Economic Note

NZ Budget 2021 Preview

14 May 2021

Striking the right balance

- The NZ economy and public finances have held up much better than earlier thought and we expect Budget 2021 to show smaller forecast fiscal deficits, a lower peak in Crown debt and an associated scaled-back NZ Government bond programme.
- The focus is turning increasingly towards a more targeted and fiscally prudent message. Delivering on this will not be easy.
- Longer-term fiscal challenges also remain, with the Government expected to signal an enhanced focus on converting policy intent into action and results. The proof will be in the pudding.

Summary

Budget 2021 is expected to show a turnaround in fiscal fortunes from the gloom that characterised much of 2020. We expect Budget 2021 to show smaller fiscal deficits, a lower peak in Crown debt and a trimmed bond issuance programme. However, this is from a considerably weaker fiscal starting point than pre-pandemic levels, with public debt having mushroomed since the onset of COVID-19. This was necessary given the need for fiscal policy to support the economy. From the throwing the kitchen sink at it approach of Budget 2020, we expect a change in tone in Budget 2021, with more targeted and fiscally prudent fiscal messages instilled. Striking the right balance between supporting the economy, achieving the Government's key priorities, and putting the public finances on a sounder trajectory so as to meet longer-term challenges will prove tricky. Moves by the Government to set up an Implementation Unit to get more bang for its policy buck and to reconnect with our key trading partners are steps in the right direction. It remains to be seen, however, whether positive intent will translate into better economic and societal outcomes for NZ.

FISCAL PROJECTIONS - ASB Budget 2021 Estimates					
June years	**2021**	**2022**	**2023**	**2024**	**2025**
Total Crown OBEGAL (% GDP)					
ASB Budget 2021 Estimate	**-4.5**	**-3.8**	**-2.5**	**-2.3**	**-2.0**
Half Year Update 2020	*-5.7*	*-5.2*	*-3.8*	*-3.5*	*-3.2*
Net core Crown debt (%GDP)					
ASB Budget 2021 Estimate	**38.5**	**46.5**	**48.7**	**45.6**	**40.6**
Half Year Update 2020	*39.7*	*49.1*	*52.6*	*50.7*	*46.9*
Bond Tender Programme ($bn)					
ASB Budget 2021 Estimate	**45.0**	**20-25**	**20-25**	**20-25**	**15-20**
Half Year Update 2020	*45.0*	*30.0*	*30.0*	*30.0*	*25.0*

Stronger fiscal starting point but still a long way to go

Budget 2021 is expected to confirm that the NZ economy has weathered the COVID-19 storm much better than envisaged a year ago. As we discussed in a recent note, the massive dollop of policy support has played a key role, with the $50bn COVID-19 Response and Recovery Fund (CRRF) mostly spent (about 15% of NZ annual GDP) helping to keep much of the economy afloat. **The fiscal projections from Budget 2021 are expected to be revised up significantly**, with Operating Balances excluding gains/losses (OBEGAL) deficits of less than 5% for this year and next and a declining deficit profile over the forecast horizon. Such is the depth of the economic hit posed by COVID-19 and the magnitude of fiscal support put in place, the return to outright surpluses still looks to be a long way off.

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Careful, but balanced

With the worst of the COVID-19 crisis arguably behind us and the NZ economy showing considerable resilience, there would be the temptation for the Government to deliver a more business-as-usual Budget. However, with the pandemic still raging in many parts of the world and with the NZ economy not firing on all cylinders, the urgency to move the books back into surplus can wait until the government is confident that the economic expansion is entrenched.

We do, however, expect that the Budget will seek to place fiscal settings onto a sounder medium-term trajectory. April 1 tax increases for high labour income earners were a step in that direction. **Moreover, a key focus will be on getting better value for money from the provision of public goods and services, with more targeted and fiscally prudent messages instilled.** With core Crown expenditures now more than one-third of our nationwide GDP, improved efficiencies here could not only save the Crown money but could also improve economy-wide productivity.

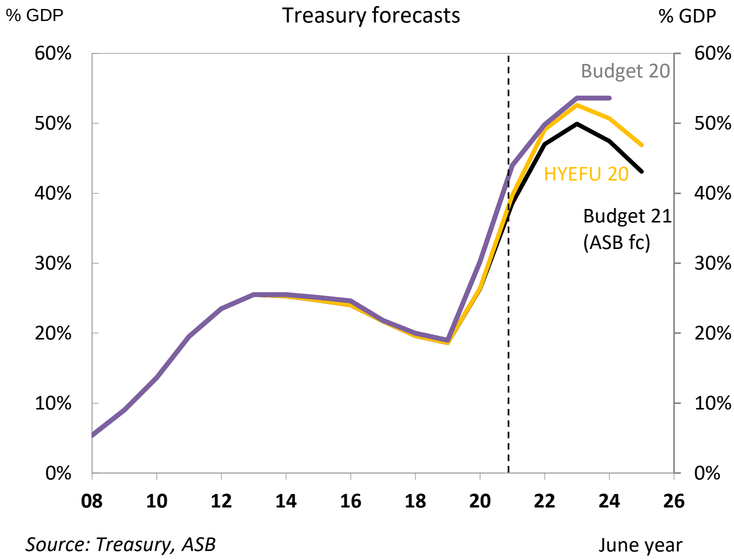
There are signs that the Government intends to take a prudent approach, although this will be easier said than done. The Government recently announced that it had 'found' $926m of savings from the CRRF that would be recycled into other spending. It has also sought to instil restraint amongst government employees, signalling public servants earning more than $60,000 per annum will only be offered pay increases under select circumstances for the next three years. This may be difficult to achieve, given escalating costs and acute skill shortages. The Government may be giving itself more wiggle room, with reports they will expand the operating allowances (an extra $2.625bn per year across the next four Budgets) and capital allowances ($7.8bn over for years) above what was signalled in the February Budget Policy Statement.

Taking the Treasury projections at face value we expect that the Treasury fiscal impulse will show a mildly more contractionary stance from Budget 2021 than signalled in recent Treasury updates. This will be mildly more negative for NZ short-term interest rates and the NZD.

Debt & Bond Programme lower

With smaller deficits expected over the forecast horizon, public debt is expected to rise less rapidly. We anticipate that net core crown debt will peak under 50% of GDP by 2023/23 and modestly decline thereafter. **The NZ Government bond programme is expected to be trimmed by up to $40bn over the 2021/2025 period, with gross issuance as low as $120bn.** Gross issuance over 2020/21 is expected to be close to the $45bn earmarked in the 2020 HYEFU, with NZ Debt Management (NZDM) looking to have pre-funded much of the year's issuance. However, we expect the Government to issue roughly $20-25bn in each of the next three fiscal years (vs. $30bn p.a. forecast in the HYEFU), before dropping back to around $15-20bn by 2025 (was $25bn). The Crown Settlement Account ($42bn in March) is bursting at the seams, providing another avenue for funding. Syndications remain another option if more funding is required. In tandem with lower NZDM issuance, there will likely be a further scaling back in Large Scale Asset Purchases by the RBNZ (with purchases increasingly unlikely to hit the $100bn cap).

Net Core Crown Debt
Treasury forecasts



Source: Treasury, ASB

Implementation Unit a signal of intent to improve delivery

At his pre-Budget speech, Finance Minister Robertson set three core key goals for the Government this term:

- Keeping NZ safe from COVID-19;
- Accelerating NZ's economic recovery;
- Addressing foundational changes of housing affordability, climate change and child wellbeing.

These themes were reiterated in yesterday's speech by PM Ardern and link to the five key wellbeing objectives identified in the 2021 Budget Policy Statement. These included the transition to a low emissions and sustainable economy, boosting innovation and diffusing the gains of new technology, lifting Maori and Pacific incomes, skills &

opportunities, reducing child poverty/improving wellbeing, and supporting physical and mental wellbeing.

The Government has done well in minimising the healthcare and economic toll of COVID-19, and our COVID-19 healthcare response has been close to (or at) global best practice. **However, the Government's track record on meeting other policy objectives has been decidedly mixed.** There has been little progress in boosting economy-wide productivity, addressing bottlenecks in transport and improving housing affordability. Furthermore, longer-term fiscal challenges posed by climate change and the ageing population loom, and preparations need to be made.

To better ensure delivery of its key priorities, the Government has established an Implementation Unit to monitor and support implementation of a small number of initiatives where multiple agencies are involved. The Government is also taking a closer look at various policy settings and is also actively engaging with key trading partners to ensure that the NZ economy will reap more benefits from the post-COVID-19 recovery. Better co-ordination between government departments and reconnecting with key trading partners are steps in the right direction. **Positive intent is one thing, but enhancing structural performance, social and economic wellbeing and resilience is another matter entirely.**

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