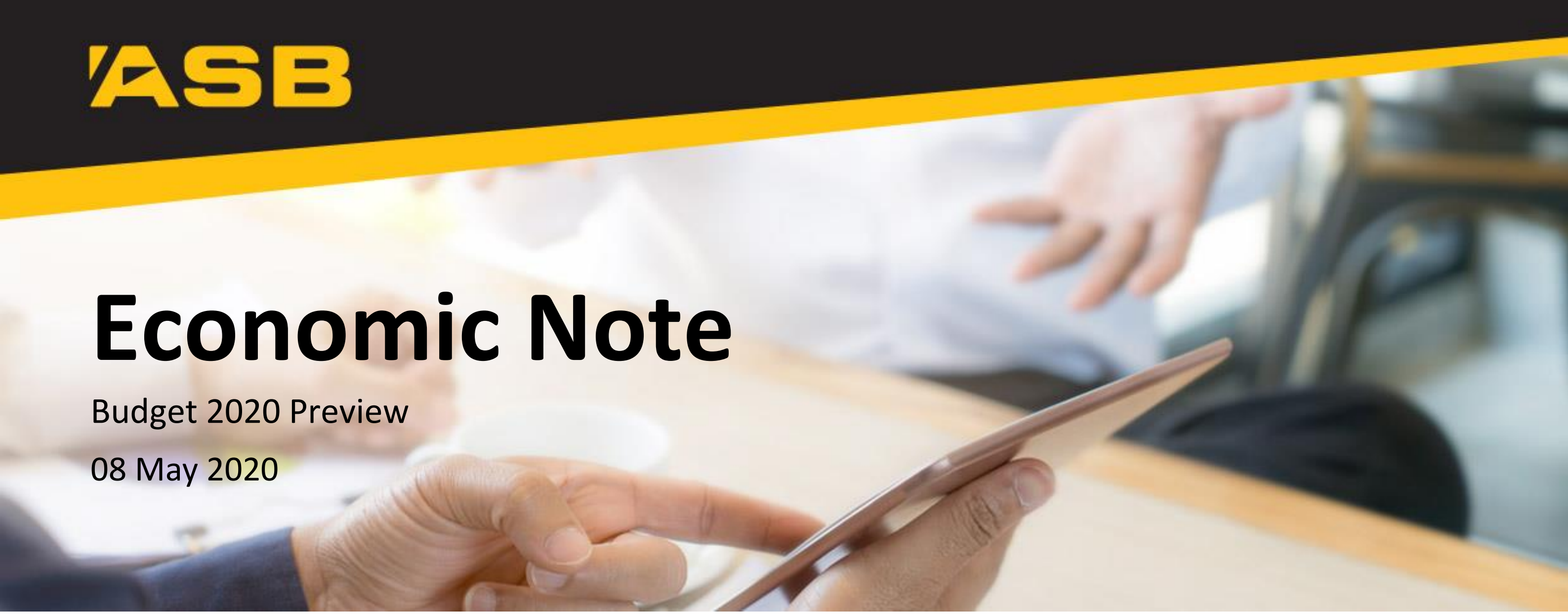


Economic Note

Budget 2020 Preview

08 May 2020

COVID-19 economic response part II

- We expect the Government to appropriately announce a *Budget* spending package of circa $15 to $20 billion, representing a doubling of the initial COVID-19 economic response package.
- Extra fiscal policy support and the weak economy are expected to culminate into sizeable fiscal deficits over the next few years.
- We subsequently expect net core crown debt to lift to over 60% of GDP and for a massive lift in the NZ Government bond programme. However, NZ should stack up well relative to our global peers.

Summary

What a difference 12 months makes. For *Budget 2019*, we expected and got a relatively prudent *Budget*. For *Budget 2020*, it's more of a case of appropriately throwing the fiscal kitchen sink at an unprecedented health and economic crisis.

With this in mind, the first thing we will be looking for is an appropriately large package of spending and investment. Roughly, that may mean a doubling of the initial COVID-19 package or an increase in operating spending of around $15 to $20 billion. It could be more than that.

Second, we will be looking at the appropriateness of the *Budget* package. Key principles should include that the spending be temporary in nature and targeted to help those most severely impacted by the crisis. With the Government looking at projects to kickstart the economy, the quality of the spending and investment still matters. Ultimately, however, the Government will eventually need to repair its books from the COVID-19 hit, so it should keep an eye on the future.

FISCAL PROJECTIONS - ASB Budget Update 2020 Estimates					
June years	**2020**	**2021**	**2022**	**2023**	**2024**
Total Crown OBEGAL (% GDP)					
ASB Budget 2020 Estimate	**-6.5**	**-12.8**	**-12.0**	**-7.7**	**-4.8**
Half-Year 2019	*-0.3*	*0.0*	*0.5*	*1.1*	*1.5*
Net core Crown debt (%GDP)					
ASB Budget 2020 Estimate	**26.9**	**43.1**	**56.0**	**62.0**	**64.3**
Half-Year 2019	*19.6*	*21.0*	*21.5*	*20.9*	*19.6*
Bond Tender Programme ($bn)					
ASB Budget 2020 Estimate	**25.0**	**45.0**	**45.0**	**40.0**	**25.0**
Half-Year 2019	*25.0*	*10.0*	*8.0*	*8.0*	*6.0*

Operating balance – appropriately in the red

We expect *Budget 2020* to show that the Government is forecast to run large operating deficits over the forecast period. We anticipate that the largest OBEGAL deficits of circa 10% of GDP will fall in the 20/21 and 21/22 fiscal years. In the June 2023 year the deficit is expected to narrow, reaching around 5% of GDP by the 2023/24. Such is the depth of the economic hit posed by COVID-19 and the need for fiscal policy settings to remain supportive, the return to outright surpluses looks to be a long way off. By the same token the hit to the revenue base of the economy posed by COVID-19 is likely to provide a significant hit to Government revenues. There will also be extra spending for components of Government spending, particularly income support.

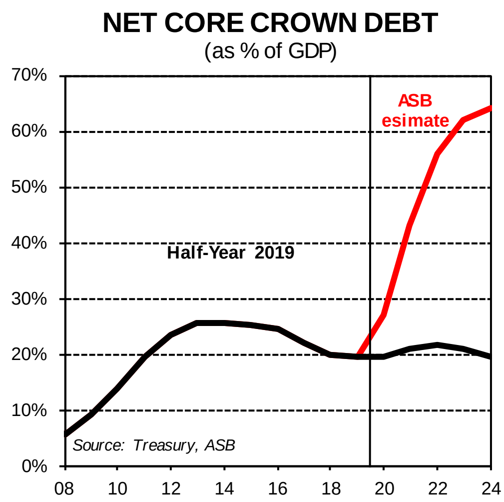
Nick Tuffley – Chief Economist (649) 301 5659 nick.tuffley@asb.co.nz
Nathan Penny – Senior Rural Economist (649) 448 8778 nathan.penny@asb.co.nz

Please refer to the important disclosures at the end of this document.

We have assumed an additional $15 billion of operating spending in this Budget over and above the $3 billion signalled in the *Budget Policy Statement*. This represents a rough doubling of the initial COVID-19 economic response package. We note though that the government could choose to go bigger than this and we wouldn't argue with an additional $5 to $10 billion of spending on top of that we have factored in.

Net Debt & Bond Programme – appropriately massive

With deficits forecast for the foreseeable future, public debt is expected to rise rapidly. We anticipate that net core crown debt will move above 50% of GDP by 2021/22 and 60% of GDP by 2022/23.



While a massive increase, this is entirely appropriate given the need by fiscal policy to support the economy. NZ is well placed relative to many of our trading partners. As at June 2019, NZ's net public debt stood at under 20% of GDP, which on an international basis was very low. Even after an increase to 60% of GDP, NZ's net public debt position will be lower than most of our OECD peers.

The NZ Government bond programme is likely to see a massive increase. We expect the Government to issue over $40-45 billion in each of the next three fiscal years, before dropping back to $25 billion by 2024. In total this amounts to over $120 billion more issuance than previously announced.

Budget 2020 Policy announcements

The Government is adopting the 3 'R's approach: Respond, Recover, Rebuild.

We expect that the Government will announce an extension to the wage subsidy package. To date $10.6 billion has paid out for the programme that covers employees for 12 weeks. The Government could reasonably extend the package out to 24 weeks in line with the Australian programme. Tweaks to coverage are also possible via targeting businesses most impacted from COVID-19.

The health and education sectors are also likely to see spending boosts. In the initial COVID-19 package, the Government provided a one-off spending boost of $0.5 billion. We could reasonably expect a similar boost in the Budget. For education, we expect a boost to training programmes that aim to assist those out of work due to COVID-19 to retrain. The Finance Minister has said "the Future of Work has arrived, even if not how we expected". That will see the Government putting added emphasis on moving NZ further into the digital age, including for how NZ exporters connect with the rest of the world.

Also, **the Government has already announced loans to small businesses (via the IRD) as well as an increase in the Winter Energy Payment**. These two policies better represent, in our view, support that appropriately targets the those most impacted by COVID-19 (in the case of the small business loans) and a policy that doesn't (in the case of the increased Winter Energy Payment). With the above precedent in mind, we anticipate that *Budget 2020* will offer up a mixed bag of targeted tax relief and other targeted payments, while boosting spending in areas in line with the Government's traditional priorities.

Part of the Rebuild phase is literally that: a push to expand infrastructure development and solve the housing crisis. These are areas where getting it right will be important, given the longer lasting impacts compared to spending money on temporary economic support. Ensuring the net benefits will be maximised remains just as important, but also more challenging to get right when travel patterns and population growth may be quite different in future compared to the recent past.

ASB Economics & Research			Phone
Chief Economist	Nick Tuffley	nick.tuffley@asb.co.nz	(649) 301 5659
Senior Economist	Jane Turner	jane.turner@asb.co.nz	(649) 301 5853
Senior Economist	Mark Smit	mark.smith4@asb.co.nz	(649) 301 5957
Senior Economist	Mike Jones	mike.jones@asb.co.nz	(649) 301 5660
Senior Rural Economist	Nathan Penny	nathan.penny@asb.co.nz	(649) 448 8778
Senior Economist, Wealth	Chris Tennent-Brown	chris.tennent-brown@asb.co.nz	(649) 301 5915
Data & Publication Manager	Judith Pinto	judith.pinto@asb.co.nz	(649) 301 5660

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