
Change	0	-10	-10	-10	-5

Having its cake and eating it too.

Budget 2021 is also likely to be a case of the Government having its cake and eating it too. Such has been the magnitude of the positive surprise, Finance Minister, Grant Robertson, will be able to present massively improved fiscal accounts next week and at the same time also announce an increase in spending and investment plans.

Indeed, the Government has the political capital to burn. Its handling of the pandemic and its outright majority in parliament have given it the mandate to unashamedly pursue its policy goals. This means that effectively, the Government has returned to its Wellbeing Budget goals from 2019, with Covid recovery goals added as appropriate. As such the Budget 2019 priorities are:

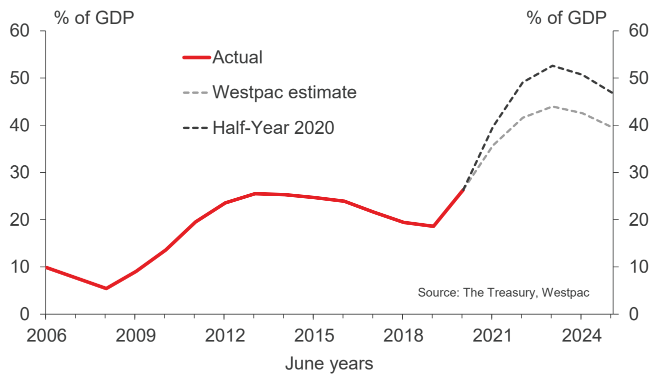
- **Just Transition** – Supporting the transition to a climate-resilient, sustainable and low-emissions economy while building back from COVID-19.
- **Future of Work** – Enabling all New Zealanders and New Zealand businesses to benefit from new technologies and lift productivity and wages through innovation, and support into employment those most affected by COVID-19, including women and young people.
- **Māori and Pacific** – Lifting Māori and Pacific incomes, skills and opportunities, and combatting the impacts of COVID-19.
- **Child Wellbeing** – Reducing child poverty and improving child wellbeing
- **Physical and Mental Wellbeing** – Supporting improved health outcomes for all New Zealanders and keeping COVID-19 out of our communities.

Putting this into effect, the Finance Minister has foreshadowed that he will lift Budget operating and capital allowances beyond that announced in the Budget Policy Statement back in February. We have allowed for an additional $1 billion and $2 billion for the operating and capital allowances, respectively. Given the size of the improvement in the books, we wouldn't rule out larger increases.

At the same time, we expect the Finance Minister will keep his powder relatively dry for future Budgets by keeping those allowances relatively modest. In that vein, Mr Robertson has stated that he views "this Budget as one of a package of three this term."

We have no fixed view as to what the additional spending is earmarked for other than it will broadly align with the Government's priorities listed above. That said, there isn't the same urgency to create jobs lost because of Covid, with the unemployment rate falling to a relatively low 4.7% over the March quarter. Recall that the unemployment was 4.0% pre-Covid and then peaked at 5.2% in the September 2020 quarter.

Net core Crown debt as a % of GDP



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