

Economic Note

Budget 2018 Preview

11 May 2018

Earning their fiscal stripes

- As has been signalled, we expect the Budget to show the new Government is on track to hit its fiscal targets.
- Although to do so, the new Government has had to scale back some of its spending plans.
- Meanwhile, Budget 2018 will be the first to report using the Treasury’s Living Standards Framework.

Summary

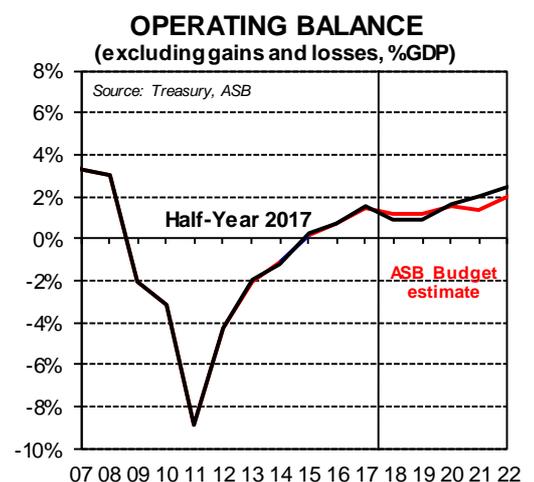
The Labour-NZ First Government releases its much-anticipated first Budget next Thursday (2pm NZT).

We expect a prudent first-up effort from new Minister of Finance, Grant Robertson. Mr Robertson has been at pains to point out that this Government will continue to work within the fiscal parameters it set itself ahead of last year’s election. As a result, we expect Budget 2018 to show small operating surpluses and a declining net debt profile, mixed with modestly higher spending and investment.

However, the new Government has had to scale back some of its spending plans. Since coming into power, the Government has revealed funding pressures in key priority areas such as health, education and housing. In order to meet these pressures while keeping to its fiscal plan, we expect Budget 2018 to find room for spending in these key areas, but not a lot elsewhere. That said, spending reprioritisation will free up some room.

Budget 2018 also marks the first time that Treasury’s Living Standards Framework will be reported on. The framework is a way of looking at wellbeing in a broader sense than the normal financial focus of the Budget. We elaborate on what this may look like in Budget 2018 over the page.

<i>June Years</i>	2018	2019	2020	2021	2022
<i>Total Crown OBEGAL (% of GDP)</i>					
ASB Budget 2018 Estimate	1.2	1.2	1.5	1.3	2.0
<i>Half-Year 2017</i>	0.9	0.9	1.6	2.0	2.5
<i>Net core Crown debt (% of GDP)</i>					
ASB Budget 2018 Estimate	20.8	21.4	21.3	20.9	19.9
<i>Half-Year 2017</i>	21.7	22.2	21.9	20.8	19.3
<i>Bond Tender programme (\$bn)</i>					
ASB Budget 2018 Estimate	7.0	7.0	7.0	7.5	7.5
<i>Half-Year 2017</i>	7.0	7.0	7.0	7.0	7.0



Operating Surpluses – steady as she goes

In keeping with the above themes, **we expect the Government to comfortably run an operating surplus (OBEGAL) of a similar magnitude to that forecast at the 2017 Half-Year Update.** That said, the Budget forecast OBEGAL is likely to be a little stronger in the short term compared to the Half-Year Update, but then a little weaker by the end of the forecast period.

On balance, Budget surpluses over the forecast period are likely to be of a broadly similar magnitude. The near-term improvement is likely to reflect stronger recent growth in tax revenues; as at March 2018, the OBEGAL was running around \$900m ahead of the Half-Year forecast. However, we expect a weaker growth outlook since the Half-Year forecast to translate into smaller surpluses by the end of the forecast period.

We suspect, however, **that the desire to increase spending may also be shoehorned into Budget 2020 or 2021 via modest increases in spending allowances. There is some leeway, with operating allowances currently set at \$1.875bn per year in Budgets 2019 to 2021, and capital allowances of around \$3bn per annum over that period.** Modest increases in spending (say, in the vicinity of \$500m) would still allow the government to meet its net debt targets as discussed below.

Net Debt & Bond Programme – small changes at most

We don't expect much change in either the net debt forecast or the Government's bond programme. As mentioned above, forecasts for the OBEGAL are likely to be similar to that as at the Half-Year Update. Indeed, with the Finance Minister signalling that he has kept to his fiscal plans, we'd be surprised to see net debt remaining above 20% of GDP by 2022.

If anything, there may be a minor increase in net debt and or bond issuance towards the end of the forecast period relative to the Half-Year Update. If so, this may see net debt push up against the 20% target in 2022. We have net debt hitting 19.9% of GDP by 2022, in contrast to 19.3% forecast as at the Half-Year Update. With this in mind, we have factored in a minor increase (of \$1bn) in bond issuance spread over 2021 and 2022, but we wouldn't be surprised if the issuance forecast is kept unchanged.

Growth – weaker than the Half-Year Update

The economic outlook has weakened since the Half-Year Update. Our forecasts now show lower growth than the Treasury's, particularly over 2018/19. However, we are more optimistic around wage growth than the Treasury was back in the Half-Year Update, given our view that wage growth will start to firm and net immigration inflows will remain elevated.

All up, **the risks are skewed towards a weaker economic outlook than we have factored in.** If that proves the case, then the Half-Year Update may show less wiggle room for fiscal policy than we have shown here.

Incorporating the Living Standards Framework and wellbeing for the first time

In this Budget, **the Government has stated an intention to report against a wider set of wellbeing indicators than traditionally is the case.** The Government sees this approach as a core element of how it will create our future Budgets and measure progress. To facilitate this, the Budget will incorporate aspects of the Treasury's Living Standards Framework (LSF).

The LSF is based on an OECD framework that organises indicators of sustainable intergenerational wellbeing. It focuses on measuring New Zealand's success in developing and maintaining four capitals – financial and physical, human, social, and natural. By using the LSF, the Government has stated that it aims to give a broad measure of how government policy is improving New Zealanders' wellbeing.

To a degree on Budget Day this will be a venture into the unknown. On the following page, we have included Treasury's definitions of the four capitals. We have also included a table of wellbeing indicators for New Zealand that Treasury has provisionally identified. Potentially reporting on indicators such as these could be included in Budget 2018. Given that this is the first time that the LSF will be used, it is likely that Budget 2018 will be used to set the benchmark for future Budget's to be judged against.

The Four Capitals

Intergenerational wellbeing relies on the growth, distribution, and sustainability of the Four Capitals. The Capitals are interdependent and work together to support wellbeing.



Natural Capital

This refers to all aspects of the natural environment needed to support life and human activity. It includes land, soil, water, plants and animals, as well as minerals and energy resources.



Human Capital

This encompasses people's skills, knowledge and physical and mental health. These are the things which enable people to participate fully in work, study, recreation and in society more broadly.



Social Capital

This describes the norms and values that underpin society. It includes things like trust, the rule of law, the Crown-Māori relationship, cultural identity, and the connections between people and communities.



Financial & Physical Capital

This includes things like houses, roads, buildings, hospitals, factories, equipment and investments. These are the things which make up the country's physical and financial assets which have a direct role in supporting incomes and material living conditions.

Source: The Treasury

Provisional table of current wellbeing indicators for New Zealand

Dimension	Indicators	
Housing	<ul style="list-style-type: none"> Housing Expenditure Rooms per person 	<ul style="list-style-type: none"> Dwellings with basic facilities
Income	<ul style="list-style-type: none"> Household financial wealth 	<ul style="list-style-type: none"> Household net adjusted disposable income
Jobs	<ul style="list-style-type: none"> Job security Long-term unemployment rate 	<ul style="list-style-type: none"> Personal earnings Employment rate
Community	<ul style="list-style-type: none"> Quality of support network 	
Education	<ul style="list-style-type: none"> Years in education Educational attainment 	<ul style="list-style-type: none"> Student skills
Environment	<ul style="list-style-type: none"> Water quality 	<ul style="list-style-type: none"> Air Quality
Civic Engagement	<ul style="list-style-type: none"> Stakeholder engagement for developing regulations Corruption 	<ul style="list-style-type: none"> Voter turnout
Health	<ul style="list-style-type: none"> Self-reported health Suicide rate 	<ul style="list-style-type: none"> Life expectancy
Life Satisfaction	<ul style="list-style-type: none"> Life satisfaction 	
Safety	<ul style="list-style-type: none"> Homicide rate 	<ul style="list-style-type: none"> Feeling safe walking alone at night
Work-Life Balance	<ul style="list-style-type: none"> Time devoted to leisure and personal care Volunteering 	<ul style="list-style-type: none"> Employees working very long hours
Cultural Identity	<ul style="list-style-type: none"> Local Content on New Zealand television Language retention 	<ul style="list-style-type: none"> Maori language speakers

Source: The Treasury

ASB Economics & Research

Chief Economist
Senior Economist
Senior Economist
Senior Rural Economist
Senior Economist, Wealth
Economist
Data & Publication Manager

Nick Tuffley
Jane Turner
Mark Smith
Nathan Penny
Chris Tennent-Brown
Kim Mundy
Judith Pinto

nick.tuffley@asb.co.nz
jane.turner@asb.co.nz
mark.smith4@asb.co.nz
nathan.penny@asb.co.nz
chris.tennent-brown@asb.co.nz
kim.mundy@asb.co.nz
judith.pinto@asb.co.nz

Phone

(649) 301 5659
(649) 301 5853
(649) 301 5957
(649) 448 8778
(649) 301 5915
(649) 301 5661
(649) 301 5660

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