WESTPAC ECONOMIC BULLETIN

Preview of New Zealand Budget 2022.

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Soft reboot.

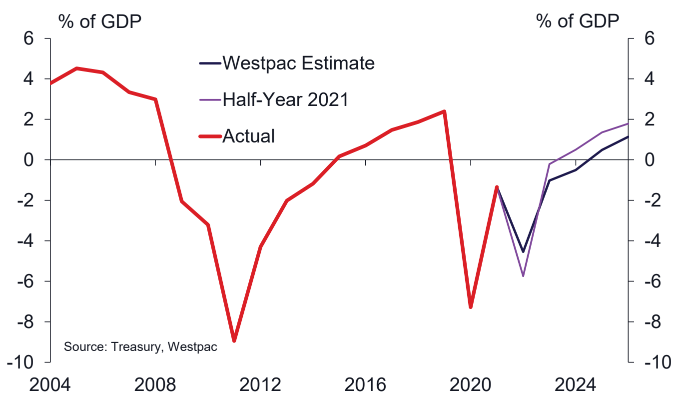
- We expect Budget 2022 to show that, all things Covid considered, the Government's books continue to be in good shape.
- While not strictly news, Budget 2022 will highlight the Government's newly minted fiscal rules and the realisation that the Government is not as debt constrained as previously thought.
- We don't expect major spending announcements outside of the Government's stated priorities, although room may be made for be some targeted cost of living assistance.
- Market interest will be on the expansion in the bond programme to facilitate buy back of the Reserve Bank's Government bond holdings. To this end, we anticipate a circa $28 billion increase in bond issuance spread over the 2023 through 2026 fiscal years.

All things Covid considered, the books are likely to be in good shape.

We expect Budget 2022 to show that, all things Covid considered, the Government's books continue to be in good shape. We expect that the Government's operating balance will continue show improvement over the forecast period, with surpluses likely from around the 2025 fiscal year.

In the 2022 year, the Budget forecasts may even show a slight improvement versus the Half-Year Update. The catalyst for the improvement has been the smaller than expected impact from the Delta lockdown on economic growth and thus tax revenue. For example, the operating balance (before gains and losses) was running about $4 billion ahead of the Half-Year Update forecast as at March 2022, and, we anticipate that this improvement will be maintained, if not improve, through to the end of the fiscal year.

Operating balance (OBEGAL) as a % of GDP

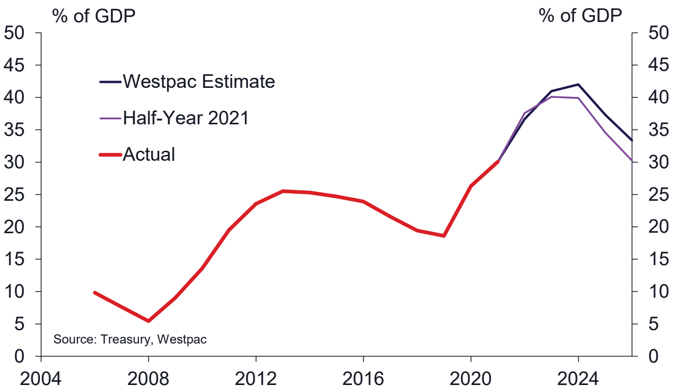


But from 2023 onwards, we expect the books to show a somewhat weaker picture than forecast at the Half-Year Update. This change stems from the deterioration in the economic growth outlook as the combination of very high inflation and rising interest rates weighs on the economy. Similarly, we expect the outlook for tax revenue and the operating balance has softened since the Half-Year Update.

We also expect Budget 2022 to show the Government's net debt position remaining relatively low and heading in the right direction in the outyears. We expect net debt to peak in 2024 at around 42% of GDP. From there, we expect Budget 2022 to indicate that net debt will fall to around 33% of GDP by the end of the forecast period. Note for comparison with the Half-Year Update, we have used the old measure of net debt.

Again, all things Covid considered, the increase in net debt has been considerably less than first feared and the outright level of debt continues to stack up well compared to other countries. Although, when compared to the Half-Year Update, we expect the net debt track will show a modest deterioration.

Net core Crown debt as a % of GDP



New fiscal rules – debt is no longer the key constraint.

In his pre-Budget speech last week, the Minister of Finance, Grant Robertson, announced a new set of fiscal rules. These new rules are:

1. To maintain operating surpluses within a low range 0% to 2% of GDP over time;
2. Introduce a new net debt measure that includes a broader range of the Government's financial assets; and
3. Introduce a net debt ceiling of 30% under the new measure (which is the equivalent of 50% of GDP under the old measure).

Of the new rules, the new debt ceiling is the most significant move. It effectively acknowledges that the Government has more fiscal headroom in terms of its net debt position. Or simply put, it can reasonably borrow more for longer than it has in the past and still maintain its sovereign credit rating.

This is similar to a view that we have held for some time. Back in 2018, we wrote in a research paper [1] that fiscal responsibility rules are not the key constraint holding back more public capital investment. That key constraint to more investment as stated in the paper at the time, and it remains so today, is capacity, particularly the lack thereof in the construction industry.

Nonetheless, the key impact of the new debt ceiling will be felt in the years, if not decades, to come. In essence, the Government now has greater license to get on and build infrastructure. Minister Robertson noted in his speech that one estimate pegged the nation's 'infrastructure gap' at $104 billion. And with one bottleneck cleared, the onus then shifts to the Infrastructure Commission to come up with ways to increase the capacity to deliver infrastructure over coming years.

The other two fiscal rules are sensible, albeit not a lot different to what was previously in place. The surplus target is a little more precise than previous, while the new debt measure makes more sense conceptually plus makes international comparisons easier. The key shift in the debt measure sees the New Zealand Superfund's assets brought into the net debt calculation. As a result, the new measure shows the Government's net debt position approximately 20 percentage points lower than under the old measure. For example, using the old measure, the Half-Year Update showed net debt peaking at 40.1% of GDP, while the under the new measure that same peak would be 21.3% of GDP.

The announcement of the new rules and objectives was also a timely one. First of all, and we agree that now is the right time to recalibrate fiscal settings in the wake of the Covid pandemic. Previous fiscal settings were no longer fit for purpose, but these new ones are and are also consistent with global best practice.

With that in mind, Budget 2022 then gives the Government the opportunity to restate its fiscal credentials. That is, (we expect) the books are in good shape as we note above and thus adhere to these new fiscal rules.

Bond programme expansion.

Market interest in Budget 2022 will be on the expansion of the bond programme to facilitate the buy back of a portion of the Reserve Bank's Government bond holdings. The Reserve Bank has signalled that it intends to sell back to the Treasury a total of $25 billion worth of bonds from its quantitative easing programme over five years, starting in the 2023 fiscal year.

To this end, we anticipate a circa $28 billion increase in bond issuance spread over the 2023 and 2026 fiscal years. $20 billion of the additional issuance will be to cover the first four years of the buy backs from the RBNZ, with the remaining $8 billion borrowed to cover the Government's additional debt resulting from larger deficits (and smaller surpluses). The remaining $5 billion of buy backs from the RBNZ (scheduled for 2027) falls outside the Budget forecast period.

1 https://www.westpac.co.nz/assets/Business/economic-updates/2018/Bulletins/Fiscal-responsibility-May-2018.pdf

Bond programme, $bn (June year)

	2022	2023	2024	2025	2026	5-year total
Westpac estimate	**20.0**	**22.0**	**26.0**	**26.0**	**18.0**	**112.0**
Half-Year	20.0	18.0	18.0	18.0	10.0	84.0
Change	0.0	+4.0	+8.0	+8.0	+8.0	+28.0

Budget 2022 policy initiatives.

We don't expect major spending announcements outside of the Government's stated priorities. For the record, the Government has identified two policy areas of focus for Budget 2022: *embedding the health reforms*, and *making progress towards our emissions reduction goals*. If anything does crop up outside those core initiatives, we think the Government may find some room for targeted cost of living assistance.

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