Fiscal Forecasts – Finalisation Dates and Key Assumptions

Finalisation Dates	
Economic outlook (refer Chapter 1)	27 April
Tax revenue forecasts	28 April
Fiscal forecasts	7 May
Government decisions and circumstances	7 May
Actual asset revaluations	31 March
Foreign exchange rates	31 March
Specific fiscal risks (refer Chapter 4)	7 May
Contingent liabilities and commitments (refer Chapter 4)	31 March

Key assumptions

The fiscal forecasts have been prepared in accordance with the Fiscal Responsibility Act 1994. They are based on the Crown's accounting policies and assumptions (refer page 106 of the GAAP tables). As with all assumptions, there is a degree of uncertainty surrounding them. This uncertainty increases as the forecast horizon extends. A summary of the key economic assumptions that are particularly relevant to the fiscal forecasts is provided below (on a June-year-end basis to align with the Crown's balance date of 30 June):

	2003/04		2004/05	2005/06	2006/07	2007/08
June years	**BEFU 03**	**BEFU**	**BEFU**	**BEFU**	**BEFU**	**BEFU**
Real GDP (P) (ann avg % chg)	2.1	3.5	2.4	2.8	3.3	3.0
Nominal GDP (E) ($m)	134,034	137,763	144,441	150,947	158,626	167,051
CPI (annual % change)	1.6	2.2	2.5	2.4	2.1	2.0
Govt 10-year bonds (qty avg %)	6.2	6.0	6.3	6.0	6.0	6.0
90-day bill rate (qty avg %)	5.3	5.6	5.8	5.8	5.8	5.8
Unemployment rate ((HLFS) basis ann avg %)	5.5	4.6	4.7	5.0	4.9	4.8
Full-time equivalent employment (ann avg %)	1.0	2.9	1.0	0.9	1.6	1.4
Current account (% of GDP)	-5.1	-4.9	-5.9	-5.8	-5.3	-4.9

Source: The Treasury

New Zealand Superannuation (NZS) Fund

The estimated annual contribution to the NZS Fund for the year ending 30 June 2005 is $2.107 billion. The contribution to the NZS Fund is calculated over a 40-year rolling horizon to ensure superannuation entitlements over the next 40 years could be met if the contribution rate were to be held constant at that level for 40 years.

The Government is making the required annual contribution for 2004/05 as calculated by the formula set out in the NZS Fund Act.

$ billion (June year end)	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Required contribution	N/A	N/A	1.879	2.107	2.219	2.342	2.504
Actual/Budgeted contribution	600	1.200	1.879	2.107	2.219	2.342	2.504

The underlying assumptions in calculating the contribution are the nominal GDP series to 2048, the New Zealand Superannuation (NZS) expense series to 2048, and the expected long-run net after-tax annual return of the NZS Fund (6.8%) (6.8% *December Update*). The forecast rate of return is based on the forecasts of the Guardians of NZS. The GDP and NZS expense series were projected using the assumptions stated on page 29 of the 2004 FSR.

The Treasury website contains further information on the NZS Fund, as well as a copy of the NZS Fund model.

2

Fiscal Outlook

Summary of *Budget Update*

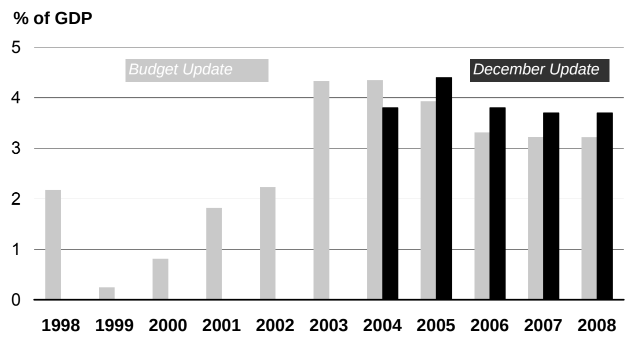
The forecast fiscal outlook is strong with the OBERAC remaining above 3% of GDP and debt-to-GDP drifting down. These tracks are slightly weaker than the *December Update* due to:

- the impact of the final 2004 Budget package being higher than that signalled in the 2004 BPS, and
- the decision to fund additional foreign exchange reserves for the Reserve Bank of New Zealand.

These changes translate into:

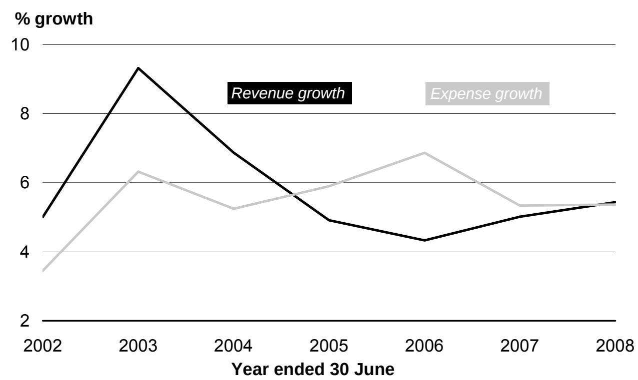
- an OBERAC of $6.0 billion (4.3% of GDP) forecast in 2003/04, around $0.8 billion higher than the *December Update* largely reflecting lower expenses due to delays in departmental spending (transferred to 2004/05)
- an OBERAC that decreases in 2004/05 to 3.9% of GDP ($5.7 billion) due to expense growth outpacing revenue growth mainly driven by both the effect of the 2004 Budget package and the catching up in spending delays from 2003/04
- the OBERAC continuing to decrease in 2005/06 to 3.3% of GDP ($5.0 billion), reflecting a softening in the economic position resulting in slower growth in tax revenue, and the rising profile of the *Working for Families* package included in the 2004 Budget package. The OBERAC remains relatively flat over the remainder of the forecast horizon as revenue growth and expense growth converge at around 5% per annum

Figure 2.1 – OBERAC comparison



Source: The Treasury

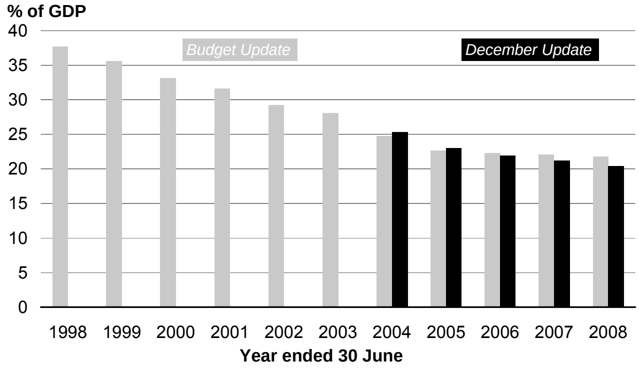
Figure 2.2 – Core Crown revenue and expense growth (excluding GSF valuation)



Source: The Treasury

- the OBERAC being fully or more than fully utilised on expanding the balance sheet through the building up of financial assets (NZS Fund) and funding the Government's capital programme (refer page 56)
- gross sovereign-issued debt (gross debt) in nominal terms being forecast to fall until 2004/05, reflecting that residual cash surpluses from actual outturns are adequate to fund the Government's spending commitments and repay debt
- in 2005/06 and beyond, nominal gross debt being forecast to slowly rise as the capital spending is not fully funded from operating surpluses
- gross debt rising in nominal terms, but as a percentage of GDP it is continuing to fall. This is because the rate of increased borrowing is lower than the expected growth in the economy. A falling debt-to-GDP ratio is consistent with the Government's long-term fiscal objectives

Figure 2.3 – Gross sovereign-issued debt comparison



Source: The Treasury

- gross sovereign-issued debt as a percentage of GDP being forecast to fall from 28.0% of GDP in 2002/03 to 21.8% of GDP by 2007/08, but at a rate slower than forecast in the *December Update* reflecting the effects of the final 2004 Budget package and additional capital commitments (such as the purchase of additional foreign exchange reserves)
- as a result of the increased overall cash expected in 2003/04 partially offsetting the forecast increased spending for 2004/05, the Government's domestic bond programme for 2004/05 remains unchanged from that signalled in the *December Update* of $2.3 billion. The Government's domestic bond programme is $3 billion for 2005/06, $3.6 billion for 2006/07 and $0.5 billion for 2007/08. There is no change to the remaining 2003/04 programme
- the NZS Fund being forecast to grow to $15.5 billion by 2007/08, reflecting cumulative contributions of around $11.1 billion between 2003/04 and 2007/08. The remaining growth represents the expected return on the Fund's financial assets
- Tables of the key indicators are located on pages 66 and 67.

Fiscal Indicators and the Use of the Operating Surplus

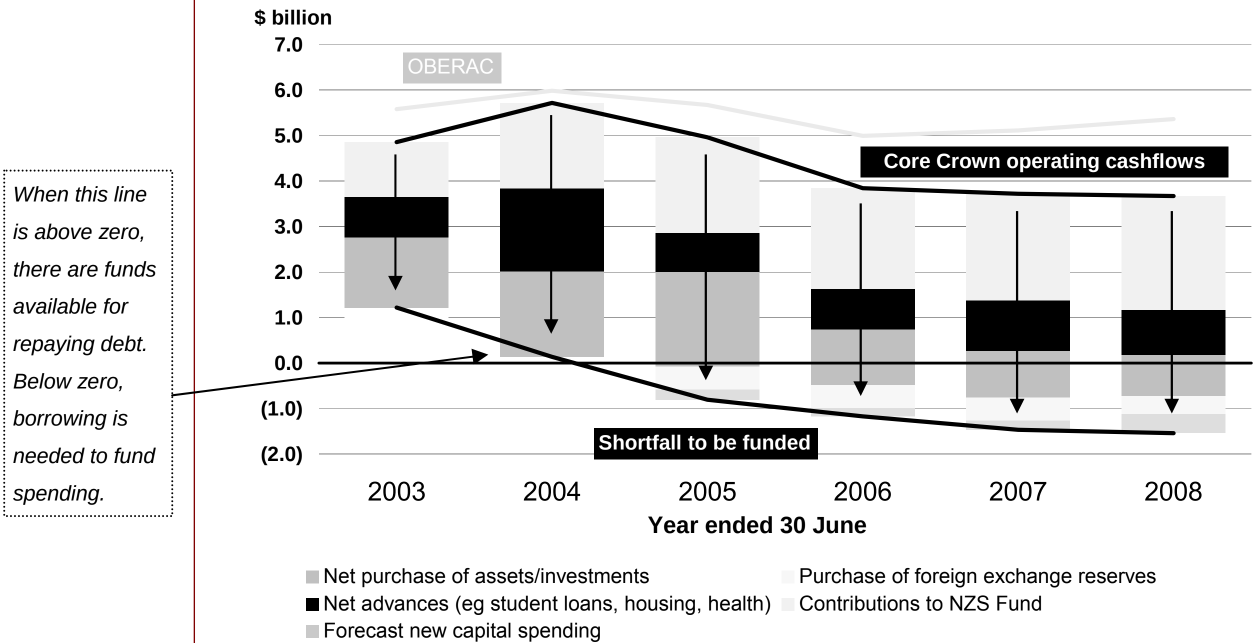
There are a number of indicators that are important in understanding the state of the Government's fiscal position. All provide important information on the Government's activity and no one indicator can explain everything. For example:

- the operating surplus reflects the difference between current revenues and current expenses. It also includes the results of SOEs and Crown entities. It is an accrual measure showing whether the Government is raising sufficient revenue to cover current expenses. It does not capture all spending, especially new capital spending
- cash flows provide an indicator of the net effect of all activity, operating and capital, and how it will be financed. Put another way, cash flows can be used to show how any operating surplus is utilised. They show the cash effect of any operating surplus and how it is then either used to repay debt (which happened through the 1990s when government debt was high) or spent on acquiring assets (which has been the focus recently to save in the NZS Fund or allocate more to new assets)
- gross debt is a stock (a balance sheet item). The debt burden captures the effect of government decisions in that all operating and capital expenditure not funded by revenues or asset sales will need to be funded by borrowing. The Government is working to ensure debt is falling through 20% of GDP before 2015.

Why does the Government run an operating surplus? Why is it not "available" for more spending or tax cuts?

The answer to these questions is the Government's fiscal strategy. The Government runs an operating surplus to help it save for future demographic issues (hence the contributions to the NZS Fund) and to assist in the financing of the Government's capital programme. The Government still needs to borrow some money in many years to fund the shortfall between the forecast operating surplus and the capital programme (which is often larger than the surplus).

The following graph shows how the operating surplus (or OBERAC) is used in each year over the forecast horizon, and therefore why nominal debt has to increase even when there is a "surplus".



Source: The Treasury

The following table explains how the operating surplus/OBERAC is calculated for the 2003/04 and the 2004/05 financial years and then how it is applied. Any extra spending or reduced tax revenue would add to the bottom-line cash shortfall (and add to the need to borrow).

	2003/04 $ million	2004/05 $ million	Description of Items
(the sum of the first three lines = operating balance)	46,621	48,910	**Core Crown revenues** – these are the revenues the Government collects. They are mainly taxes.
	-42,211	-44,474	**Core Crown expenses** – these represent most of the Government's spending, *BUT not all of it*. They are the day-to-day spending (salaries, benefit payments, etc) that does not create Government assets.
	1,465	1,235	**Net surplus of SOEs and Crown entities** – this is the net surplus (after dividends) that SOEs and Crown entities make.
	111	-	**OBERAC adjustments** – removal of large revaluation movements
OBERAC	**5,986**	**5,671**	**OBERAC** – the residual from revenues and expenses less removal of large valuation movements (the OBERAC and operating balance are the same in forecast years).
Less	-266	-710	**Retained items and non-cash items** – items such as the net surplus of SOEs/Crown entities and the net investment returns of the NZS Fund are retained by these entities. The surpluses generated (unless withdrawn from the entities) cannot be used for other purposes so do not aid in funding other government spending. Depreciation expense is also removed as it is non-cash (it is captured in the actual purchase of assets below).
Equals surplus cash flows	**5,720**	**4,961**	**Cash from operations** – these are the cash flows from core Crown operations (excluding the NZS Fund). They are the cash equivalent of the operating surplus. They are available to assist funding the capital spending.
Less capital spending	-1,879	-2,107	**Contributions to the NZS Fund** – the Government's annual contribution to the NZS Fund to build up assets to contribute to future NZS payments.
	-1,593	-1,277	**Purchase of assets** – departments buy assets including computer equipment, new buildings (eg, prisons) and defence equipment.
	-1,830	-857	**Loans to others (advances)** – these are mainly student loans (the Government is committed to help students access tertiary education by funding student loans).
	-283	-800	**Capital injections** – investments in Crown entities to enable them to build hospitals and housing.
	-	-500	**Reserve Bank reserves** – purchase of extra reserves to assist the Reserve Bank to maintain financial stability.
	-	-228	**Capital forecast** – an amount set aside for further capital activity. The Government has not yet decided on the specific initiatives.
What is left	**135**	**-808**	**Cash available**/(**shortfall**) – this amount needs to be funded. Funding is provided by selling surplus financial assets (because of surplus cash from prior years) or borrowing more.

Key Trends

The Government continues to sustain strong operating surpluses…

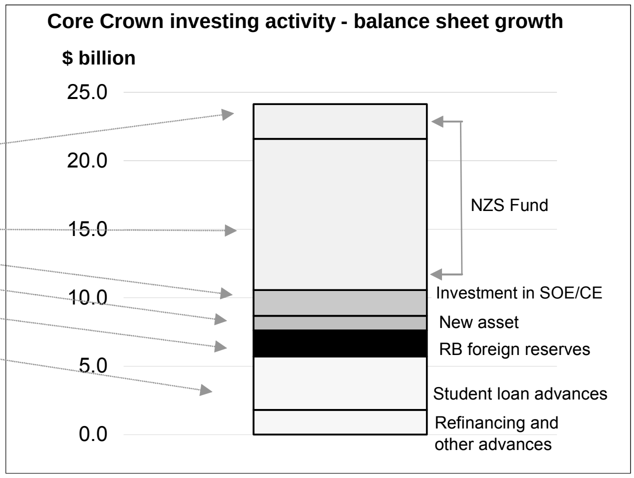
The OBERAC is forecast to peak in 2003/04 at $6.0 billion, before reducing to $5.7 billion in 2004/05 and then to around $5.0 billion over the remaining outyears. The OBERAC as a percentage of GDP declines from 4.3% in 2003/04 to 3.9% in 2004/05 and then flattens at 3.2% from 2005/06 onwards.

… enabling the cash surpluses to be utilised to fund its investment programme…

The core Crown cash flow from operations (core Crown OBERAC equivalent) will be fully utilised to fund capital programmes.

Table 2.1 – Impact of core Crown operating surpluses on the balance sheet from 2003/04 to 2007/08 inclusive

	$ billion
Total Core Crown Operating Balances	19.6
Add	
Depreciation	5.1
Less	
Retained NZS Fund returns	(2.5)
Other	(0.3)
Operating cash flows	21.9
Invested in	
NZS Fund contributions	(11.1)
SOE/Crown entities net capital injections	(1.9)
Increase asset base	(1.1)
Purchase of foreign reserves	(1.9)
Maintain existing asset base	(5.1)
Advances	(5.7)
Other	0.0
Requiring Finance	(4.9)



Source: The Treasury

Over the current year and entire forecast horizon (2003/04 to 2007/08) the core Crown generates operating cash surpluses of $21.9 billion. The cash is invested primarily in NZS Fund contributions of $11.1 billion, advances of $5.7 billion (mainly student loans and refinancing existing private sector debt of the health and housing sectors), purchases of physical assets of $8.1 billion (schools, hospitals, defence equipment, for example) and the purchase of foreign exchange reserves of $1.9 billion. The table above illustrates that cash operating surpluses are not sufficient to fund all the capital commitments and that there is a residual financing requirement of $4.9 billion.

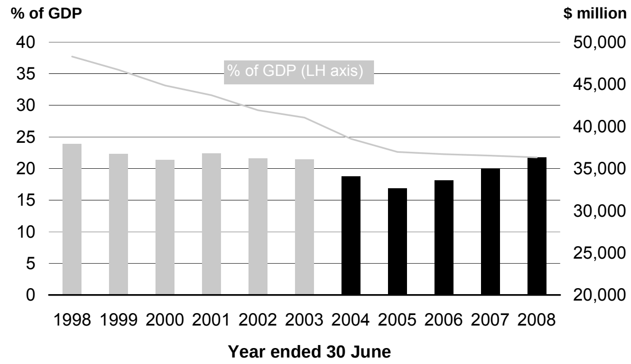
The residual financing requirement is met from selling existing holdings of surplus marketable securities and deposits and raising some debt.

… while gross debt initially falls and then rises over the forecast horizon…

Gross debt falls in nominal terms to $32.7 billion by 2004/05, and then rises to $36.3 billion by the end of the forecast horizon to be at a similar level to the 2002/03 actual outturn. As a percentage of GDP, gross debt falls from 28.0% in 2002/03 to 21.8% by 2007/08.

The initial decrease in debt reflects surplus cash from the strong OBERAC results in actual outturns. Gross debt then slowly rises, reflecting the fact that capital spending is greater than the funding available due to the OBERAC.

Figure 2.4 – Gross sovereign-issued debt (% of GDP and $ million)



Source: The Treasury

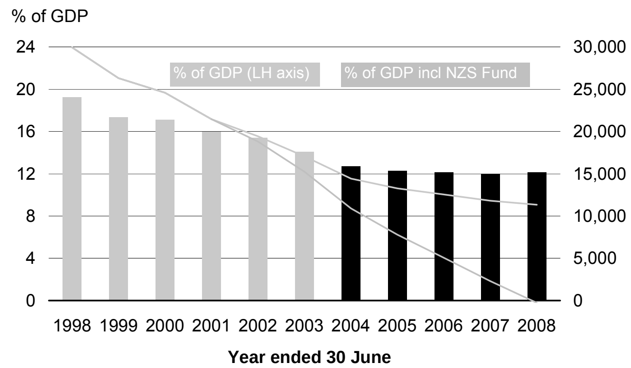
The increased cash position from 2003/04 is partially sufficient to absorb the additional spending commitments forecast in 2004/05, resulting in the Government's 2004/05 bond programme remaining unchanged from that signalled in the *December Update* of $2.3 billion. The forecast 2005/06 programme has been increased to $3.0 billion from the $2.8 billion previously forecast.

… net debt also falls before flattening by the end of the forecast horizon.

In nominal terms in the current year net debt falls, reflecting the stronger cash position due to a higher OBERAC and delays in the capital programme. Unlike gross debt, net debt remains relatively flat between 2004/05 and 2007/08, reflecting the fact that some of the anticipated borrowing is net debt neutral (such as the additional purchase of foreign currency reserves and advances) and the utilisation of past build-up of deposits.

Net debt as a percentage of GDP reduces from 13.7% in 2002/03 to 9.1% by 2007/08, similar to the trend in gross debt.

Figure 2.5 – Net debt (% of GDP and $ million) and % of GDP including assets of NZS Fund



Source: The Treasury

Net core Crown debt with the financial assets of the NZS Fund is forecast to be below zero by 2007/08.

Revenue and Expenses

Table 2.2 – Revenue and expenses comparison with *December Update*

Revenue and Expenses (% of GDP)	2003 Actual	2004 Forecast	2005 Forecast	2006 Forecast	2007 Forecast	2008 Forecast
Core Crown Revenue						
Budget Update	33.9	33.8	33.9	33.8	33.8	33.8
December Update		34.0	34.1	33.9	33.8	33.7
Total Tax Revenue						
Budget Update	30.9	30.7	30.6	30.4	30.3	30.2
December Update		31.0	30.9	30.5	30.2	30.1
Total Crown Revenue						
Budget Update	44.3	43.7	43.3	43.3	43.2	43.1
December Update		43.7	44.2	43.9	43.6	43.3
Core Crown Expenses						
Budget Update	32.4	30.6	30.8	31.5	31.6	31.6
December Update		30.8	30.7	31.2	31.2	31.1
Total Crown Expenses						
Budget Update	42.9	39.5	39.5	40.1	40.1	40.0
December Update		39.3	39.8	40.1	39.9	39.6

Source: The Treasury

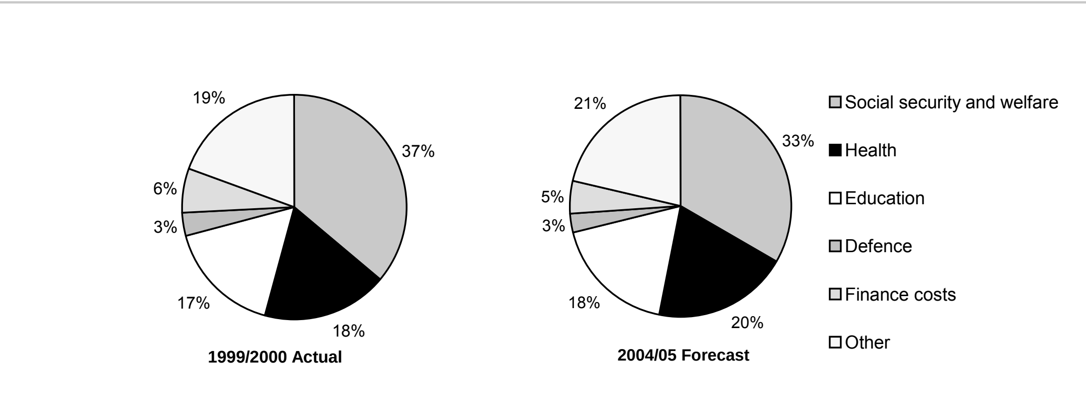
Over the forecast period, the total Crown revenue-to-GDP and expenses-to-GDP ratios are reasonably stable.

The revenue-to-GDP trend of the total Crown is driven mainly from the trend in "core Crown" revenue forecasts, which are discussed in more detail under the Tax Revenue heading below.

The core Crown expenses-to-GDP ratio rises marginally in 2005/06, reflecting the impact of the final 2004 Budget package and then levelling out at around 31.6% of GDP.

Working for Families, health and education received the majority of funding in the 2004 Budget. As illustrated below, the make-up of core Crown expenses have not altered significantly over the past five years. The majority of the decrease in social welfare expenses as a percentage of total spending over the five years is due to minimal growth in beneficiary numbers reducing the growth in social security expenses compared with other spending areas.

Figure 2.6 – Core Crown functional expenses as a percentage of total expenses



Source: The Treasury

Tax Revenue

Table 2.3 – Tax revenue indicators

Tax Revenue ($ million)	2003 Actual	2004 Forecast	2005 Forecast	2006 Forecast	2007 Forecast	2008 Forecast
Total Crown	39,785	42,353	44,193	45,915	48,048	50,532
(% of GDP)						
Total Crown	30.9	30.7	30.6	30.4	30.3	30.2

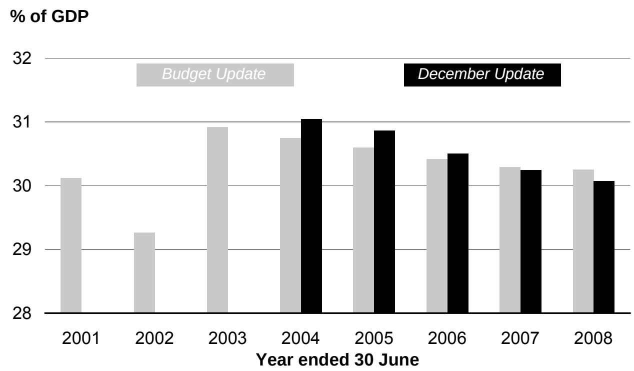
Source: The Treasury

Tax forecasts are little changed since the December Update…

The tax forecast relative to GDP follows a pattern broadly similar to that seen in the *December Update* forecast. In nominal terms, the tax forecasts have not changed by much in any one year, primarily due to two offsetting factors:

- Lower other persons tax across the forecast horizon.
- Transport-related taxes increasing from 2004/05 to fund additional transport-related spending.

Figure 2.7 – Comparison of tax revenue forecast



Source: The Treasury

By June 2008, expected tax revenue is $8 billion higher than in 2003/04, enabling the Government to deliver on its spending programmes while continuing to lower debt levels relative to GDP. The forecast growth in the economy is the dominant driver of tax revenue across the period to 2008, but behavioural and policy changes also play a role.

Table 2.4 – Change in tax revenue forecasts since *December Update*

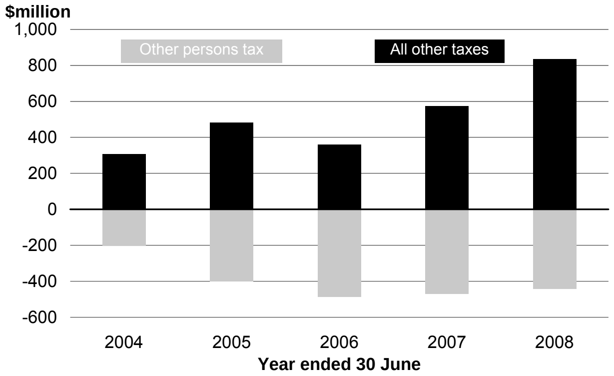
($ million)	2003/04 Forecast	2004/05 Forecast	2005/06 Forecast	2006/07 Forecast	2006/07 Forecast
Tax revenue 2003 *December Update*	42,251	44,114	46,043	47,944	50,140
Changes					
Other persons tax	(205)	(403)	(489)	(470)	(443)
Corporate taxes	126	222	(9)	(62)	16
Resident withholding tax	26	118	150	194	239
Goods and services tax	234	212	103	177	238
Transport tax-related policy changes	-	37	216	243	272
Source deductions	(42)	(81)	(68)	48	90
Other	(37)	(26)	(31)	(26)	(20)
Total Changes	**102**	**79**	**(128)**	**104**	**392**
Tax Revenue 2004 *Budget Update*	42,353	44,193	45,915	48,048	50,532

Source: The Treasury

Other persons tax forecasts are down…

Over the past few years, we have seen stagnation in the number of other persons taxpayers. Despite this stagnation, other persons tax revenue has continued to increase. This is because many other persons taxpayers, such as farmers and builders, have experienced high rates of income growth. This income growth has more than compensated for the lack of growth in the number of taxpayers.

Figure 2.8 – Change in other persons tax forecasts since December Update



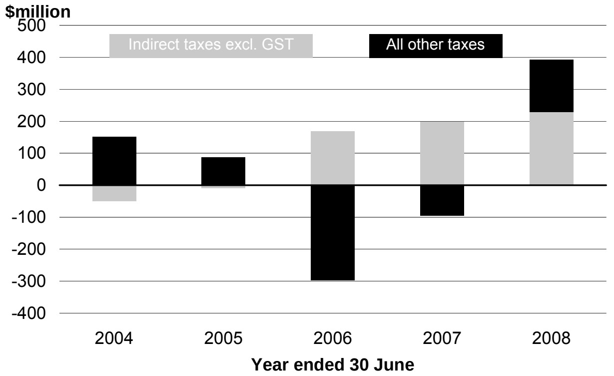
Source: The Treasury

Looking ahead, average income growth within this tax type is now expected to be much lower than before. Combining this with negligible growth in the number of taxpayers, we now expect to see other persons tax revenue much lower than forecast in the *December Update*.

… and changes to fuel taxes boost tax revenue from 2005/06 onward …

On 1 April 2005, the excise rate on petrol will increase by 5 cents per litre exclusive of GST. Further, starting from 1 April 2006, the National Land Transport Fund (NLTF) portion of the petrol excise rate will be inflation-adjusted each year. Corresponding adjustments are planned for some road user charges' rates.

Figure 2.9 – Change in other indirect tax forecasts since December Update



Source: The Treasury

These two policy changes combined are expected to add upwards of $200 million to tax revenue from 2005/06 onwards. Note that the net effect on the core Crown operating balance and gross debt is neutral as corresponding amounts are included in the expense forecasts to pay for transport-related spending.

… other tax changes are relatively minor against the December Update.

- Corporate profits are expected to continue their recent run of relatively high growth rates through 2003/04 and 2004/05 before pausing in 2005/06 as the pace of economic growth slows, producing a distinct cycle in the corporate tax forecasts.

- Resident withholding tax (RWT) forecasts have been revised up because of changes to forecast assumptions. In this *Budget Update* forecast, we have assumed that the deposit base will increase each year by an amount equivalent to about half of the interest earned by households each year.

- GST forecasts have been revised up due to changes to the historical base received from Statistics New Zealand showing that the household consumption base is higher than forecast in the *December Update*. The upward revision to the consumption base has pushed up the GST forecasts in all years.

Effects of Tax Policy Changes on the Tax Forecasts

An up coming additional requirement included in the Public Finance (State Sector Management) Bill is an annual statement of tax policy changes that materially affect the tax revenue forecasts. In anticipation of that change, Table 2.5 details the effect of tax policy changes that have been included in these *Budget Update* tax forecasts.

Table 2.5 – Material changes in tax revenue forecasts owing to changes in tax policy since *December Update*

($ million)	2004 Forecast	2005 Forecast	2006 Forecast	2007 Forecast	2008 Forecast
Material policy changes					
Improving taxpayer compliance	-	-	34	67	67
Fuel excise and road user charges (RUC) rate changes	-	37	209	213	217
CPI-indexation of transport taxes	-	-	7	30	55
Total changes (GST exclusive)	**-**	**37**	**250**	**310**	**339**

The details of each policy change are as follows:

Improving taxpayer compliance

This initiative provides funding for Inland Revenue to position its audit function to respond to the increasing complexity of business structures and tax arrangements. The additional funding will progressively increase available audit hours, resulting in additional audit-assessed revenue from 2005/06.

Fuel excise and road user charges (RUC) rate changes

On 1 April 2005, the excise rate on petroleum fuels will increase by 5 cents per litre, exclusive of GST. An equivalent adjustment will be made to the light-vehicle RUC rates. The additional revenue raised will be used for transport-related spending.

CPI-indexation of transport taxes

From 1 April 2006, the NLTF portion of the petrol excise rate and light-vehicle RUC rates will be inflation-adjusted each year. The additional revenue raised will be used for transport-related spending.

Inland Revenue's tax forecasts

In line with established practice, Inland Revenue has prepared an independent set of tax forecasts, based in the short term on more detailed analysis of taxpayer information, and in the longer term reflecting the same underlying macroeconomic trends that underpin the Treasury's tax forecasts.

Overall, the Inland Revenue and Treasury tax forecasts are broadly similar. Differences in total tax revenue forecasts are less than $100 million in all forecast years. These differences are much smaller than has usually been the case in previous forecasting rounds.

A comparison of Treasury and Inland Revenue forecasts can be found at www.treasury.govt.nz/forecasts/befu/2004.

Expenses

Table 2.6 – Expenses indicators

Expenses	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
($ million)	**Actual**	**Forecast**	**Forecast**	**Forecast**	**Forecast**	**Forecast**
Core Crown	41,749	42,211	44,474	47,526	50,062	52,749
Core Crown (excluding GSF valuation)	39,905	41,997	44,474	47,526	50,062	52,749
Total Crown	55,224	54,470	57,005	60,531	63,605	66,786
(% of GDP)						
Core Crown	32.4	30.6	30.8	31.5	31.6	31.6
Core Crown (excluding GSF valuation)	31.0	30.5	30.8	31.5	31.6	31.6
Total Crown	42.9	39.5	39.5	40.1	40.1	40.0

Source: The Treasury

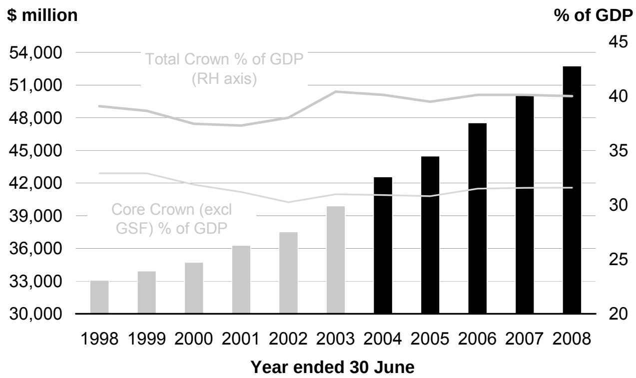
Expenses as a percentage of nominal GDP rise before stabilising

Core Crown operating expenses (excluding valuation items) are expected to rise by 1% of GDP from 30.6% in 2003/04 to around 31.6% of GDP by 2006/07 onwards. This largely reflects the rising profile of the *Working for Families* package and other initiatives included in the final 2004 Budget package.

Total Crown expenses follow a similar trend to core Crown operating expenses.

Core Crown expenses (excluding GSF valuation movements) increase on average by around 5.7% per year, though expense growth is lower towards the end of the forecast horizon at around 5% reflecting smaller budgets for 2006 to 2008.

Figure 2.10 – Core expenses excluding valuations ($ and % of GDP)



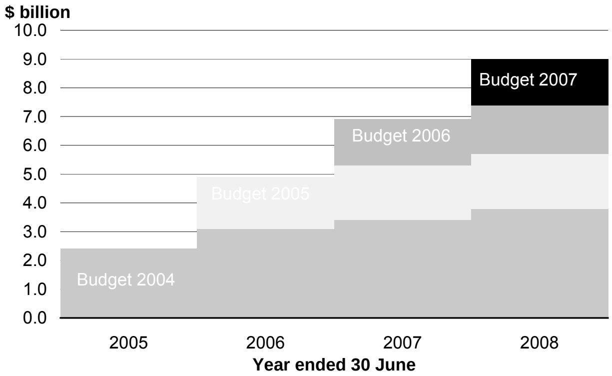
Source: The Treasury

Nominally, core Crown expenses increase around $10.5 billion between 2003/04 and 2007/08. Removing the GSF liability movements, expenses increase by $10.7 billion over the same period. The major drivers of these expense increases are indexation of benefits (around $1.3 billion), demographic changes in benefits, the 2004 Budget package and forecast new spending for future Budgets. The new Budget spending has increased expenses by around $8 billion (GST exclusive, see Figure 2.11 for GST inclusive cumulative increases).

Budget 2004

Details of new spending in the 2004 Budget are documented in a separate *Executive Summary* released with other Budget documentation. In summary, Budget 2004 commits new operating resources of around $2.4 billion (GST inclusive) for 2004/05 rising to around $3.8 billion (GST inclusive) in future years. This is higher than the $2.1 billion rising to $3.4 billion signalled in the 2004 Budget Policy Statement. The majority of the new spending has been allocated to social services and welfare, health and education spending (refer pages 5 to 14 of the *Executive Summary* for further details of the new spending in the 2004 Budget).

Figure 2.11 – New Budget spending (GST inclusive)



Source: The Treasury

Figure 2.11 represents the cumulative new operating spending for the 2004 Budget through to Budget 2007. It shows:

- the 2004 Budget new spending is $2.4 billion rising to $3.8 billion. It has a rising profile, as some costs of initiatives rise as some policies take time to fully implement (eg, the *Working for Families* package)
- Budget 2005 new spending is around $1.8 billion (rising to just under $1.9 billion), while Budget 2006 and Budget 2007 allow for around $1.6 billion of new operating spending. A portion of the future Budget packages have already been allocated to baselines (eg, health funding package).

Budget 2004 forecasts capital spending totalling $1.3 billion spread over the next four years, plus the legislatively-required NZS Fund contributions and purchase of foreign exchange reserves (totalling $1.9 billion).

Table 2.7 – New capital spending since *2003 Budget Update*

($ million)	2004 Forecast	2005 Forecast	2006 Forecast	2007 Forecast	2008 Forecast
2004 Budget capital spending					
Assistance to Business	101	158	92	140	140
Strong Public Service	148	308	183	161	11
Clean and Green Package	(64)	54	19	19	13
Foreign Exchange Reserves	-	500	500	500	400
Total 2004 Budget capital spending	185	1,020	794	820	564

Comparison with *December Update*

OBERAC and operating balance

Compared with the *December Update* the OBERAC is forecast to be stronger in 2003/04, reflecting delays in expenses which have been transferred to 2004/05.

From 2005/06, the OBERAC is relatively flat, which is similar to the profile in the *December Update*, however the *Budget Update* OBERAC is at lower levels, reflecting the final make-up of the 2004 Budget package and the forecast decrease in SOE and Crown entity surpluses.

Table 2.8 – OBERAC reconciliation (explains changes to the OBERAC since the *December Update*)

($ million)	2003/04 Forecast	2004/05 Forecast	2005/06 Forecast	2006/07 Forecast	2007/08 Forecast
OBERAC *2003 December Update*	5,207	6,338	5,795	5,918	6,187
Changes					
Tax revenue	102	79	(128)	104	392
Other sovereign revenue	23	20	12	10	11
Investment income	(26)	52	(8)	(23)	(28)
Other revenue	56	13	(20)	(23)	(24)
Other change to SOEs and Crown entities (excluding ACC valuation change)	389	(234)	(185)	(198)	(289)
Changes (core Crown expenses excluding GSF 2003/04 valuation)					
Reduction in allowance for future operating spending	35	712	1,212	1,965	2,200
Welfare benefits	91	(102)	(503)	(767)	(965)
Education	(19)	(167)	(203)	(260)	(384)
Health	122	(300)	(155)	(683)	(770)
Transport	(18)	(85)	(244)	(316)	(338)
Other core Crown functional expenses	94	(637)	(566)	(565)	(535)
Finance costs	(70)	(18)	(13)	(51)	(92)
Total core Crown expense change	**235**	**(597)**	**(472)**	**(677)**	**(884)**
Total Changes	**779**	**(667)**	**(801)**	**(807)**	**(822)**
OBERAC *2004 Budget Update*	5,986	5,671	4,994	5,111	5,365

Source: The Treasury

Table 2.9 – Reconciling the OBERAC to the operating balance for the year ended 30 June 2004

	BEFU $ million	DEFU $ million	Change
OBERAC 2004	5,986	5,207	779
Adjustment for material valuation items			
ACC valuation movement	107	419	312
Net GSF valuation movement	(218)	466	684
	(111)	885	996
Operating balance 2004	5,875	6,092	(217)

Source: The Treasury

Changes to components within the OBERAC/operating balance forecast include:

- tax revenue is broadly similar to the *December Update* over the forecast horizon; the changes reported are a mix of forecasting and policy changes (as outlined earlier in the chapter)
- the SOE and Crown entity surpluses were higher in 2003/04, mainly reflecting higher investment returns. From 2004/05 forward, surpluses are forecast to be lower by between $190 million and $290 million, partially reflecting lower ACC surpluses and a shift in transport capital spending into operating (this is debt neutral).

In 2003/04 expenses are lower than the *December Update,* largely reflecting spending delays transferring into the following year. Beyond the current year expenses are forecast to be higher mainly due to the final 2004 Budget package and transport expenses (core Crown operating balance neutral as offset by increased tax revenue). Specific expense changes include:

- welfare benefit changes are higher over the forecast period due to the introduction of the *Working for Families* package; partially offset by forecast changes in benefit costs reflecting a lower benefit base than forecast in the *December Update*, of around $200 million from 2004/05 onwards
- transport expenses have increased, reflecting new spending, although the increase is funded by an increase in transport-related taxes
- the change in other functional expenses (education, health and other core Crown functional expenses in Table 2.8) mainly represents the allocation of new spending in the 2004 Budget package, which at the time of the *December Update* was disclosed as allowance for future operating spending (which has decreased in Table 2.8).

Debt indicators

Gross sovereign-issued debt for 2003/04 has reduced from that forecast in the *December Update* by around $400 million due to the appreciation of the New Zealand dollar[8]. The change is net debt neutral as the value of foreign currency marketable securities and deposits has also reduced.

The increased cash position from 2003/04 contributes to debt being lower than the *December Update* in 2004/05. Gross debt is forecast to be higher by $2.3 billion in 2007/08, reflecting the effects of the final 2004 Budget package and additional capital commitments (such as purchase of foreign exchange reserves).

Net debt follows the same trend as gross sovereign-issued debt and is higher by $1.7 billion by 2007/08. The lower difference compared with gross sovereign-issued debt reflects, the fact that some of the increase in gross sovereign issued-debt is being used to fund financial assets (eg, purchase of foreign exchange reserves).

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8 Foreign exchange rates were based on those at 31 March 2004.

Table 2.10 – 2004 *Budget Update* fiscal indicators

Fiscal Indicators ($ million)	2003 Actual	2004 Forecast	2005 Forecast	2006 Forecast	2007 Forecast	2008 Forecast
	Year ended 30 June					
Revenue						
Total revenue	57,027	60,194	62,525	65,374	68,565	72,000
Core Crown revenue	43,624	46,621	48,910	51,027	53,586	56,499
Expenses						
Total expenses	55,224	54,470	57,005	60,531	63,605	66,786
Core Crown expenses	41,749	42,211	44,474	47,526	50,062	52,749
Operating balance - Core Crown	1,875	4,410	4,436	3,501	3,524	3,750
Operating balance - Crown entities	(123)	995	749	936	1,050	1,078
Operating balance - SOEs	428	688	835	928	934	965
Dividend elimination	(214)	(218)	(349)	(371)	(397)	(428)
Operating balance	1,966	5,875	5,671	4,994	5,111	5,365
OBERAC	5,580	5,986	5,671	4,994	5,111	5,365
Cash available/(shortfall to be funded)	1,217	135	(808)	(1,176)	(1,466)	(1,541)
Debt Indicators						
Gross sovereign-issued debt	36,086	34,031	32,663	33,622	34,946	36,344
Total gross Crown debt	38,285	35,640	34,857	36,579	37,572	37,684
Net core Crown debt	17,577	15,901	15,336	15,162	14,985	15,136
Net core Crown debt with NZS Fund assets	15,693	12,016	9,013	6,118	2,909	(345)
Net worth	23,781	29,732	35,403	40,397	45,508	50,873
Domestic bond programme	2,551	2,216	2,311	2,958	3,556	538
Nominal GDP	128,730	137,763	144,441	150,947	158,626	167,051
Fiscal Indicators as a % of GDP						
Revenue						
Total Crown revenue	44.3	43.7	43.3	43.3	43.2	43.1
Core Crown revenue	33.9	33.8	33.9	33.8	33.8	33.8
Expenses						
Total Crown expenses	42.9	39.5	39.5	40.1	40.1	40.0
Core Crown expenses	32.4	30.6	30.8	31.5	31.6	31.6
Operating balance	1.5	4.3	3.9	3.3	3.2	3.2
OBERAC	4.3	4.3	3.9	3.3	3.2	3.2
Debt Indicators						
Gross sovereign-issued debt	28.0	24.7	22.6	22.3	22.0	21.8
Total gross Crown debt	29.7	25.9	24.1	24.2	23.7	22.6
Net core Crown debt	13.7	11.5	10.6	10.0	9.4	9.1
Net core Crown debt with NZS Fund assets	12.2	8.7	6.2	4.1	1.8	-0.2
Net worth	18.5	21.6	24.5	26.8	28.7	30.5
New Zealand Superannuation Fund						
Fund asset returns (after tax)	69	122	331	502	690	901
Fund contributions	1,200	1,879	2,107	2,219	2,342	2,504
Fund assets (year end)	1,884	3,885	6,323	9,044	12,076	15,481
% of GDP	1.5	2.8	4.4	6.0	7.6	9.3

Source: The Treasury

Table 2.11 – 2003 *December Update* fiscal indicators

Fiscal Indicators ($ million)	2003 Actual	2004 Forecast	2005 Forecast	2006 Forecast	2007 Forecast	2008 Forecast
	Year ended 30 June					
Revenue						
Total revenue	57,027	59,522	63,160	66,223	69,077	72,128
Core Crown revenue	43,624	46,330	48,718	51,173	53,539	56,180
Expenses						
Total expenses	55,224	53,508	56,900	60,508	63,240	66,022
Core Crown expenses	41,749	41,868	43,877	47,054	49,385	51,865
Operating balance - Core Crown	1,875	4,462	4,841	4,119	4,154	4,315
Operating balance - Crown entities	(123)	1,308	1,028	1,084	1,178	1,276
Operating balance - SOEs	428	606	781	981	1,032	1,088
Dividend elimination	(214)	(284)	(312)	(389)	(446)	(492)
Total operating balance	1,966	6,092	6,338	5,795	5,918	6,187
OBERAC	5,580	5,207	6,338	5,795	5,918	6,187
Cash available/(shortfall to be funded)	1,217	(1,107)	652	6	(412)	(530)
Debt Indicators						
Gross sovereign-issued debt	36,086	34,469	32,940	33,019	33,604	34,057
Total gross Crown debt	38,285	36,118	35,091	34,937	34,103	33,154
Net core Crown debt	17,577	16,935	15,442	14,619	13,878	13,439
Net core Crown debt with NZS Fund assets	15,693	13,050	9,250	5,780	2,101	(1,626)
Net worth	23,781	29,920	36,258	42,053	47,971	54,158
Domestic bond programme	2,551	2,235	2,317	2,841	3,314	-
Nominal GDP	128,730	136,112	142,932	150,944	158,512	166,744
Fiscal Indicators as a % of GDP						
Revenue						
Total Crown revenue	44.3	43.7	44.2	43.9	43.6	43.3
Core Crown revenue	33.9	34.0	34.1	33.9	33.8	33.7
Expenses						
Total Crown expenses	42.9	39.3	39.8	40.1	39.9	39.6
Core Crown expenses	32.4	30.8	30.7	31.2	31.2	31.1
Operating balance	1.5	4.5	4.4	3.8	3.7	3.7
OBERAC	4.3	3.8	4.4	3.8	3.7	3.7
Debt Indicators						
Gross sovereign-issued debt	28.0	25.3	23.0	21.9	21.2	20.4
Total gross Crown debt	29.7	26.5	24.6	23.1	21.5	19.9
Net core Crown debt	13.7	12.4	10.8	9.7	8.8	8.1
Net core Crown debt with NZS Fund assets	12.2	9.6	6.5	3.8	1.3	-1.0
Net worth	18.5	22.0	25.4	27.9	30.3	32.5
New Zealand Superannuation Fund						
Fund asset returns (after tax)	69	122	328	491	673	878
Fund contributions	1,200	1,879	1,979	2,156	2,265	2,410
Fund assets (year end)	1,884	3,885	6,192	8,839	11,777	15,065
% of GDP	1.5	2.9	4.3	5.9	7.4	9.0

Source: The Treasury

Risks to Fiscal Forecasts

The fiscal forecasts were finalised on 7 May 2004 in accordance with the forecast accounting policies. There are certain risks around the forecast results. To assist in evaluating such risks the following chapters should be read in conjunction with the fiscal forecasts:

- Specific fiscal risks (Chapter 4) – The fiscal forecasts incorporate government decisions up to 7 May 2004. The specific fiscal risks chapter covers specific policy decisions that are under active consideration by the Government at the time of the finalisation of the forecasts.
- Risks and scenarios (Chapter 3) – The fiscal forecasts are based on the economic forecasts presented in Chapter 1 and any variation from the economic forecast will affect on the fiscal forecasts, in particular tax revenue and benefit expenses. The risks and scenarios chapter discusses the effect on the forecasts under different circumstances.

In addition to the specific fiscal risks and the link to the economic forecasts, there are a number of forecasting issues explained below that may arise in future.

Tax forecasting risks

Since the New Zealand economy is entering a slowdown period, we have exercised some caution in the tax revenue estimations, particularly in the tax types most affected by the business cycle. It is possible that the response of tax revenues to the economic slowdown will be more pronounced than we have forecast, meaning that the tax forecasts may be too high. On the other hand, it is also possible that business incomes and, consequently, business taxes may hold up better than expected because, for example, balance sheets may be in better shape than they were in the last downturn of the late 1990s.

On balance, we believe that the tax forecasts are close to the mid-point of possible outcomes, given the macroeconomic forecasts. However, given the uncertainty around the magnitude of the response of the tax system to an economic slowdown, the range of possible outcomes for tax revenue over the next few years may be larger than has been the case in recent forecasts.

State-owned enterprises and Crown entities forecasts

The forecasts for large SOEs and Crown entities were provided in March 2004 based on their best assessments at that time. These entities are still in the process of finalising their individual *Statements of Intent* and their individual forecasts may alter.

Revaluation of property, plant and equipment

Crown accounting policy is to revalue certain classes of property, plant and equipment on a regular basis. In certain circumstances the valuation will be affected by foreign exchange rates, so any appreciation in the New Zealand dollar (from 30 June 2003) will adversely affect the current physical asset values included in the fiscal forecasts.

Discount rates

The GSF and ACC liabilities included in these forecasts have been valued as at 29 February and 31 March respectively. The liabilities are to be next valued at 30 June 2004 for inclusion in the year-end financial statements. Any change in discount rates will affect the presented fiscal forecast. For example, if the discount rate rises, the value of the liabilities will decrease.

International financial reporting standards

The New Zealand Accounting Standards Review Board announced in December 2002 that International Financial Reporting Standards (IFRSs) will apply to financial reporting by both public and private sector entities from 1 January 2007, but with entities having the option to adopt from 1 January 2005.

The Crown plans to adopt the New Zealand IFRSs in the 2007 Budget.

Tertiary education institutes' (TEIs') accounting treatment

The forecast information presented in the *2003 Budget Update* combined TEIs on a line-by-line basis. As noted in previous publications the combination treatment of TEIs remains unresolved.

The combination method adopted in these forecasts is to equity account for the TEIs' net surpluses and net investment and not the TEI revenues, expenses, assets and liabilities on a line-by-line method. This is consistent with the treatment adopted in the 2003 Crown financial statements.

To ensure comparability, the forecasts contained in the *2003 Budget Update* have been restated where published as part of the *2004 Budget Update*. The key indicators are unchanged as a result of the combination approach for TEIs (refer page 60 of the 30 June 2003 Crown financial statements).