

# Economic Note

NZ 2020 Pre-election Economic and Fiscal Update

11 September 2020

## I see Red, I see Red, I see Red!

- The Pre-election Economic and Fiscal Update updates the fiscal outlook with refreshed economic assumptions.
- The 2021 outlook is likely to show less red ink, given the economy has fared better than Budget forecasts.
- But the longer-term outlook is likely to reflect a more gradual recovery relative to the Budget.

The Pre-election Economic and Fiscal Update (PREFU) is a pro-forma update of the Budget fiscal outlook to take account of updated economic forecasts. Its purpose is to give all political parties and the wider public transparency over the fiscal position heading into October's General Election.

There is, however, nothing pro forma about the current economic outlook, and the forecasts will remain hugely clouded by uncertainty. We would expect to see a better 2020/21 outlook than was shown in the May Budget. But, as we noted in our Budget review, the longer-term economic outlook appeared too rosy. We expect to see some tempering of the Treasury's longer-term outlook, at least to factor in a longer border closure than envisaged for the Budget forecasts.

The upshot is the fiscal position should look slightly stronger over the June 2021 year, but it is possible the Treasury forecasts dial back the longer-term operating balance forecasts. At any rate, the future funding requirement will remain substantial, something for political parties to bear in mind as the election campaign promises roll out.

## Short term is more cheery

In all likelihood the economy didn't dip as much over the June quarter as the Treasury had assumed and should also hold up better than anticipated over the September quarter. The Budget economic forecasts were finalised on April 17, when NZ was at Alert Level 4 and the length and severity of the lockdown was uncertain.

The Treasury assumed that the economy would remain in Level 4 for a month (34 days in reality), Level 3 for a month (16 days in reality) and stay in Level 2 or 1 through to March 2021. Arguably to date the economy has overall been in a lower degree of restriction (notwithstanding the August/September lockdown), and economic data have indicated an encouraging rebound relative to the Budget expectation.

## Medium-term forecasts tempered but still too rosy

The main surprise we got at the Budget release was how rapidly the Treasury forecast the economy to rebound. There appeared little allowance for lingering impacts on the economy of the March-June lockdown. Furthermore, it was assumed the border would reopen from March 2021 (the assumed end of Level 1-2), which seems very optimistic. As an offset, the Budget did allocate a huge amount of stimulus, although infrastructure projects will still take time to get off the ground.

We expect the Treasury will have tempered its longer-term view to some degree. Any opening up of the NZ border to an extent that would cause a sizeable boost to the economy looks some time off, meaning up to a 5% hole in GDP that

will not be readily filled up. The global economic recovery is also likely to be more drawn out. And there is likely to be some scarring effect on the economy’s productive capability as a result of business retrenchment even outside of sectors directly affected by the ongoing border closure.

The Budget forecasts have nominal GDP in the June 2024 year sitting 9% higher than our current forecast. We would expect to see the Treasury’s forecast of nominal GDP revised down to some extent, which means the forecast tax take is likely to be more modest relative to the Budget’s.

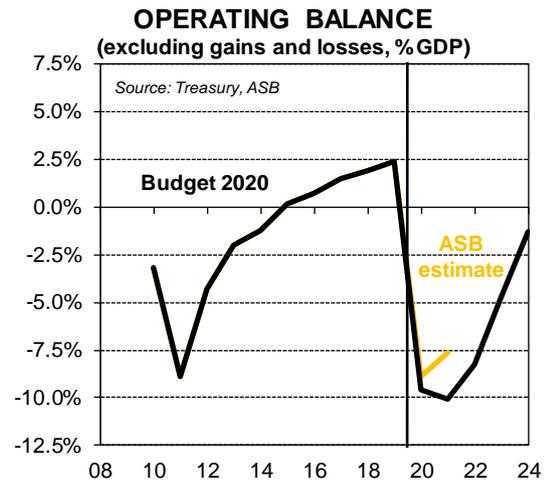
### Piecing together the Fiscal impact

Over the June 2021 year we would expect to see that the operating deficit isn’t as deep (potentially \$23.5bn) as the Budget projection (\$29.6bn). However, in our view, the longer-term operating deficits will be larger than previously forecast, on the assumption the Treasury does trim its growth outlook and – hence – the revenue base. We expect to see the PREFU operating balances move down and the debt levels up towards our own forecasts, though at this point the Treasury outlook is still likely to be more optimistic than our own.

Given heightened uncertainty over the outlook and the future direction of fiscal policy post-election, **the NZ Debt**

**Management Office will be wary of shifting the debt**

**issuance profile too much. There is the risk that the 2021 bond tender programme will be a touch lower than the \$60bn outlined in the Budget**, given the stronger than expected fiscal starting point and the success of recent syndications. Conversely, the weaker longer-term fiscal profile could see subsequent issuance revised up.



Gross NZGB issuance \$bn	2020/21	2021/22	2022/23	2023/24	4-year Total
<b>Budget 2020</b>	<b>60.0</b> ↓	<b>40.0</b> ↑	<b>35.0</b> ↑	<b>30.0</b> ↑	<b>165.0</b>

### The election implications

So far, grand visions from the political parties on how they will steer NZ through its worst economic downturn since the Great Depression are lacking – but there is still time for more elaboration. The fiscal position does have room for supporting NZ’s recovery, with allocations also already set aside. But the huge tidal wave of red ink washing over the Crown accounts is a reminder that we need to ensure that we are getting good bang for buck out of fiscal spending. Future generations will be paying for our current response, at a time when population demographics will also be exerting pressures on the future fiscal position of the Government.

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