Westpac

Institutional Bank

15 May 2014

2014 Budget

A loosening of the purse strings

- The highlight of Budget 2014 was a notable increase in the spending allowance compared to recent years.
- The Government remains on track for a surplus in 2015 but projected surpluses in following years are substantially smaller.
- The projected spending changes are not significant enough to alter our growth or interest rate forecasts.

Summary of Budget and Economic Forecasts

	2013	2014	2015	2016	2017	2018
	Actual	Forecast	Forecast	Forecast	Forecast	Forecast
Economic (March years, %)						
Economic growth	2.3	3	4	3	2.1	2.1
Unemployment rate	6.2	5.9	5.4	5.1	4.8	4.4
CPI inflation	0.9	1.5	1.8	2.5	2.3	2
Current account balance	-3.9	-3.1	-4.4	-5.9	-6.2	-6.3
Fiscal (June years, % billions)						
Core Crown revenue	64.1	67.8	72.5	76.9	80.8	84.7
Core Crown expenses	70.3	71.6	73.1	76	78.7	81.5
Total Crown OBEGAL	-4.4	-2.4	0.4	1.3	2.4	3.5
Net core Crown debt	55.8	59.4	63.6	65.3	65.5	64.9

As expected, Budget 2014 included a variety of new spending initiatives primarily scattered across health, education and family support. What was most surprising to us was the Government's willingness to increase its allowance for new spending in the absence of significant new sources of funding. There were limited measures to find savings compared to previous Budgets, and revenue forecasts were little changed despite a stronger set of economic forecasts (bringing them largely in line with our own).

Instead, the Government was willing to sacrifice larger surpluses in later years (and indeed increase the borrowing programme) in order to fund this new spending. The forecast operating balance (less gains and losses) for the 2017/18 year has fallen from $5.6bn (in December's Half Yearly Fiscal Update) to $3.5bn, as rising expenses more than offset a small improvement in the revenue forecasts. Even so, the Government remains on track to meet its targets of a modest surplus in 2014/15 and reducing the net debt to GDP ratio below 20% by 2020.

From a macroeconomic point of view, the implications of this Budget are limited. The additional spending will provide a slight boost to GDP growth, and increases the pressure for higher interest rates, though only marginally so – indeed, Finance Minister English was clear that he had sought Treasury advice on how much the spending allowance could be increased before having a significant impact on interest rates. The increase in projected bond issuance over the next few years is unlikely to worry investors, and may even be welcomed to the extent that it adds to bond market liquidity. The net debt projections are likely to keep the credit rating agencies happy.

New Policy initiatives

After keeping a very tight rein on spending in recent years, the Government loosed the purse strings a little in today's Budget. New operating spending remains capped at $1bn in 2014, but increases to $1.5bn in 2015 and rises by 2% a year after this. That's an increase from the flat $1bn per year profile incorporated into Treasury forecasts prior to today's Budget.

As signalled, new spending focused a range of areas including health, welfare and education. Some of the initiatives announced today included:

- An extension to the paid parental leave scheme, from 14 to 16 weeks in April 2015 and to 18 weeks in April 2016.
- Free GP visits and prescriptions extended from under-6s to under-13s.
- Increased early childhood funding.
- New funding for tertiary education providers targeted at particular disciplines.
- Additional funding for elective surgery, disability and home based support services
- More funding for the community housing sector.

There were also further announcements about new capital spending allocated to the Future Investment Fund (funded by the partial sales of state-owned assets). $3bn of this fund has now been allocated in the last three budgets, leaving $1.7bn yet to be allocated.

Unlike in previous years, there were relatively few new initiatives on the revenue side of the ledger. As previously announced, Inland Revenue will get additional funding to bolster tax compliance and the duty-free tobacco allowance will be slashed. On the flip side, duties on some imported building materials will be temporarily suspended (estimated to reduce the cost of building a new home by $3,500) and there were some loosening of the criteria around R&D tax deductions.

Economic forecasts

The Treasury's economic assumptions over the next few years are similar to our own. GDP growth is expected to peak at 4% in the year to March 2015, slowing to around 3% in the following year and 2% afterward. Inflation is set to remain below 2% until the second half of next year (in part due to the ongoing strength of the exchange rate), but then to accelerate to around 2.5%yr over the following two years. With that in mind, the Reserve Bank is expected to continue to raise the OCR at a fairly rapid clip, reaching around 4% by March 2015 and then more gradually heading to a peak of about 5% by March 2018.

There are a few aspects where we feel the Treasury forecasts are on the optimistic side, particularly in the later years. First, they have assumed a fairly muted response to rising interest rates in the housing market, with house prices forecast to rise 7.3% in the year to March 2015, 4.3% in the following year, then settling at around 2.5% annual growth – i.e. real house price growth never turns negative. We expect a more substantial cooling in the housing market, which in turn would undermine the Treasury's assumptions about household spending growth and tax revenue.

Second, the Treasury is assuming a very gentle letdown in the pace of growth as the Canterbury rebuild passes its peak and the level of spending starts to fall. And the long-term fiscal forecasts are predicated on steady economic growth and rising surpluses as far as the eye can see. That assumption is not unusual, but it's worth noting in a year when the Government has chosen to leave itself a substantially smaller buffer for coping with the inevitable future downturns.

Bond programme

The additional spending means an increased cash requirement compared to the December Half-Year Update. Total issuance over the forecast period has been increased by $3bn to $37bn, with an additional $1bn in each of the 2015, 2017 and 2018 years.

Subject to market conditions, a new 15 April 2027 nominal bond, followed by a new inflation-indexed bond are expected to be launched, via syndication, in the first half of 2014/15. The maturity date of the inflation-indexed bond is yet to be determined. Inflation-indexed bond issuance will be up to $3bn of the $8bn 2014/15 domestic bond programme.

Anne Boniface
Senior Economist
Ph: 027 742 8816

Michael Gordon
Senior Economist
Ph: 021 288 5349

Westpac economics team contact details

Dominick Stephens, Chief Economist
+64 9 336 5671

Michael Gordon, Senior Economist
+64 9 336 5670

Felix Delbrück, Senior Economist
+64 9 336 5668

Anne Boniface, Senior Economist
+64 9 336 5669

Any questions email:
economics@westpac.co.nz

For email address changes contact:
WNZResearch@westpac.co.nz

Disclaimer

Things you should know: Each time someone visits our site, data is captured so that we can accurately evaluate the quality of our content and make improvements for you. We may at times use technology to capture data about you to help us to better understand you and your needs, including potentially for the purposes of assessing your individual reading habits and interests to allow us to provide suggestions regarding other reading material which may be suitable for you.

If you are located in Australia, this material and access to this website is provided to you solely for your own use and in your own capacity as a wholesale client of Westpac Institutional Bank being a division of Westpac Banking Corporation ABN 33 007 457 141 AFSL 233714 ('Westpac'). If you are located outside of Australia, this material and access to this website is provided to you as outlined below.

This material and this website contain general commentary only and does not constitute investment advice. Certain types of transactions, including those involving futures, options and high yield securities give rise to substantial risk and are not suitable for all investors. We recommend that you seek your own independent legal or financial advice before proceeding with any investment decision. This information has been prepared without taking account of your objectives, financial situation or needs. This material and this website may contain material provided by third parties. While such material is published with the necessary permission none of Westpac or its related entities accepts any responsibility for the accuracy or completeness of any such material. Although we have made every effort to ensure the information is free from error, none of Westpac or its related entities warrants the accuracy, adequacy or completeness of the information, or otherwise endorses it in any way. Except where contrary to law, Westpac and its related entities intend by this notice to exclude liability for the information. The information is subject to change without notice and none of Westpac or its related entities is under any obligation to update the information or correct any inaccuracy which may become apparent at a later date. The information contained in this material and this website does not constitute an offer, a solicitation of an offer, or an inducement to subscribe for, purchase or sell any financial instrument or to enter a legally binding contract. Past performance is not a reliable indicator of future performance. The forecasts given in this material and this website are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.

Transactions involving carbon give rise to substantial risk (including regulatory risk) and are not suitable for all investors. We recommend that you seek your own independent legal or financial advice before proceeding with any investment decision. This information has been prepared without taking account of your objectives, financial situation or needs. Statements setting out a concise description of the characteristics of carbon units, Australian carbon credit units and eligible international emissions units (respectively) are available at www.cleanenergyregulator.gov.au as mentioned in section 202 of the Clean Energy Act 2011, section 162 of the Carbon Credits (Carbon Farming Initiative) Act 2011 and section 61 of the Australian National Registry of Emissions Units Act 2011. You should consider each such statement in deciding whether to acquire, or to continue to hold, any carbon unit, Australian carbon credit unit or eligible international emissions unit.

Additional information if you are located outside of Australia

New Zealand: The current disclosure statement for the New Zealand division of Westpac Banking Corporation ABN 33 007 457 141 or Westpac New Zealand Limited can be obtained at the internet address www.westpac.co.nz. Westpac Institutional Bank products and services are provided by either Westpac Banking Corporation ABN 33 007 457 141 incorporated in Australia (New Zealand division) or Westpac New Zealand Limited. For further information please refer to the Product Disclosure Statement (available from your Relationship Manager) for any product for which a Product Disclosure Statement is required, or applicable customer agreement. Download the Westpac NZ QFE Group Financial Advisers Act 2008 Disclosure Statement at www.westpac.co.nz.

China, Hong Kong, Singapore and India: Westpac Singapore Branch holds a wholesale banking licence and is subject to supervision by the Monetary Authority of Singapore. Westpac Hong Kong Branch holds a banking license and is subject to supervision by the Hong Kong Monetary Authority. Westpac Hong Kong branch also holds a license issued by the Hong Kong Securities and Futures Commission (SFC) for Type 1 and Type 4 regulated activity.

Disclaimer continued overleaf.

Disclaimer continued

Westpac Shanghai and Beijing Branches hold banking licenses and are subject to supervision by the China Banking Regulatory Commission (CBRC). Westpac Mumbai Branch holds a banking license from Reserve Bank of India (RBI) and subject to regulation and supervision by the RBI.

U.K.: Westpac Banking Corporation is registered in England as a branch (branch number BR000106), and is authorised and regulated by the Australian Prudential Regulatory Authority in Australia. WBC is authorised in the United Kingdom by the Prudential Regulation Authority. WBC is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority in the United Kingdom. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request. Westpac Europe Limited is a company registered in England (number 05660023) and is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. This material and this website and any information contained therein is directed at a) persons who have professional experience in matters relating to investments falling within Article 19(1) of the Financial Services Act 2000 (Financial Promotion) Order 2005 or (b) high net worth entities, and other persons to whom it may otherwise be lawfully communicated, falling within Article 49(1) of the Order (all such persons together being referred to as "relevant persons"). The investments to which this material and this website relates are only available to and any invitation, offer or agreement to subscribe, purchase or otherwise acquire such investments will be engaged in only with, relevant persons. Any person who is not a relevant person should not act or rely upon this material and this website or any of its contents. In the same way, the information contained in this material and this website is intended for "eligible counterparties" and "professional clients" as defined by the rules of the Financial Services Authority and is not intended for "retail clients". With this in mind, Westpac expressly prohibits you from passing on the information in this material and this website to any third party. In particular this material and this website, website content and, in each case, any copies thereof may not be taken, transmitted or distributed, directly or indirectly into any restricted jurisdiction.

U.S.: Westpac operates in the United States of America as a federally licensed branch, regulated by the Office of the Comptroller of the Currency. Westpac is also registered with the US Commodity Futures Trading Commission ("CFTC") as a Swap Dealer, but is neither registered as, or affiliated with, a Futures Commission Merchant registered with the US CFTC. Westpac Capital Markets, LLC ('WCM'), a wholly-owned subsidiary of Westpac, is a broker-dealer registered under the U.S. Securities Exchange Act of 1934 ('the Exchange Act') and member of the Financial Industry Regulatory Authority ('FINRA'). This communication is provided for distribution to U.S. institutional investors in reliance on the exemption from registration provided by Rule 15a-6 under the Exchange Act and is not subject to all of the independence and disclosure standards applicable to debt research reports prepared for retail investors in the United States. WCM is the U.S. distributor of this communication and accepts responsibility for the contents of this communication. If you would like to speak to someone regarding any security mentioned herein, please contact WCM on +1 212 389 1269. All disclaimers set out with respect to Westpac apply equally to WCM.

Investing in any non-U.S. securities or related financial instruments mentioned in this communication may present certain risks. The securities of non-U.S. issuers may not be registered with, or be subject to the regulations of, the SEC in the United States. Information on such non-U.S. securities or related financial instruments may be limited. Non-U.S. companies may not be subject to audit and reporting standards and regulatory requirements comparable to those in effect in the United States. The value of any investment or income from any securities or related derivative instruments denominated in a currency other than U.S. dollars is subject to exchange rate fluctuations that may have a positive or adverse effect on the value of or income from such securities or related derivative instruments.

The author of this communication is employed by Westpac and is not registered or qualified as a research analyst, representative, or associated person under the rules of FINRA, any other U.S. self-regulatory organisation, or the laws, rules or regulations of any State. Unless otherwise specifically stated, the views expressed herein are solely those of the author and may differ from the information, views or analysis expressed by Westpac and/or its affiliates.

For the purposes of Regulation AC only: Each analyst whose name appears in this report certifies that (1) the views expressed in this report accurately reflect the personal views of the analyst about any and all of the subject companies and their securities and (2) no part of the compensation of the analyst was, is, or will be, directly or indirectly related to the specific views or recommendations in this report.