Budget 2017 First Impressions

Having your cake and eating it too

25 May 2017

- Strengthening economic conditions are allowing the Government to have its cake and eat it too.
- In Budget 2017, the Government has introduced a Family Incomes Package to support those on lower and middle incomes. This includes an adjustment to tax thresholds, an increase in Working for Families, as well as increases in accommodation support.
- Spending is being increased in a range of areas, including public and social services, as well as much needed infrastructure investment.
- Firm economic conditions mean that the Government can make these changes while maintaining its focus on longer-term debt reduction and improving the economy's financial resilience.
- The initiatives announced today are likely to support GDP growth over the coming years. However, we have some concerns that economic growth, and therefore the surpluses, are unlikely to be as healthy as the Government expects over the course of the next five years.

Budget 2017 forecasts

	2016	2017	2018	2019	2020	2021
	Actual	F/cast	F/cast	F/cast	F/cast	F/cast
Economic (June years, %)						
Real GDP growth	2.7	3.1	3.5	3.8	2.9	2.4
Unemployment rate	5.0	5.0	5.0	4.6	4.3	4.3
CPI inflation	0.4	1.8	1.6	2.1	2.2	2.1
Current account balance	-2.9	-2.8	-3.0	-3.3	-3.7	-3.9
Fiscal						
(June years, % of GDP)						
Total Crown OBEGAL	0.7	0.6	1.0	1.4	2.0	2.2
Net core Crown debt	24.4	23.2	22.8	22.1	20.6	19.3
(June years, $ billion)						
Core Crown revenue	76.1	80.8	83.8	87.5	92.5	96.8
Core Crown expenses	73.9	77.5	80.5	83.5	86.2	89.2
Bond programme		8	7	7	7	6

Firm economic growth over the past year means that the Government's books are in good shape. The Treasury is now forecasting an operating surplus of $1.6b in the current fiscal year – stronger than the modest $0.5b surplus expected in the Half-Year Fiscal and Economic Update (HYEFU) last December.

Over the next few years the surplus is expected to continue growing, but at a more gradual pace than previously assumed. The Government is now forecasting an operating surplus of $7.2b in 2021, down from the $8.5b that was forecast in the HYEFU.

A key reason for the more gradual improvement in the operating surplus over the coming years is that Budget 2017 has introduced a Family Incomes Package (described below) that includes adjustments to income tax thresholds. While this is assumed to boost activity and spending (and hence the GST take), the reduced income tax take per person pulls down core Crown tax revenues by $6.3b over the forecast period.

Core Crown expenses are also expected to grow more rapidly than previously assumed, with around $1.8b additional expenditure assumed in this year's Budget. In addition, allowances for new spending in future years have also been increased.

Policy initiatives

The big policy announcement today was the announcement today was a $2b Family Income Package targeting those on low to middle incomes. This package comes into effect from 1 April 2018. It has four key parts:

1. Income tax thresholds are being increased. The current $14,000 threshold will be increased to $22,000, and the current $48,000 threshold will increase to $52,000. In terms of cash in hand, those earning more than $22,000 will now get an extra $11 per week, rising to $20 per week for those earning more than $52,000.
2. The Independent Tax Earners credit of up to $10 per week is being removed. This was available to those on lower incomes without families. But its removal will be offset by the change in tax thresholds.
3. Working for Families payments for those with children under 16 will be increased to the same level as those with older children.
4. Accommodation supplements will be increased for families and students.

In addition to the policy changes themselves, there will be flow-on effects for superannuitants due to the link between after-tax wages and NZ Superannuation. The couples rate for superannuitants will increase by $13/week from 1 April.

The 2017 Budget makes allowances for increased spending in four key areas:

– Public services: $7b including spending on health services, education, law and order, and social services.
– Infrastructure: Around $4b of spending is planned. This includes spending on roading in Kaikoura, rail networks, and schools.
– Business growth agenda: $1b. This includes $373 million as part of the Innovative NZ program, as well as spending to support increased trade, the tourism sector, and the film industry.
– Social investment: $321m – social spending to support those in need including mental health support and support for vulnerable children.

To help replenish the National Disaster Fund, the Government has announced that the EQC premium for homeowners will increase by 15-20c per $100 of cover from 1 November.

The Government is investing $11b in new capital spending over Budgets 2017 to 2020 on top of existing plans. Budget 2017 includes $4b of new spending in areas including education, transport, defence, housing, health and justice.

Economic forecasts

The Budget forecasts are underpinned by some fairly bullish views about the strength of the economy. The Treasury expects GDP growth to average 3.1% a year over the next five years. What's more, the Treasury appears to regard this as close to the country's potential – the projected output gap remains near zero over the next four years, and inflation settles at around 2%.

In contrast, we're expecting average annual growth of 2.6%. One key point of difference in our forecasts is residential investment: the Treasury is forecasting nationwide growth of almost 9% in each of the 2019 and 2020 years, at a time when the Christchurch quake rebuild will be winding down. The need for more housing, particularly in Auckland, is not in doubt; the homebuilding industry's ability to ramp up activity that quickly is more of a concern.

Net debt

Despite the increase in spending, firm economic conditions mean that the Government continues to forecast a decline in debt levels. As a share of nominal GDP, core Crown debt is still forecast to fall below 20% in FY2021, though by slightly less than previously assumed. As already announced, the Government is aiming to reduce net debt to between 10% and 15% of GDP by 2025.

$35b of Government bonds are expected to be issued between 2017 and 2021. That's up by $1b compared to estimates at the time of the HYEFU. The increased issuance is projected to occur in 2020. Forecast issuance in other years is unchanged from the HYEFU.

Economic implications

The economy has been growing at a firm pace in recent years. However, some of the current drivers will fade over time. In particular we're already seeing some slowdown in the housing market. In that sense, the initiatives in today's Budget are a welcome development in that they will help to brace the economy as other drivers of growth moderate.

There was no market reaction in either interest rates or the exchange rate after the Budget announcement

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