Economic Update

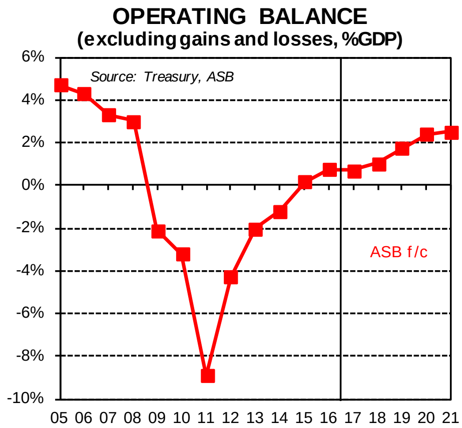
Budget 2017 Preview 19 May 2017

All Black

- With the economy firing, we expect the Budget to show a very healthy set of Government books.
- Indeed with the election looming, there is room for tax cuts or increases in spending.
- Also despite a new Finance Minister, the Budget is likely to retain Bill English's conservative touch.

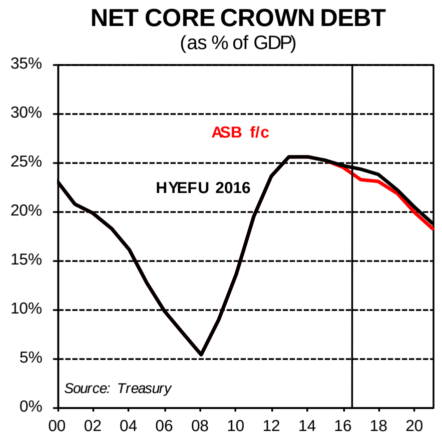
Operating balance – "All Black"

With the NZ economy strong, we expect that Budget 2017 will show that the Government's books remain very healthy. As a result, the Government and new Finance Minister are likely to be spoilt for fiscal policy choices this election year. As at March 2017, the operating balance before gains and losses (OBEGAL) was running ahead of forecast by around $1.3bn. If this trend continues, the Budget is likely to signal an increased surplus to end the 2017 fiscal year and reconfirm surpluses over the Budget forecasting horizon.



Indeed, with the books further into the black than expected, modest tax cuts are possible. Finance Minister, Steven Joyce, has indicated a Government preference for lifting the personal tax income thresholds.

In this sense, the Government may be considering a one-off lift in the thresholds to counter recent effects of fiscal drag. Alternatively, Minister Joyce may look to a more modest lift in the thresholds, but also introduce indexing to the thresholds. As a result, fiscal drag would be removed from the picture on a permanent basis. In addition, Joyce has hinted that a boost to the Working For Families package is possible in a way of delivering income support to lower-income families.



While increases in spending allowances are possible, at the same time the Finance Minister is likely to balance that with stated goals around further reducing net debt. With that in mind, the Budget is likely to show that the Government continues to meet its net debt target of 20% of GDP by 2020 and then reaches 15% or less by 2025.

Growth strong, with some extra inflation

We expect Treasury's updated growth (real GDP) forecasts to reflect continued solid growth over coming years. Similarly, nominal GDP is likely to get a boost on the back of the recent inflation lift. Moreover, higher dairy and other export prices are likely to filter through to higher national incomes. Indeed, it is nominal growth which matters for the Government's tax take. In particular, company tax revenue has been healthy this year, and that is likely to continue.

On the labour market front, we expect Treasury's jobs forecasts to show more job creation over the coming years. However, high population growth via migration, in particular, may mean that subdued wages offset some of the job market strength. On balance, we expect slightly higher PAYE growth than forecast as at the Half-Year Update.

Bond programme – Unders and overs

Given the emphasis the Government continues to place on reducing debt levels, we expect minor changes to the debt programme, despite the possibility of tax cuts or extra spending. In particular, the larger than expected surplus this year gives the Government options. As it stands at March, residual cash is already running $1.1bn ahead of forecast. With that in mind, the Government has announced an additional $2bn of new capital spending compared to the Half-Year Update. If anything, the bond programme may see less issuance at the end of the forecast horizon. However, if the tax cut or spending programmes are larger than we anticipate, the risk is that the bond programme is also larger.

Bond tender programme $bn					
Period Ending June	2017	2018	2019	2020	2021
BEFU 2017*	**8.0**	**7.0**	**6.0**	**6.0**	**6.0**
HYEFU 2016	*8.0*	*7.0*	*7.0*	*6.0*	*6.0*

*ASB Estimates

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Budget Pre-announcements

Budget pre-announcements have focused on the extra capital spending as well as hints from the Finance Minister on tax threshold changes (both discussed above). In addition, the Government has also outlined a $2bn pay settlement for aged-care workers, although that settlement was already largely incorporated into the Half-Year Update. On the day, the majority of focus, particularly in an election year, will be on the details of the tax package as well the topic du jour, housing.

Implications

All up, with a lift in the tax thresholds likely (and less fiscal drag) in addition to extra capital spending, **we expect fiscal policy to be more expansionary at the margin.** In turn, this shift will have a similar marginal impact on the RBNZ's monetary policy outlook.

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