Westpac Institutional Bank

New Zealand Government Budget 2015

21 May 2015

Taking the long view

- The Government has maintained its operational spending plans in the face of a lower revenue forecast.
- There was a reprioritisation of some spending, which we support. Addressing child hardship will have significant long-term benefits, while the Kiwisaver kick-starter was fairly low value expenditure.
- Changes to the tax treatment of property probably won't affect house prices in the long run, but could dampen investor enthusiasm in the near term.
- The balance of new initiatives is mildly more stimulatory than expected, but not enough to have a bearing on monetary policy.
- The economic forecasts underpinning this Budget seem too optimistic about the pace of growth in later years, when the Christchurch rebuild will be winding down.
- Consequently, the forecasts of ever-rising surpluses may be too optimistic.
- This leaves us concerned that the fiscal accounts are not strong enough to deal with the long-term challenge of the aging population.

The 2015 Budget contained few surprises. While the fiscal accounts have deteriorated since the previous Budget, much of the damage was done last year and was already baked into last December's Half-Year Fiscal and Economic Update (HYEFU). The economy is in reasonable shape, but inflation has proven to be much softer than expected, which has weighed on growth in nominal incomes and hence on tax revenue.

The government has largely taken this on the chin, rather than reducing its allowances for new spending to compensate. Consequently, the surpluses projected in coming years have shrunk further, and the projected surplus of just $176m next year could easily tip over into another year of deficit.

As previously signalled, the 2015 Budget allowed for a net $4bn of new initiatives over the next four years. However, the mix of initiatives will be modestly more stimulatory for the economy than we expected. Planned new spending exceeded $6bn – even more than in last year's election-year Budget – and much of this will boost domestic demand. There was a partial offset by new revenue and savings measures, but the most significant changes – the removal of the $1,000 kick-start for Kiwisaver, and new levies for inbound and outbound passengers – will have little or no effect on New Zealanders' spending behaviour.

It's possible that the government felt less constrained in its spending decisions this year. Remember that for last year's Budget the Finance Minister sought advice from the Treasury on how much spending could be increased without provoking the Reserve Bank into raising interest rates. But with inflation dropping below the RBNZ's target and expected to remain there for some time, the risks to interest rates this year are if anything in the opposite direction.

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The 2015 Budget addressed two areas where the Government has come under fire recently. The first is child poverty, which the Government had said would be a priority for this term. The most significant new announcement today was a $790m child hardship package, with a combination of carrots and sticks – increased benefits for parents but tougher work requirements.

The second area is housing, particularly in Auckland, though here the major new policies had already been flagged. Capital gains on all investment properties will be taxed if they are sold within two years of purchase (rather than depending on the buyers' intentions), vacant crown land will be sold for residential use in Auckland. The long-run impact of the tax change is likely to be modest – fundamentally, the value of an asset doesn't depend on the owner's holding period. But in practice the new rules could have a dampening effect on investor sentiment, particularly ahead of the October implementation date.

The government continues to portray its fiscal management as "responsible". We'd agree with that assessment to the extent that it has largely avoided the common temptation to run fiscal policy in a pro-cyclical manner. The spending increases planned for the next two years are moderate, with a step-up in 2017/18 coinciding with an expected slowdown in the pace of economic growth.

But we question whether the medium-term outlook is realistic enough. The Treasury is projecting only a modest slowdown in GDP growth and ever-rising surpluses from 2017 onward, at a time when the level of quake rebuild activity in Christchurch will be winding down. As we detail in the Economic Forecasts section, we're expecting a much more significant drag on the pace of growth over that period. And while we'd normally say that there's a high degree of uncertainty around economic forecasts that far ahead, the completion of a massive but finite investment project is completely foreseeable and needs to be treated seriously.

If we're right about the extent of the slowdown, there's a real risk that instead of a smooth profile of ever-rising surpluses, we might only see a year or two of surpluses before the balance starts to deteriorate again. That would not reflect well on the structural position of the fiscal accounts, or the claim that net Government debt is on a sustainable downward path. And that reignites our long-running question of whether enough is being done today to meet the longer-term challenges of an aging population.

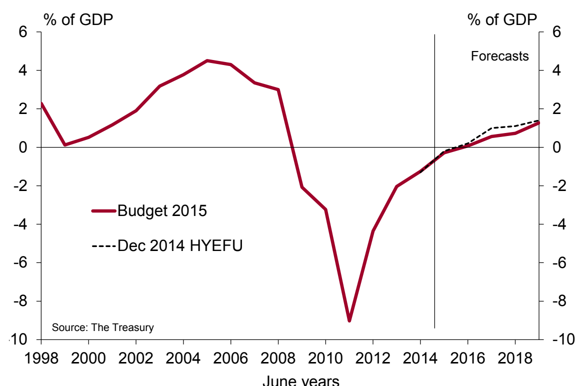
Government Bond Programme

The weaker fiscal position in the near term means a modest increase in the cash requirement compared to the December HYEFU. Gross bond issuance has been increased from $7bn to $8bn for the 2015/16 year, but remains unchanged at $7bn in each of the following three years.

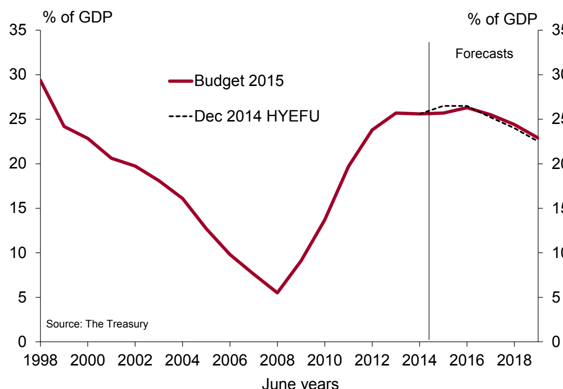
Subject to market conditions, a new April 2033 nominal bond will be launched via syndication in the second half of this year. Inflation-indexed bonds will account for up to $2bn of the $8bn bond programme for the 2015/16 fiscal year.

Treasury forecasts, Budget 2015

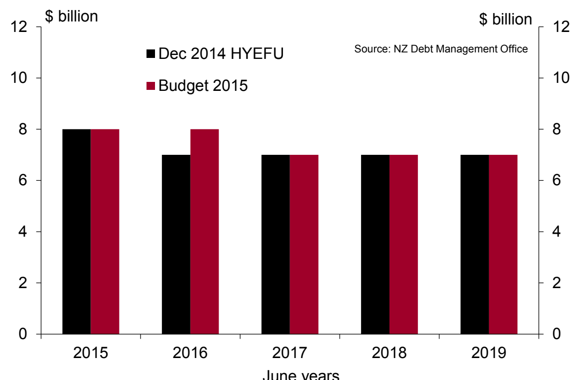
Operating balance (excluding gains and losses)



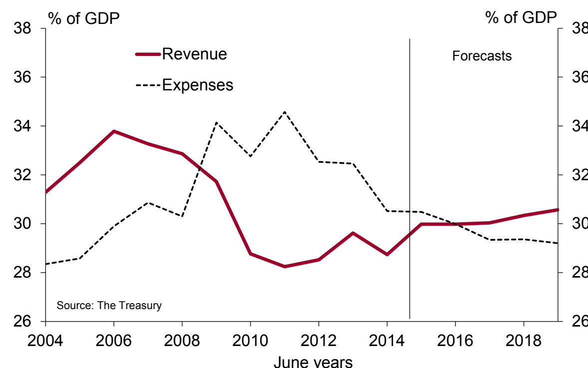
Core Crown net debt



Bond issuance



Core Crown revenue and expenses



Policy announcements in a nutshell

Many of the new policy initiatives covered in the Budget had already been well-signalled, including further chunky ACC levy cuts in 2015/16 and 2016/17, a tightening of capital gains tax rules around investor property (with additional funds for the IRD to enforce them), and more money to open up Crown-owned land for Auckland housing development.

The main new policy announcement was the Budget's flagship $790m Child Hardship Package, raising benefit rates for families with children, Working for Families payments, and childcare subsidies – while also further raising the pressure on beneficiaries with children to work.

As we've said before, it is easy to accuse the Government of tinkering, but it has shown itself to be adept at reprioritising spending and identifying efficiencies, and we suspect these many small efficiency drives have helped bringing about New Zealand's recent record of solid growth amid low inflation. In this Budget, the key savings and reallocations look broadly sensible to us. In particular, there is little evidence that the Kiwisaver 'kick-start' subsidy generated much in the way of net new savings. That money is probably better spent on social policy initiatives, particularly given concerns around rising economic inequality.

Policy	Cost/Savings over 4 years to June 2019	Comment
Spending Measures	**$m**	
Child Hardship Package	790	More carrots and sticks to support parents in work, including higher Working for Families payments.
Health	1660	Mostly to meet the needs of a growing and aging population. More money for palliative care, elective surgery, and cancer screening.
Education	443	Includes $75m for early childhood education and $63m for children with special needs.
Business growth agenda	425	$113m for tertiary education, $80m for previously announced R&D grants, $58m for border control, $25m for Regional Research Institutes.
Defence	294	
Law and order	219	$164m for police.
Canterbury	176	Focus is on supporting Anchor Projects.
Housing	151	$70m for social and Maori housing, $52m to free up Crown land in Auckland, $29 to enforce tighter property tax rules.
Other social spending	141	$109m for Whanau Ora and early intervention, $32 to reduce welfare dependancy.
Other	1869	Includes spending for future contingencies.
Total New Spending	**6168**	
Saving measures		
Reprioritisation and savings	1095	Something this Government has been good at doing.
Kiwisaver	500	Remove $1,000 subsidy to 'kick-start' enrolment in Kiwisaver.
Other revenue	510	Customs and biosecurity levy for international travelers.
Total Saving Measures	**2105**	
Other major initiatives		
ACC levy cuts	1500	Annual ACC levy revenue cut by $375m from 2016 and $120m from 2017, depending on consultation.
Capital Spending		
Future investment fund	939	$244 for new schools and classrooms; $210m to extend the ultra-fast broadband network; another $210m shot in the arm for Kiwirail; $137 for other transport.

Economic Forecasts: The Treasury and Westpac

Compared to the forecasts issued six months ago, the Treasury's new forecasts incorporate stronger outlooks for migration and house price inflation, as well as lower oil prices. They also allow for continued softness in consumer price inflation, which has dampened forecasts for nominal GDP growth but means that interest rates are expected to stay low for longer than previously assumed.

Over the next year or two the Treasury's forecasts are now fairly similar to our own, with GDP growth of a little above 3% expected over 2015/16. However, where we continue to have questions is around the Treasury's forecasts in the outer years of the projection, as the Canterbury rebuild winds down and net immigration moderates. The Treasury is forecasting growth to slow to 2.4% in the year to March 2019, with continued rising house prices, a strong exchange rate and rising interest rates. That strikes us as a very benign view of what a post-rebuild economic slowdown might look like.

On our forecasts, we'll see growth slowing to around 1% in the year to March 2019, with house prices and the exchange rate falling, as well as interest rate reductions. As such we have concerns about Treasury's forecasts for growing surpluses in the latter part of the decade.

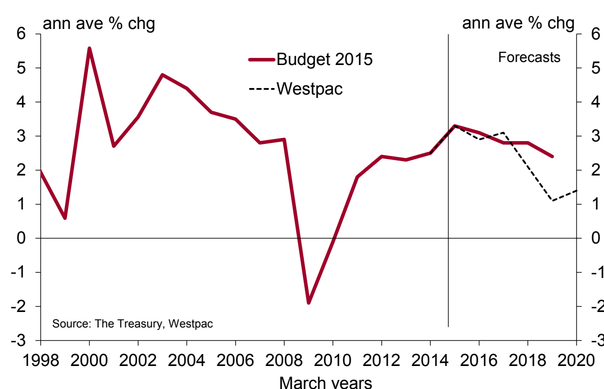
Australia's recent experience is illustrative in this regard. The sharp downturn in Australia growth following the slowdown in mining investment placed significant pressure on the Australian fiscal position, prompting the need for a sharp tightening in fiscal policy.

Economic Forecasts: The Treasury and Westpac

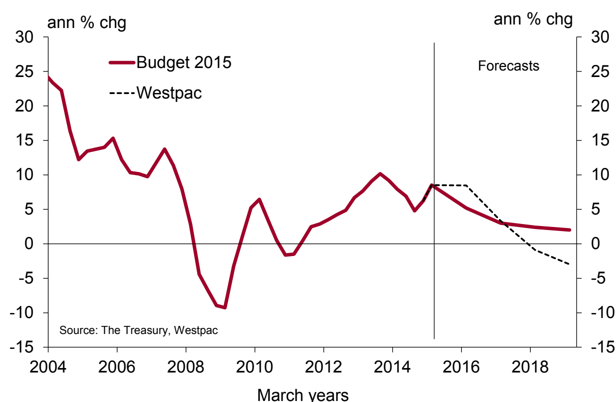
	Actual	Treasury					Westpac				
March years	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2015**	**2016**	**2017**	**2018**	**2019**
Real GDP growth*	2.5	3.3	3.1	2.8	2.8	2.4	3.3	2.9	3.1	2.1	1.1
Annual CPI inflation	1.5	0.2	1.4	2.1	2.0	2.1	0.1	1.3	2.1	2.4	2.2
Unemployment rate**	6.1	5.6	5.1	4.7	4.5	4.5	5.8	5.1	4.5	4.8	5.4
Nominal GDP growth*	6.8	3.9	3.3	5.3	4.8	4.1	3.9	3.1	5.3	4.4	3.3
90-day interest rate***	3.0	3.6	3.6	3.7	4.3	4.8	3.6	3.7	3.7	3.7	3.2
TWI exchange rate***	80.0	77.9	77.9	77.9	77.9	77.1	77.9	78.7	75.7	71.7	65.1

*Annual average % change, **March quarter, seasonally adjusted, ***March quarter

GDP growth



House price inflation



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