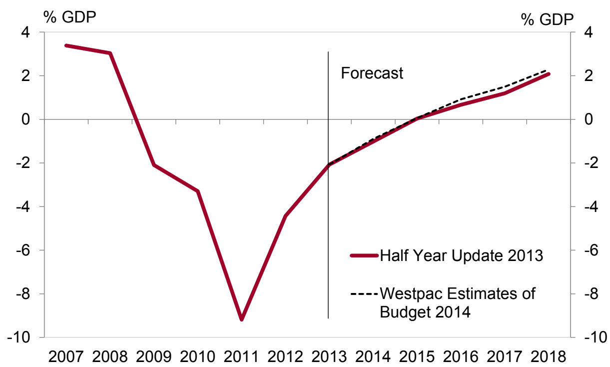
Westpac Institutional Bank

Lucky dip

Budget 2014 Preview (15 May 2:00pm)

- Finance Minister Bill English is likely to repeat familiar cautious rhetoric when he unveils the 2014 Budget on Thursday.
- An upgrade to GDP growth forecasts should see the Government's books looking in better shape than at the December update.
- This should leave room for both maintaining fiscal discipline and funding modest new spending initiatives beyond 2015.

Operating balance (excluding gains and losses)



In the lead-up to Budget 2014 both Prime Minister Key and Finance Minister English have been at pains to hose down expectations of a big pre-election spend-up. In his pre-budget speech Key emphasised the importance of "maintaining fiscal discipline", while in his own pre-Budget comments English reiterated messages about keeping a lid on government spending as an important way of limiting interest rate rises.

However, momentum in the economy is set to translate into an upgraded revenue forecast. This would leave the Government room to announce some modest new spending initiatives beyond 2015 while at the same time reducing debt and continuing the message of fiscal responsibility.

Treasury Forecasts

The Treasury is likely to forecast stronger GDP growth in this week's Budget than in December's Half Year Economic and Fiscal Update (HYEFU), reflecting stronger momentum in the domestic economy over the latter part of 2013 and early 2014. Notably it will probably upgrade its migration forecasts (a key risk identified in the HYEFU). The HYEFU projected annual net migration peaking at around 26,000 with an upside scenario of 32,000 peak. This now looks rather conservative given our own forecasts of net migration peaking a touch above 40,000.

	Actual	Treasury's HYEFU Forecasts					Westpac's estimates of main changes				
June Years	2013	2014	2015	2016	2017	2018	2014	2015	2016	2017	2018
OBEGAL $bn	-4.4	-2.3	0.1	1.7	3.1	5.6	-2.5	0.1	2.4	4.0	6.4
net debt (% GDP)	26.2%	26.3%	26.5%	25.8%	24.4%	22.3%	26.1%	25.9%	25.0%	23.6%	21.7%
Bond Programme ($bn)	14	8	7	7	6	6	8	7	6	5.5	5.5
March Years											
Real GDP (ann avg % change)	2.7	2.7	3.6	2.7	2.0	2.2	GDP growth likely to be stronger but…				
CPI (ann % change)	0.9	1.4	2.4	2.4	2.3	2.2	…inflation being held down in the near term by the high NZD…				
90day interest rates	2.7	2.7	3.6	4.4	4.9	5.2	…implying similar path for interest rates relative to HYEFU				

In contrast, Treasury's inflation forecasts could well be shaded down a touch in the near term, reflecting strength in the exchange rate. However, it remains to be seen whether the Treasury forecasters will be completely convinced of RBNZ Governor Wheeler's renewed focus on the mid-point of the inflation target (HYEFU forecasts had inflation remaining consistently above 2% from 2015).

The stronger outlook for the economy should more than offset the weaker starting point of this year's below-forecast tax take. Core Crown tax revenue was running about 1.8% behind December's forecasts for the nine months ended March. However this shortfall is expected to be largely offset next year thanks to the stronger outlook for the economy. Consequently the Government remains on track to deliver a (small) surplus in 2015.

Beyond 2015 the stronger outlook for the economy and an associated improvement in the tax take should translate to a more substantial increase in forecast surpluses (even after taking into account a modest increase in spending).

Policy Changes

In recent Budgets, much of the attention has been on cost cutting initiatives as the Government focused on keeping a tight rein on spending and debt during relatively rocky period for the New Zealand economy. But with the economy now clearly on a firmer footing and September's election looming, this focus is surely set to shift (even if modestly) away from cost cutting and toward new spending initiatives in this week's Budget. That said, some of the loosening in the purse strings might be rather subtle. While we don't know what form any additional spending measures might take, the Government has indicated a preference to retain its focus on spending on healthcare, education and "safe communities and less welfare dependency".

Announcements in the run up to Budget 2014 have been relatively minor as the Government keeps its powder dry for Budget day. The largest pre-budget announcement so far has been $100 million of new money for the Defence Force. Other smaller spending initiatives already announced include new funding for sexual violence services, apprenticeships and cochlear ear implants, cash incentives for beneficiaries to move to Christchurch and more money for NZ Trade and Enterprise operations.

Bond Programme

The improving Government accounts are likely to allow the Debt Management Office to continue to scale back its borrowing programme. In the HYEFU borrowing requirements were reduced by $4bn out to 2017. We think this could be extended in the budget, with potentially another reduction in the bond programme of around $2bn between 2016 and 2018.

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