Fiscal Forecasts – Finalisation Dates and Key Assumptions

Finalisation Dates	
Economic outlook (refer Chapter 1)	16 April
Tax revenue forecasts	20 April
Fiscal forecasts	9 May
Government decisions and circumstances	9 May
Actual asset revaluations	28 February
Foreign exchange rates	28 February
Specific fiscal risks (refer Chapter 4)	9 May
Contingent liabilities and commitments (refer Chapter 4)	31 March

Key Assumptions

The fiscal forecasts have been prepared in accordance with the Public Finance Act 1989. They are based on the Crown's accounting policies and assumptions (refer page 158 of the *GAAP Series 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):

	2006/07		2007/08	2008/09	2009/10	2010/11
June years	**HYEFU**	**BEFU**	**BEFU**	**BEFU**	**BEFU**	**BEFU**
Real GDP (P) (ann avg % chg)	2.0	2.1	2.3	1.8	3.0	3.2
Nominal GDP (E) ($m)	162,667	164,868	173,187	179,132	186,985	196,177
CPI (annual avg % change)	2.7	2.7	2.4	2.4	2.3	2.1
Govt 10-year bonds (ann avg %)	5.9	5.8	6.1	6.1	6.1	6.0
90-day bill rate (ann avg %)	7.5	7.7	7.9	6.8	6.4	6.2
Unemployment rate ((HLFS) basis ann avg %)	4.0	3.8	3.9	4.4	4.5	4.3
Full-time equivalent employment (ann avg % change)	0.9	0.8	1.6	0.9	0.8	1.4
Current account (% of GDP)	-9.3	-8.3	-7.2	-6.9	-6.8	-6.1

Source: The Treasury

New Zealand Superannuation (NZS) Fund

The contribution to the NZS Fund for the year ending 30 June 2007 is $2.049 billion. The contribution to the NZS Fund is calculated over a 40-year rolling horizon to ensure that superannuation entitlements over the next 40 years can be met if the contribution rate were to be held constant at that level. The Government is making the required minimum annual contribution for 2006/07 and 2007/08 as calculated by the formula set out in the NZS Act.

$billion (June year end)	2005	2006	2007	2008	2009	2010	2011
Required contribution	2.107	2.337	2.049	2.103	2.194	2.312	2.458
Actual/Budgeted contribution	2.107	2.337	2.049	2.103	2.194	2.312	2.458

Source: The Treasury

The underlying assumptions in calculating the contributions for 2007 are the nominal gross domestic product (GDP) series to 2047, the NZS expense series to 2047 and the expected long-term, net after-tax annual return of the NZS Fund (6.1%) (6.1% *Half Year Update*). The forecast rate of return is based on the Treasury's assumptions for the rate of return on financial portfolios of Crown financial institutions. 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 the *Budget Update*

Economic growth has accelerated again after a period of weak growth in 2005 and 2006. Growth over 2007/08 is expected to be stronger than forecast at the time of the 2006 *Half Year Economic and Fiscal Update* (*Half Year Update*).

This rebound in growth has largely been the result of resurgence in domestic demand, with both private consumption and housing and business investment showing renewed strength.

This growth, together with higher terms of trade and persistent domestic price pressures has resulted in higher GDP, flowing directly into higher tax forecasts of around $3.3 billion over the forecast horizon.

Offsetting some of the forecast growth in tax are tax policy initiatives of around $1.4 billion which form part of Budgets 2007 and 2008. In addition, new expense initiatives are above what was signalled in the *2007 Budget Policy Statement (BPS)* by around $1.2 billion by 2010/11. The main driver of this increase in expenses is the enhancements to the KiwiSaver initiative previously announced in Budget 2005. These factors result in a fiscal outlook for the *Budget Update* that shows:

- Slower core Crown revenue growth relative to recent years, with revenue remaining stable at around 34% of GDP over the forecast period, and expenditure rising to around 33% of GDP by 2010/11.
- After peaking last year at 7.3% of GDP the operating balance returns to just under 4% of GDP in 2006/07 and declines over the rest of the forecast period. The operating balance before gains and losses (OBEGAL) and excluding NZS Fund revenue follows a similar trend.
- After taking account of the Government's capital programme, including contributions to the NZS Fund, the core Crown is forecast to record cash deficits from 2007/08.
- Gross sovereign-issued debt rising in nominal terms, but falling slowly to 21.8% of GDP by the end of the forecast period.
- Net core Crown debt rising over the forecast period, but at 3.5% of GDP in 2010/11 it is lower than the levels forecast at the *Half Year Update*.
- The NZS Fund is forecast to be $27 billion (13.8% of GDP) by the 2010/11.

Table 2.1 – Summary fiscal indicators[6]

($million)	OLD GAAP 2006 Actual	OLD GAAP 2007 Forecast	NEW GAAP 2007 Forecast	NEW GAAP 2008 Forecast	NEW GAAP 2009 Forecast	NEW GAAP 2010 Forecast	NEW GAAP 2011 Forecast
Year ended 30 June							
Core Crown revenue excluding NZS Fund revenue			57,123	59,304	61,077	63,733	66,906
Core Crown revenue	59,170	59,502	57,006	59,402	61,172	63,825	66,993
Core Crown expenses	49,900	53,775	52,783	56,096	58,819	61,677	64,898
OBEGAL[7] excluding NZS Fund revenue			5,654	4,860	3,862	3,438	3,260
OBERAC	8,648	7,380					
Operating balance	11,473	6,568	6,327	6,431	5,569	5,310	5,366
Residual cash	2,985	1,720	1,720	(976)	(1,687)	(1,649)	(1,426)
Gross sovereign-issued debt	35,461	37,217	37,935	40,400	40,231	39,894	42,737
Net core Crown debt (incl NZS Fund)	(5,138)	(7,962)	(7,534)	(10,784)	(13,145)	(16,008)	(19,287)
% of GDP							
Core Crown revenue excluding NZS Fund revenue			*34.6*	*34.2*	*34.1*	*34.1*	*34.1*
Core Crown revenue	*37.8*	*36.1*	*34.6*	*34.3*	*34.1*	*34.1*	*34.1*
Core Crown expenses	*31.9*	*32.6*	*32.0*	*32.4*	*32.8*	*33.0*	*33.1*
OBEGAL excluding NZS Fund revenue			*3.4*	*2.8*	*2.2*	*1.8*	*1.7*
OBERAC	*5.5*	*4.5*					
Operating balance	*7.3*	*4.0*	*3.8*	*3.7*	*3.1*	*2.8*	*2.7*
Residual cash	*1.9*	*1.0*	*1.0*	*(0.6)*	*(0.9)*	*(0.9)*	*(0.7)*
Gross sovereign-issued debt	*22.6*	*22.6*	*23.0*	*23.3*	*22.5*	*21.3*	*21.8*
Net core Crown debt (incl NZS Fund)	*(3.3)*	*(4.8)*	*(4.6)*	*(6.2)*	*(7.3)*	*(8.6)*	*(9.8)*

Source: The Treasury

Old GAAP and New GAAP

The forecasts in Budget 2007 have been prepared under a new set of accounting standards – New Zealand equivalents to International Financial Reporting Standards (NZ IFRS). These new standards will be part of Generally Accepted Accounting Practice (GAAP) for financial statements relating to periods commencing after 1 January 2007.

To help navigate the transition from current reporting standards (Old GAAP) to NZ IFRS (New GAAP) this chapter uses:

- Old GAAP numbers only for actual results to June 2006
- New GAAP numbers only for forecasts beyond 2007, and
- Both Old GAAP and New GAAP numbers for forecasts to June 2007.

Information on the impact of NZ IFRS adoption on the financial statements is provided on page 90, and on fiscal indicators on page 91.

6 Detailed tables of the key indicators for the *Budget Update* and *Half Year Update* are located on pages 105-106. With the adoption of New GAAP there is a series break in the graphs and tables presented in the fiscal chapter. For some indicators there is not a comparable trend series.

7 Operating balance before gains and losses (OBEGAL) less NZS Fund revenue represents the residual of operating revenue and expenses minus the portion of operating revenue earned by the NZS Fund. The indicator does not take into account any gains and losses which are now reported in a separate section of the *Statement of Financial Performance* (refer page 161).

Table 2.2 – Reconciliation of residual cash

	$million	2007 Forecast	2008 Forecast	2009 Forecast	2010 Forecast	2011 Forecast
		Year ended 30 June				
	Core Crown revenue	57,006	59,402	61,172	63,825	66,993
Less	Core Crown expenses	52,783	56,096	58,819	61,677	64,898
Plus	Core Crown gains and losses and other items	1,578	1,157	1,314	1,482	1,686
Plus	Net surpluses/(deficits) of SOEs and CEs	526	1,968	1,902	1,680	1,585
Equals	**Operating balance**	**6,327**	**6,431**	**5,569**	**5,310**	**5,366**
Less	Net gains and losses and other items	790	1,473	1,612	1,780	2,019
Equals	**Operating balance before gains and losses (OBEGAL)**	**5,537**	**4,958**	**3,957**	**3,530**	**3,348**
Less	NZS Fund revenue after-tax[8]	-117	98	95	92	87
Equals	**OBEGAL less NZS Fund revenue**	**5,654**	**4,860**	**3,862**	**3,438**	**3,260**
Less	Net retained surpluses of SOEs and CEs	1,314	1,652	1,604	1,382	1,252
	Non-cash items and working capital movements	3,592	(1,830)	(1,065)	(1,495)	(1,764)
Equals	**Net core Crown cashflow from operations**	**7,932**	**5,038**	**3,323**	**3,551**	**3,772**
Less	Contribution to NZS Fund	2,049	2,103	2,194	2,312	2,458
Equals	**Net core Crown cashflow from operations after contributions to NZS Fund**	**5,883**	**2,935**	**1,129**	**1,239**	**1,314**
Less	Purchase of physical assets	2,141	1,803	1,201	1,179	1,034
	Advances and capital injections	2,022	1,924	1,047	903	802
	Capital allowance for future Budgets	-	184	567	806	903
Equals	**Residual cash**	**1,720**	**(976)**	**(1,687)**	**(1,649)**	**(1,426)**

Source: The Treasury

The New Zealand Superannuation Fund

The NZS Fund is an important component of the Government's fiscal strategy. The NZS Fund's assets provide the means for the Government to partially pre-fund future New Zealand superannuation expenses and may only be used for New Zealand superannuation.

The NZS Fund's assets are to be built up through a combination of investment returns earned on the Fund's portfolio and Government contributions. The Government's contributions to the NZS Fund are calculated over a 40-year rolling horizon to ensure that superannuation entitlements over the next 40 years can be met.

The Fund's net assets are forecast to grow over the forecast period to $27 billion, an increase of $17.1 billion. Over $8 billion of this increase is expected to come from the NZS Fund's investment performance, with the remaining increase from Government contributions.

($million)	OLD GAAP 2006 Actual	OLD GAAP 2007 Forecast	NEW GAAP 2007 Forecast	NEW GAAP 2008 Forecast	NEW GAAP 2009 Forecast	NEW GAAP 2010 Forecast	NEW GAAP 2011 Forecast
	Year ended 30 June						
Opening net worth	6,555	9,861	9,855	12,910	15,977	19,321	22,984
Gross contribution from the Crown	2,337	2,049	2,049	2,103	2,194	2,312	2,458
NZS Fund revenue	1,190	1,505	382	447	519	599	685
NZS Fund gains and losses			1,123	866	1,055	1,259	1,486
Tax	(221)	(497)	(499)	(349)	(424)	(507)	(598)
Closing net worth	**9,861**	**12,918**	**12,910**	**15,977**	**19,321**	**22,984**	**27,015**

8 NZS Fund returns are the sum of its revenue (ie, interest and dividends), gains and losses (which comprise the bulk of its returns) and tax expenses. As OBEGAL does not include gains and losses, the remaining returns to deduct from OBEGAL are NZS Fund revenue less taxes.

Updated Fiscal Indicators

The fiscal indicators have been updated as a consequence of:

- the increasing size of the NZS Fund and its importance to the Government's fiscal strategy. A new indicator, "NZS Fund returns" has been added, and
- the change in accounting standards to New GAAP (page 90 discusses these changes further).

Previous Fiscal Indicator	Updated Fiscal Indicator
	NZS Fund returns
Core Crown revenue	Core Crown revenue ex NZS Fund revenue
OBERAC	Operating balance before gains and losses
OBERAC excluding NZS Fund returns	Operating balance before gains and losses ex NZS Fund revenue
Core Crown expenses Residual cash Gross sovereign-issued debt Net core Crown debt Net core Crown debt (inc NZS Fund)	Core Crown expenses Residual cash Gross sovereign-issued debt Net core Crown debt Net core Crown debt (inc NZS Fund)

The noticeable change from adopting New GAAP is OBERAC (operating balance excluding revaluations and accounting changes) being superseded by the "Operating balance before gains and losses". Unlike the OBERAC the OBEGAL is visible on the *Statement of Financial Performance*.

A less obvious change is in the composition of the indicators. The core Crown revenue (now excluding NZS Fund revenue) and core Crown expenses indicators will no longer include gains or losses, as gains and losses (refer page 91) will be reported in a separate section of the *Statement of Financial Performance*.

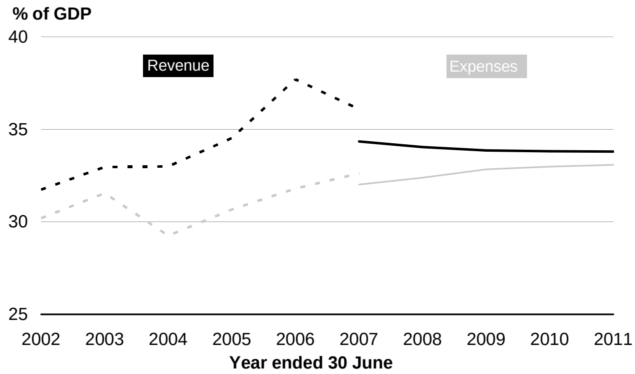
Key Trends

Revenue grows in line with the economy …

Tax revenue as a percentage of GDP remains relatively flat over the forecast period. However there are a number of offsetting factors influencing this trend. In particular:

- the Business Tax Reform will resulted in a structural reduction in the tax revenue to GDP ratio. The most significant tax type affected is company income tax as a result of lowering the company tax rate from 33% to 30%, and
- the impact of fiscal drag, whereby income growth over time moves people into higher tax brackets. This is more prominent with the removal of personal income tax threshold indexation.

Figure 2.1 – Core Crown revenue excluding NZS Fund revenue and expenses



Source: The Treasury

The 2005/06 core Crown revenue includes the one-off non-cash adjustment of $1.8 billion booked at 30 June 2006 (1.1% of GDP), reflecting the change in accounting treatment for the recognition of provisional tax.

… while Budget initiatives increase expenses …

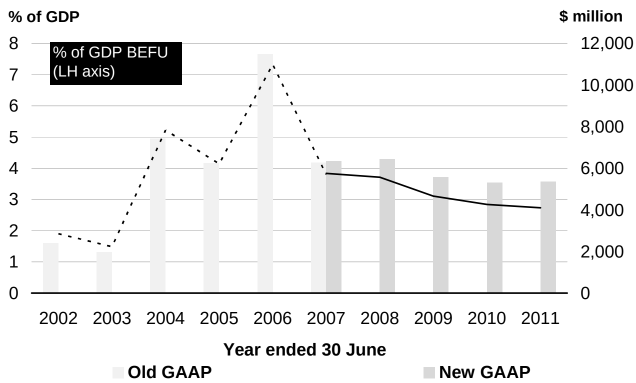
The Government has made significant policy decisions in recent Budgets. Core Crown expenses are expected to increase by around $1 billion between 2006/07 and 2007/08 as a result of past Budget initiatives such as Working for Families and KiwiSaver. In addition, the 2007 Budget includes new initiatives of $2.5 billion in 2007/08 rising to $3.1 billion by 2010/11. The enhancements to the KiwiSaver initiative is a key feature of Budget 2007 and is the main driver of the rising profile. In the short term this results in a rising trend in core Crown expenses to GDP. By 2008/09 this trend flattens out, as the allocations for future Budgets are broadly consistent with the forecast growth in the economy.

… resulting in declining operating balances …

The operating balance as a percentage of GDP is expected to decline from 7.3% in 2005/06 to 3.8% in 2006/07. The main reasons for the decrease are:

- the 2005/06 outturn included a number of one-off positive revaluations (eg, investment gains) and accounting changes (eg, provisional tax revenue recognition), and

Figure 2.2 – Operating balance



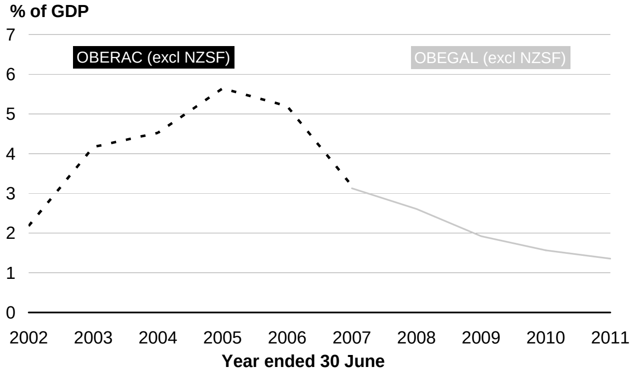
Source: The Treasury

- the forecast for 2006/07 includes some one-off expenses such as the write down of tax and fines receivables and an increase in the ACC insurance liability.

Beyond 2006/07 the operating balance continues to decrease, but at a much lesser rate.

The operating balance before gains and losses (OBEGAL) and excluding NZS Fund revenue provides a better picture of the underlying movement in the fiscal position. The balance also declines over the forecast period, falling from 3.4% to 1.7% of GDP

Figure 2.3 – Operating balance before gains and losses (OBEGAL) and excluding NZS Fund revenue



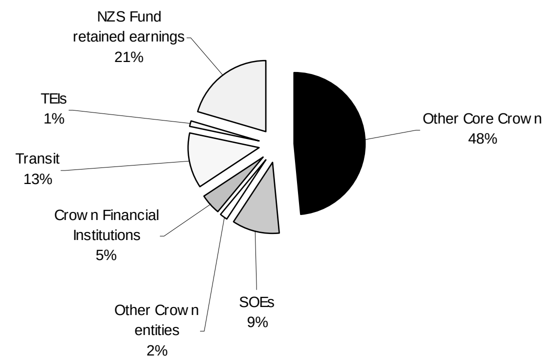
Source: The Treasury

Some components of the operating surpluses expected over the forecast period have been partitioned by the Government and are not available to fund new policy initiatives. This includes:

- entities retaining their surpluses for the purpose of achieving their long-term objectives (ACC, EQC and NZS Fund), and
- entities retaining their surpluses to accumulate assets (State-Owned Enterprises (SOEs) and some Crown entities).

This leaves around 48% of the accumulated operating balance available to finance the Government's investing activities, such as contributions to the NZS Fund and its general capital programme.

Figure 2.4 – Accumulated operating balance breakdown for the period 2006/07 to 2010/11



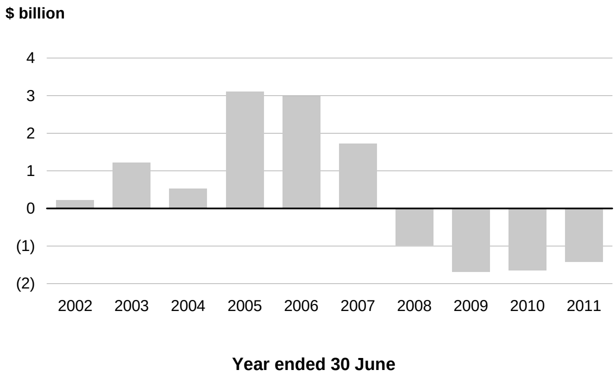
Source: The Treasury

… and a move from cash surplus to deficit …

This will be invested primarily in NZS Fund contributions of $11.1 billion, purchases of physical assets of $9.6 billion (eg, schools and defence equipment), advances of $4.4 billion (mainly student loans and refinancing existing private sector debt of the health and housing sectors), injections into Crown entities for hospitals and housing of $1.8 billion, and the purchase of foreign exchange reserves of $0.7 billion.

There is a residual financing requirement over the forecast period of around $4 billion.

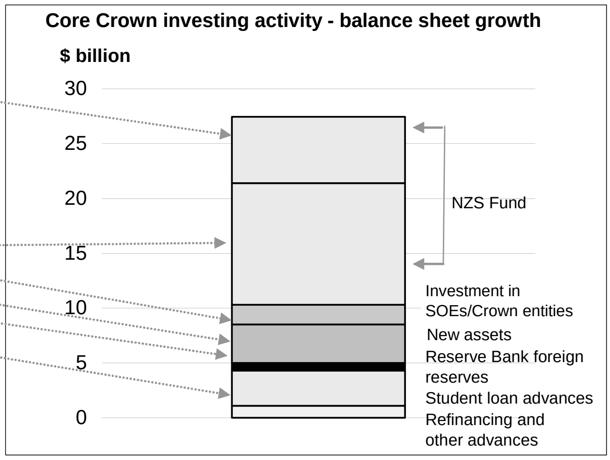
Figure 2.5 – Core Crown cash position on a year-by-year basis



Source: The Treasury

Table 2.3 – Impact of Crown operating surpluses on the balance sheet from 2006/07 to 2010/11 inclusive

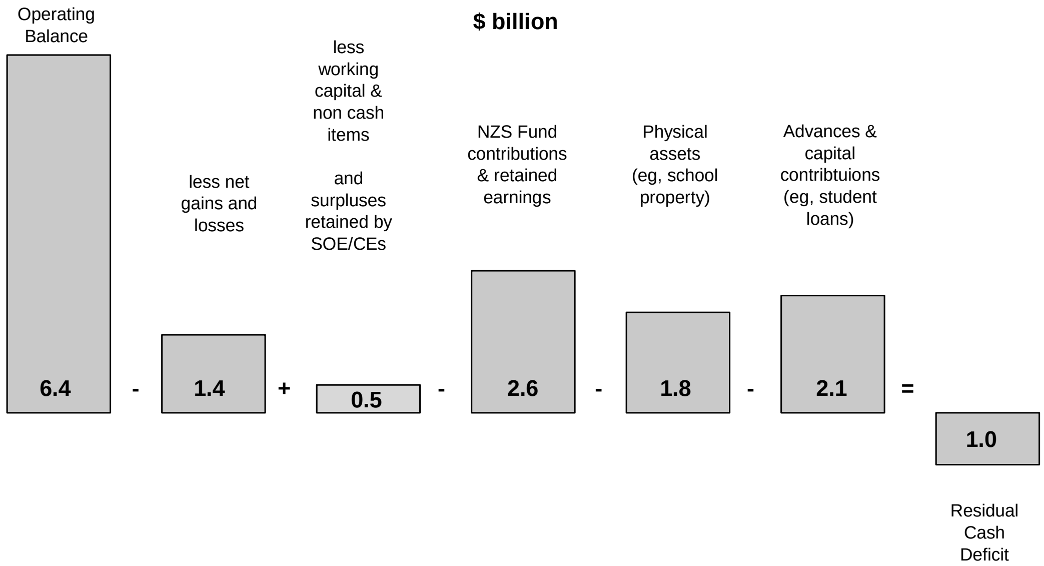
	$ billion
Operating balances	29.0
Less	
Retained NZS Fund returns	(6.0)
Retained SOE/Crown entity returns	(7.7)
Add	
Depreciation	6.1
Other	2.2
Operating cash flows	23.6
Invested in	
NZS Fund contributions	(11.1)
SOEs'/Crown entities' net capital injections	(1.8)
Increase asset base	(3.5)
Purchase of foreign reserves	(0.7)
Maintain existing asset base	(6.1)
Advances	(4.4)
Other	-
Requiring finance	(4.0)



Source: The Treasury

Application of the Operating Balance

The following graph explains how the operating balance translates into cash available and then how it has been applied for the 2007/08 financial year.



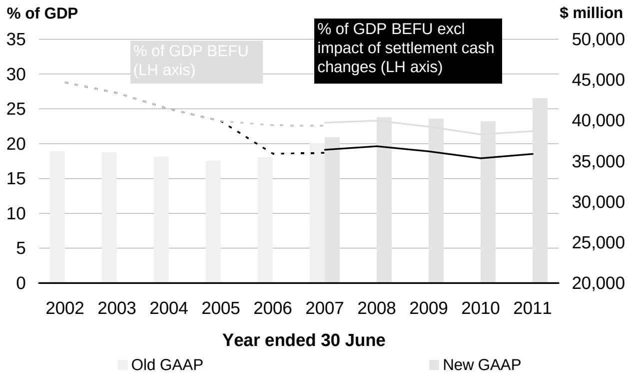
… which is met by borrowings …

The Government's intended bond programme has been set at around $2.5 billion per annum, amounting to $12.5 billion of new borrowings over the forecast period. $8.6 billion of the new borrowing replaces maturing debt. The balance of new debt issued of $3.9 billion is used to meet the cash shortfall.

In addition to the cash shortfall, gross debt is affected by:

- the Reserve Bank increasing settlement cash levels in 2006/07, this has had a net impact on borrowings of $3.2 billion (as noted in the *Half Year Update*), and
- the impact of the transition to New GAAP, this has increased gross debt by $0.7 billion.

Figure 2.6 – Gross sovereign-issued debt



Source: The Treasury

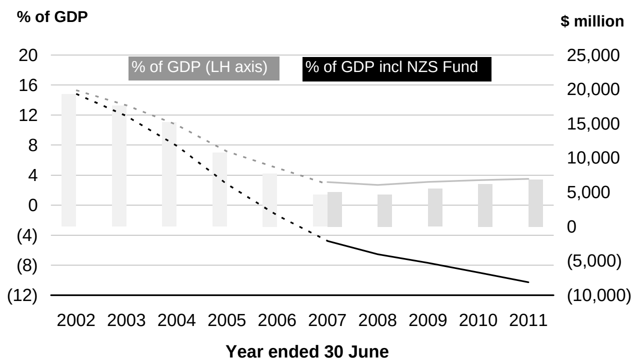
Gross debt increases by around $7.3 billion from 2005/06 to 2010/11. As a percentage of GDP, gross debt is expected to fall from 22.6% in 2005/06 to 21.8% by 2010/11. Excluding the impact of the increase in settlement cash levels, over the same period GSID falls to 18.8% by 2010/11.

… while financial assets increase …

With borrowings meeting the cash shortfall, financial assets grow by the full extent of the build-up in assets resulting from:

- contributions made to the NZS Fund and the returns earned by the Fund, and
- advance activity, such as student loans.

Figure 2.7 – Net debt (% of GDP and $million) and % of GDP including assets of NZS Fund



Source: The Treasury

… resulting in an increasing net financial assets (including NZS Fund) track

Including the NZS Fund the Crown is in a net financial asset position. Net financial assets are expected to continue to increase over the forecast period. Excluding the NZS Fund assets, net core Crown debt decreases in nominal terms by around $0.9 billion over the forecast period. This trend is contrary to what happens to gross debt reflecting the fact that some of the borrowings required to meet the cash shortfall are used to invest in financial assets (eg, student loans), so do not impact on net debt.

New Zealand International Financial Reporting Standards (NZ IFRS)

The fiscal forecasts in Budget 2007 are prepared on an NZ IFRS basis.

From 1 July 2007 the financial statements of the Government must be prepared in accordance with NZ IFRS. Hence, forecasts in Budget 2007 are prepared on an NZ IFRS basis to provide comparability with reporting actual results.

While there are relatively minor changes to the bottom line ….

Although the current New Zealand reporting standards (Old GAAP) are relatively well aligned with NZ IFRS (New GAAP), there have been some impacts on the bottom line as a result of adopting New GAAP. Using the forecast year-end position for 2006/07, changing to new GAAP results in the following impacts on fiscal indicators:

	Old GAAP	Change	New GAAP
Net worth	**$88.5b**	**1.2b**	**$89.7b**
Operating balance	**$6.6b**	**0.3b**	**$6.3b**
Residual cash	**$1.7b**	**No change**	**$1.7b**

These fiscal indicators have changed by less than 1% of GDP (refer to page 105 for fiscal indicator changes).

… but there are changes to some values …

The two main contributors to the change in net worth of $1.2 billion are:

1. The net liability of the Government Superannuation Fund (GSF) is reduced by $3.2 billion. Under New GAAP the pension liability is reported on the basis that the Government meets its obligation on a pay-as-needed basis. Under Old GAAP the liability is reported based on the amount to be invested today to fully fund future pensions. The difference between the two is the treatment of investment taxes.

   Note that, from a presentational point of view the assets of the GSF are now netted off against the liability.

   The pension obligations to GSF members are underwritten by the Government and there are no implications for GSF members' payments as a result of this reporting change.

2. The ACC liability has increased by $1.9 billion owing to adding an additional risk premium and liability adequacy test under New GAAP. The actuarially calculated liability under Old GAAP represents a mid-point estimate – that is, equal chance of actual payouts being greater than or less than the estimate. To that extent, it represents the most likely outcome. Introducing an additional risk premium and liability adequacy test under new GAAP does not change the relative risk of ACC's activities; rather, it simply changes how

this risk is reported. There are no implications for ACC levies as a result of this change in reporting.

… and to the presentation of financial information …

Under New GAAP there is:

- more detail (eg, derivatives are shown separately on the face of the *Statement of Financial Position*)
- reclassifications (eg, GSF assets are netted against the GSF liability), and
- format changes, notably to the face of the *Statement of Financial Performance*.

The key change to the *Statement of Financial Performance* is reporting gains/losses in a separate section from revenue and expenses. This section will typically, but not exclusively, capture changes from market movements or actuarial assumptions such as gains on share portfolios and actuarial changes in the GSF liability. Separately reporting gains and losses will:

- help users identify their effect on reported results and forecasts
- reduce the "noise" from changes in fair value of items (eg, share investments can provide income (gains) in one month and expenses (losses) the next), and
- better align accounting practice with other reporting frameworks, such as Government Financial Statistics.

A more detailed list of changes is provided in Chapter 7 *NZ IFRS Transition* on page 191.

… resulting in continued high-quality reporting

The Accounting Standards Review Board, by deciding that all reporting entities in New Zealand must comply with New GAAP after 1 January 2007, believed that by adopting global financial reporting standards it will improve:

- the comparability of financial reporting for New Zealand's corporate sector, thereby enhancing domestic capital market transparency and accountability, and
- the quality of financial reporting (New GAAP is more comprehensive, more widely accepted and robustly tested).

The New Zealand Government has been required to comply with generally accepted accounting practice (GAAP) since the Public Finance of 1989, and therefore must now adopt New GAAP. Common financial reporting across all sectors in New Zealand provides consistency and transparency to users of financial reports.

As the Government progresses towards full implementation of New GAAP and the audit of June 2008 Financial Statements, the potential areas of impact from adoption of New GAAP will include any change in accounting standards during that time. However, based on the current work programme of the international standard setters, such changes are expected to be minimal on the reported results at June 2008.

Further details on the adoption and expected impact of New GAAP on the Financial Statements of Government, including New GAAP accounting policies for the Government reporting entity, are available at www.treasury.govt.nz/budget2007/.

Revenue and Expenses

Table 2.4 – Revenue and expenses' comparison with *Half Year Update*

	Year ended 30 June						
	OLD GAAP		NEW GAAP				
(% of GDP)	2006 Actual	2007 Forecast	2007 Forecast	2008 Forecast	2009 Forecast	2010 Forecast	2011 Forecast
Total revenue							
Budget Update	48.8	46.2	44.5	44.4	44.4	44.5	44.3
Half Year Update			46.1	44.9	44.0	43.9	43.7
Total expenses							
Budget Update	41.5	42.3	41.2	41.5	42.2	42.6	42.5
Half Year Update			42.3	41.4	41.1	40.8	40.7
Core Crown revenue							
Budget Update	37.7	36.1	34.6	34.3	34.1	34.1	34.1
Half Year Update			36.3	35.1	34.2	34.3	34.3
Core Crown expenses							
Budget Update	31.8	32.6	32.0	32.4	32.8	33.0	33.1
Half Year Update			33.2	32.6	32.3	32.1	32.0
SOE revenue							
Budget Update	8.1	8.1	7.4	7.5	7.6	7.5	7.2
Half Year Update			7.3	7.2	7.2	7.1	6.9
SOE expenses							
Budget Update	6.9	6.9	6.8	6.9	6.9	6.9	6.7
Half Year Update			6.8	6.6	6.6	6.5	6.4
Crown entities' revenue							
Budget Update	16.1	16.1	15.9	15.9	15.6	15.2	14.6
Half Year Update			16.0	15.7	15.2	14.5	14.0
Crown entities' expenses							
Budget Update	15.2	15.2	15.4	15.5	15.3	14.9	14.4
Half Year Update			15.4	15.1	14.6	14.1	13.5

Source: The Treasury

Total revenue to GDP is forecast to remain relatively stable between 44.3% and 44.5% through the forecast period. There is a level shift downwards in revenue owing to the transition to New GAAP, as a result of transactions that were previously included in revenue being reclassified to gains and losses (refer page 91). Total expenses to GDP are forecast to increase from 41.2% to 42.5% by the end of the forecast period.

The trend in total revenue and expenses over the forecast horizon will largely be driven by activity in the core Crown segment of reported Government activity. The following section discusses the core Crown activity in more detail.

Core Crown – Revenue

Table 2.5 – Core Crown revenue

Core Crown Revenue	OLD GAAP 2006 Actual	OLD GAAP 2007 Forecast	NEW GAAP 2007 Forecast	NEW GAAP 2008 Forecast	NEW GAAP 2009 Forecast	NEW GAAP 2010 Forecast	NEW GAAP 2011 Forecast
($ billion)							
Tax revenue	52.4	52.1	52.2	54.7	56.3	58.9	62.0
Investment revenue	4.5	5.1	2.7	2.6	2.8	2.8	2.9
Other core Crown revenue	2.3	2.3	2.1	2.1	2.1	2.1	2.1
Total core Crown revenue	59.2	59.5	57.0	59.4	61.2	63.8	67.0
(% of GDP)							
Tax revenue	33.4	31.6	31.7	31.6	31.4	31.5	31.6
Investment revenue	2.9	3.1	1.6	1.5	1.6	1.5	1.5
Other core Crown revenue	1.5	1.4	1.3	1.2	1.2	1.1	1.1
Total core Crown revenue	37.8	36.1	34.6	34.3	34.1	34.1	34.1

Year ended 30 June

Source: The Treasury

Table 2.6 – Tax revenue indicators compared with the *Half Year Update*

Tax revenue	OLD GAAP 2006 Actual	OLD GAAP 2007 Forecast	NEW GAAP 2007 Forecast	NEW GAAP 2008 Forecast	NEW GAAP 2009 Forecast	NEW GAAP 2010 Forecast	NEW GAAP 2011 Forecast
(% of GDP)							
Tax revenue - *Budget Update*	33.4	31.6	31.7	31.6	31.4	31.5	31.6
Tax revenue - *Half Year Update*			32.1	31.6	31.3	31.3	31.3

Year ended 30 June

Source: The Treasury

Tax revenue is the major source of core Crown revenue.

A discussion of trends in total tax and the major tax types is included in the *Economic and Tax Outlook* chapter. The main points are:

- an increase in the level of the nominal GDP forecast has led to an increase in the forecast of total tax revenue of about $1 billion in 2008
- a shift in the balance of income in the macroeconomic forecast from profits to labour has increased the overall tax-to-GDP rate relative to the *Half Year Update,* thereby increasing the tax revenue forecasts from 2009 onwards, and
- the Business Tax Reform and other policy changes since the *Half Year Update* collectively reduce total tax revenue by as much as $500 million each year from 2009 onwards.

Inland Revenue Department's (IRD) tax forecasts

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

The Treasury's forecasts are the Crown's official forecasts. Unless otherwise stated, all forecasts in this document are Treasury forecasts. IRD tax forecasts are provided here for comparative purposes.

Table 2.7 – The Treasury and IRD tax revenue forecasts

$million	2006/07 Forecast	2007/08 Forecast	2008/09 Forecast	2009/10 Forecast	2010/11 Forecast
Source deductions					
Treasury	21,012	22,334	23,695	25,094	26,619
Inland Revenue	20,943	22,265	23,545	24,970	26,494
Difference	69	69	150	124	125
Corporate taxes					
Treasury	9,120	9,166	8,411	8,860	9,321
Inland Revenue	9,243	9,254	8,385	8,558	8,902
Difference	(123)	(88)	26	302	419
Goods and services tax					
Treasury	10,722	11,495	11,993	12,333	12,896
Inland Revenue	10,771	11,315	11,819	12,161	12,734
Difference	(49)	180	174	172	162
RWT (interest)					
Treasury	2,156	2,340	2,441	2,362	2,376
Inland Revenue	2,200	2,491	2,566	2,523	2,627
Difference	(44)	(151)	(125)	(161)	(251)
Other taxes					
Treasury	8,647	8,838	9,151	9,621	10,140
Inland Revenue	8,568	8,728	8,992	9,421	9,968
Difference	79	110	159	200	172
Total tax					
Treasury	51,658	54,173	55,691	58,269	61,351
Inland Revenue	51,725	54,053	55,307	57,633	60,725
Difference	(67)	120	384	636	626
Total tax (% of GDP)					
Treasury	31.3%	31.3%	31.1%	31.2%	31.3%
Inland Revenue	31.4%	31.2%	30.9%	30.8%	31.0%
Difference	-0.1%	0.1%	0.2%	0.4%	0.3%

Sources: IRD, The Treasury

The differences between the Treasury and IRD tax forecasts are much smaller than has been the case in the last few updates.

The main points of difference in this *Budget Update* are:

- Based on analysis of recent outturns, the Treasury has forecast source deductions about 0.5% higher than IRD in 2006/07, and this difference persists through all forecast years.
- The two departments use different approaches for forecasting taxable corporate profits, which causes a gap to open up between the Treasury and IRD corporate tax forecasts in 2009/10 and 2010/11. However, the gap between the two corporate tax forecasts has narrowed substantially since the *Half Year Update,* as the Treasury's corporate tax forecast no longer contains a prominent tax loss cycle. Further detail on the Treasury's corporate tax forecast is provided in the *Economic and Tax Outlook* chapter.
- The Treasury's GST forecast is higher than Inland Revenue's GST forecast from 2008/09 onwards as the two departments have different interpretations of the effects of the principal drivers of GST namely private consumption, public consumption and residential investment.

- The RWT on interest forecasts diverge due to the different growth drivers that each department uses. Both departments use forecasts of interest rates and a trend growth estimate for the deposit base, but the Treasury also includes cyclical components from selected wealth and income indicators.

Detailed comparisons of the Treasury and Inland Revenue tax forecasts can be found at www.treasury.govt.nz/forecasts/befu/2007/.

Gains and Losses

The adoption of New GAAP will result in more fair value changes (gains and losses) being reported in the *Statement of Financial Performance*. In some cases (eg, with gains on the sale of property), these gains must be reported separately from other revenue.

Given the impact of this change, gains and losses will be reported in a separate section of the *Statement of Financial Performance*. This will enable users to better identify and assess:

- the cause of variances between actual results and forecasts, as variances from gains/losses (which are typically not forecasted) will be readily evident, and will not obscure comparisons between forecast and actual revenues and expenses
- the impact and volatility of gains and losses on results, and
- the relationship between gains and losses (eg, gains and losses in derivatives often have a close relationship with gains or losses in other financial instruments).

It should also reduce the "noise" that could arise from changes in fair value of items such as share investments being income (gains) one month and an expense (losses) the next.

The most significant gains and losses arise from financial assets and financial liabilities that are measured at fair value, and where changes in fair value must be reported in the *Statement of Financial Performance*. The financial assets held by the NZS Fund fall into this category. Such gains or losses will exclude interest revenue, dividend revenue and interest expense – these items will continue to be reported with revenues and expenses as appropriate. Actuarial gains and losses on items such as the GSF liability and changes in other provisions arising from market movements (eg, exchange rates) will also be separately identified in this new section.

Core Crown – Expenses

Table 2.8 – Expenses indicators

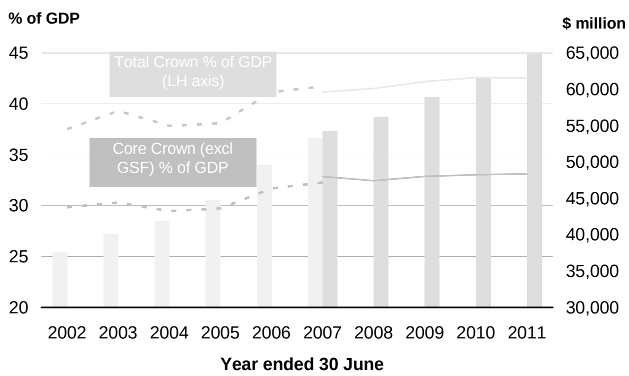
	Year ended 30 June						
	OLD GAAP		NEW GAAP				
Expenses	**2006**	**2007**	**2007**	**2008**	**2009**	**2010**	**2011**
($billion)	**Actual**	**Forecast**	**Forecast**	**Forecast**	**Forecast**	**Forecast**	**Forecast**
Core Crown	49.9	53.8	52.8	56.1	58.8	61.7	64.9
Core Crown (excluding GSF valuation)	49.6	53.2					
Total Crown	65.1	69.7	67.9	71.9	75.6	79.6	83.5
(% of GDP)							
Core Crown	31.8	32.6	32.0	32.4	32.8	33.0	33.1
Core Crown (excluding GSF valuation)	31.6	32.3					
Total Crown	41.5	42.3	41.2	41.5	42.2	42.6	42.5

Source: The Treasury

Core Crown expenses are forecast to increase by around 1% of GDP between 2006/07 and 2010/11.

The growth in expenses has largely arisen from expense initiatives announced in recent Budgets. A number of the policy decisions made in previous Budgets have rising spending profiles to allow sufficient time for full implementation. Around $1 billion of the increase in spending between 2006/07 and 2007/08 relates to previous Budget announcements like Working for Families and KiwiSaver.

Figure 2.8 – Core expenses ($ and % of GDP)



Source: The Treasury

Budget 2007 also influences expense growth. It includes an additional $2.2 billion of spending rising to $3.3 billion[9] of spending. The main expense elements of Budget 2007 include:

- an enhancement to the KiwiSaver initiative that was introduced in Budget 2005, initially costing $0.3 billion in 2007/08 rising to $1.1 billion by the end of the forecast period. This equates to 0.6% of GDP in 2010/11, and
- an additional $0.8 billion per annum on health-related spending.

The *Executive Summary* provides a detailed breakdown on the new initiatives for operating (expenses and revenue) and capital.

In nominal terms, expenses are forecast to increase by $12.1 billion between 2006/07 and 2010/11. The major drivers of this increase are:

- the Budget 2007 package and recent Budget packages ($4.3 billion)

9 The Budget 2007 package is $2.5 billion rising to $3.1 billion. The package includes a mixture of revenue and expense initiatives. Note that for accounting purposes, some policy initiatives implemented through the tax system such as Working for Families, KiwiSaver and the R & D tax credit are counted as expenses.

- forecast new operating initiatives for future Budgets ($6.1 billion), and
- indexation of benefits, primarily New Zealand Superannuation ($1.5 billion).

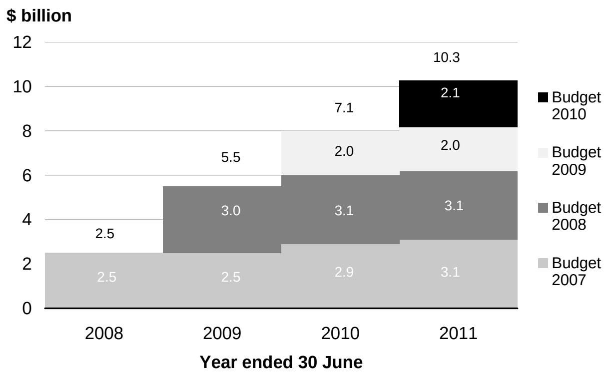
Forecast new operating and capital initiatives

The fiscal forecasts include indicative amounts for new operating and capital initiatives.

The allowance for Budget 2008 is forecast to be $3.1 billion. Around $1.1 billion of this has already been earmarked for Business Tax Reform. The remaining $2 billion is assumed for forecasting purposes to be used for increased expenditure.

New initiatives for the 2009 and 2010 Budgets remain at around $2 billion and $2.1 billion. It is also assumed for forecasting purposes all of the forecast new operating initiatives in these Budgets are allocated to increased expenditure, although in practice some portion could be used to finance revenue reductions.

Figure 2.9 – Net amounts for new operating initiatives (GST exclusive)



Source: The Treasury

Capital initiatives

As part of the 2007 Budget, the Government has allocated $1.6 billion of new capital over the next four years. Amounts for the 2008, 2009 and 2010 Budgets have been set at $0.9 billion phased in over four years, some of which falls outside the forecast horizon. On a year-by-year basis, capital spending is forecast to be on average $2.0 billion per annum over the next five years.

Table 2.9 – Capital spending

			Year ended 30 June			
	2007 Forecast	2008 Forecast	2009 Forecast	2010 Forecast	2011 Forecast	Total
($million)						
New capital spending up to Budget 2008	-	164	67	56	23	310
Budget 2008	-	20	480	250	150	900
Budget 2009	-	-	20	480	250	750
Budget 2010	-	-	-	20	480	500
	-	**184**	**567**	**806**	**903**	**2,460**
Purchase of physical assets	**2,141**	**1,803**	**1,201**	**1,179**	**1,034**	**7,359**
	2,141	**1,987**	**1,768**	**1,985**	**1,937**	**9,819**

Top-down Adjustment to Spending

The core Crown operating and capital spending for 2006/07 in the forecast incorporates a downward adjustment of $700 million to take into account the timing delays in departmental spending. The adjustment is made on both a cash and accrual basis, and is split between operating ($500 million) and capital ($200 million).

The level of the adjustment has been based on analysis of previous expenditure delays and a review of the actual outturn to 31 March 2007.

No adjustment is made to subsequent years for possible under spending.

Net Worth

Table 2.10 – Net worth comparison with *Half Year Update*

Net worth ($billion)	OLD GAAP 2006 Actual	OLD GAAP 2007 Forecast	NEW GAAP 2007 Forecast	NEW GAAP 2008 Forecast	NEW GAAP 2009 Forecast	NEW GAAP 2010 Forecast	NEW GAAP 2011 Forecast
	Year ended 30 June						
Total Crown net worth	71.4	88.5	89.7	96.1	101.6	107.0	112.4
Core Crown net worth	40.1	45.9	49.1	53.6	57.2	60.9	64.7
SOE net worth	13.1	24.0	22.1	23.0	23.7	24.4	25.1
Crown entities' net worth	41.8	42.6	39.7	41.4	42.8	43.8	44.9

Source: The Treasury

In line with the Government's fiscal strategy, net worth is forecast to increase from $89.7 billion in 2006/07 to $112.4 billion by 2010/11. This strategy is evident across the whole of the Crown. The following section focuses on the net worth of the core Crown segment of reported Government activity.

Core Crown

Table 2.11 – Components of core Crown net worth

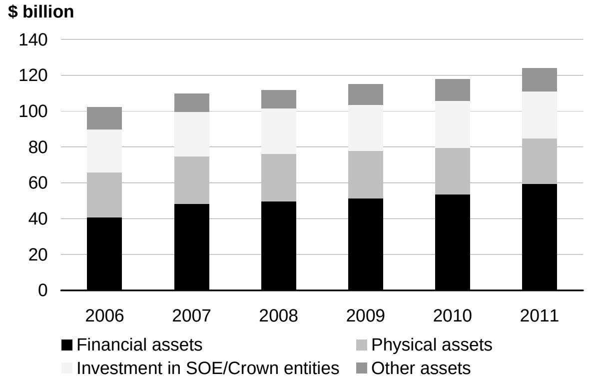
($ billion)	OLD GAAP 2006 Actual	OLD GAAP 2007 Forecast	NEW GAAP 2007 Forecast	NEW GAAP 2008 Forecast	NEW GAAP 2009 Forecast	NEW GAAP 2010 Forecast	NEW GAAP 2011 Forecast
	Year ended 30 June						
Total assets	102.3	109.7	105.5	112.2	115.4	118.2	124.3
Total liabilities	62.2	63.8	56.4	58.6	58.2	57.3	59.6
Net worth	40.1	45.9	49.1	53.6	57.2	60.9	64.7

Source: The Treasury

Over the forecast period, core Crown assets are expected to increase from $105.5 billion from 2006/07 to $124.3 billion, largely reflecting the application of the operating balance and additional borrowing to build up assets.

As Figure 2.10 illustrates, the majority of growth occurs within financial assets, which increase by around $14.9 billion, while investments in Crown entities (primarily to fund hospitals and housing capital projects), and physical assets also increase slightly.

Figure 2.10 – Core Crown asset growth



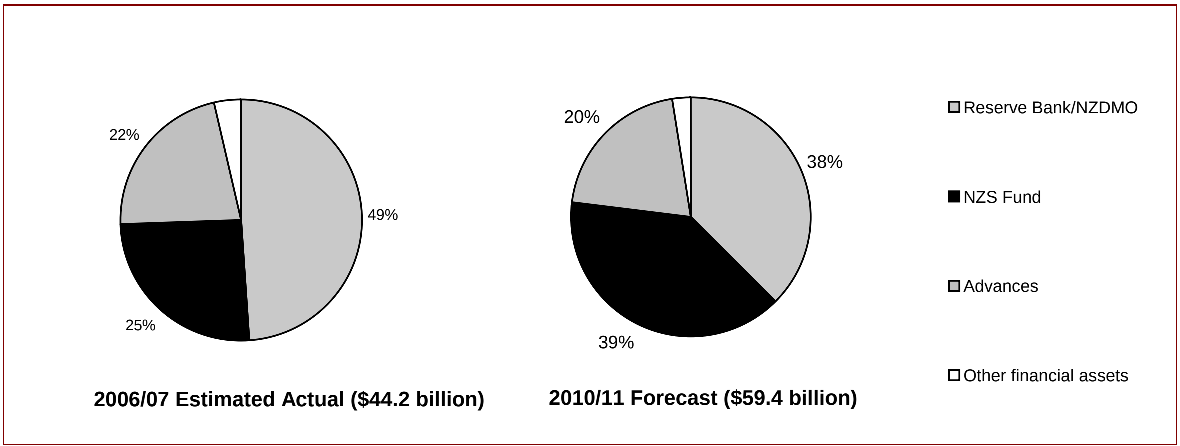
Source: The Treasury

Within the financial asset portfolio of the core Crown:

- the NZS Fund is expected to increase by around $12.2 billion from 2006/07 to 2010/11. These funds are being set aside to assist in meeting future fiscal pressures associated with an ageing population
- advances are forecast to increase by around $2.4 billion, primarily due to student loans, and
- the financial asset portfolios of the Reserve Bank and New Zealand Debt Management Office stay relatively flat over the forecast period.

By 2010/11 the make-up of the financial asset portfolio is expected to have changed significantly, primarily driven by the increase in the holdings of the NZS Fund.

Figure 2.11 – Core Crown financial assets by portfolio



Source: The Treasury

The level of core Crown liabilities is expected to increase by around $3.2 billion from 2006/07 to 2010/11. The major component of core Crown liabilities is gross sovereign-issued debt, which, as previously mentioned, is forecast to increase nominally but decrease as a percentage of GDP over the forecast period.

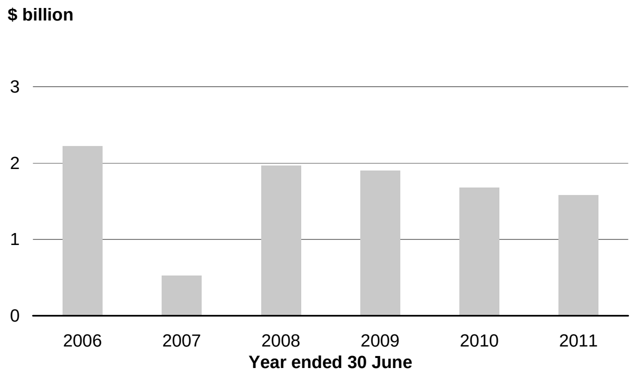
State-Owned Enterprises and Crown Entities – Net Surpluses

State-owned enterprises (SOEs) and Crown entities (CEs) are forecast to run total operating surpluses of $10 billion over the forecast period. Around $2.4 billion of the operating surpluses will be returned as dividends, and will be available to fund spending elsewhere in the Crown.

In 2006/07 SOE/Crown entities net surpluses are forecast to be $0.5 billion, which is lower than what is expected for the rest of the forecast period. The lower 2006/07 result is primarily due to an increase in the ACC unfunded liability of around $2 billion. This increase was mainly a result of changes in economic assumptions and higher rehabilitation costs (eg, more claims).

From 2007/08 onwards, SOE/Crown entities net surpluses are on average $1.8 billion.

Figure 2.12 – SOE and Crown entities operating balance



Source: The Treasury

SOE/Crown entities net surpluses after payment of dividends total $7.6 billion. This residual is maintained within the entities that have generated the net surpluses. In broad terms, the majority of the accumulated net surpluses are forecast to build up assets.

Financial assets across SOE/CEs are forecast to increase by around $7.1 billion. The majority of the increase is within the Crown Financial Institutions (including ACC and EQC), which are accumulating financial assets for the purpose of meeting future obligations.

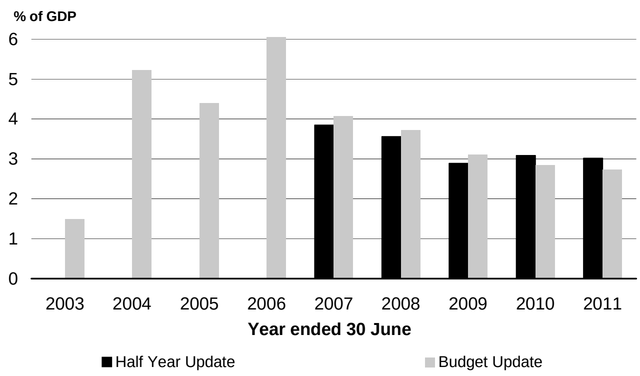
Comparison with *Half Year Update*

Operating balance

Compared to the *Half Year Update* the operating balance is expected to be similar in 2006/07. However, there are a number of counteracting factors:

- an increase in tax revenue primarily in corporate tax due to some one-off tax receipts
- delays in spending (of which some has been transferred into 2007/08), and
- non-cash write-offs of tax and fines receivables have resulted in a $1.2 billion increase in expenses.

Figure 2.13 – Operating balance comparison



Source: The Treasury

Beyond the current year the operating balance is initially higher than the *Half Year Update,* however this trend reverses from 2009/10 (refer Table 2.12). Key drivers of this trend are:

- increases to forecast nominal GDP have led to an increase in forecast tax revenue of about $1 billion in 2007/08 and 2008/09. The upward revision to tax forecasts in the last two years is much smaller
- an increase in SOE/Crown entities surpluses of around $0.2 billion per annum (spread across a numbers of entities)
- an increase in investment income primarily owing to a higher overall financial asset position
- a reduction in benefit expenses forecast of approximately $0.1 billion per annum. Most of the reduction occurs in unemployment benefits as a result of expected improvements in labour market conditions, and
- expenses are forecast to be higher than the *Half Year Update*, reflecting a higher Budget 2007 package than previously signalled in the *2007 Budget Policy Statement*.

Table 2.12 – Operating balance reconciliation (explains changes to the operating balance since the *Half Year Update*)

	NEW GAAP				
($ million)	**2007 Forecast**	**2008 Forecast**	**2009 Forecast**	**2010 Forecast**	**2011 Forecast**
Operating balance 2006 Half Year Update	**6,260**	**6,071**	**5,197**	**5,826**	**5,979**
Changes (revenue)					
Tax revenue (forecasting)	461	967	766	570	580
Tax revenue (policy)	-	(22)	(516)	(489)	(330)
New revenue allocation	-	-	1,000	1,000	1,000
Investment income	263	125	123	113	105
Total revenue changes	**724**	**1,070**	**1,373**	**1,194**	**1,355**
Other changes					
Welfare Benefit forecast changes	39	141	207	175	127
Other forecasting changes	36	(143)	(85)	(127)	(130)
Expense transfers	367	(211)	(56)	(70)	(119)
Top down expense adjustment	500	-	-	-	-
Increase in Budget 2007 and 2008 allowance	153	(667)	(1,065)	(1,547)	(1,834)
Long term receivables write-off	(1,199)	-	-	-	-
ACC insurance expenses	(1,019)	(254)	(281)	(353)	(379)
Other SOE/CE movements	585	490	404	397	400
Transition to IFRS	(243)	-	-	-	-
Other movements	124	(66)	(125)	(185)	(33)
Total other changes	**(657)**	**(710)**	**(1,001)**	**(1,710)**	**(1,968)**
Total changes	**67**	**360**	**372**	**(516)**	**(613)**
Operating balance 2007 Budget Update	**6,327**	**6,431**	**5,569**	**5,310**	**5,366**

Source: The Treasury

Effect of Policy Changes on Tax Forecasts since the *Half Year Update*

$ million	2006/07 Forecast	2007/08 Forecast	2008/09 Forecast	2009/10 Forecast	2010/11 Forecast
Material policy changes					
Reduction in company tax rate	-	(60)	(790)	(735)	(680)
Reduction in tax rate for savings vehicles	-	(5)	(50)	(60)	(65)
International tax review - CFC changes	-	-	(13)	(50)	(50)
Inclusion of life insurance in the PIE rules	-	(25)	(25)	(25)	(25)
Charitable donations threshold	-	-	(15)	(25)	(25)
SSCWT exemption extension	-	(17)	(18)	(19)	(20)
Indexation of personal income tax thresholds	-	85	395	425	535
Total	**-**	**(22)**	**(516)**	**(489)**	**(330)**

Sources: The Treasury, Inland Revenue

Reduction in company tax rate

With effect from the 2009 income year, the company income tax rate will decrease from 33% to 30%.

Reduction in tax rate for savings vehicles

In line with the reduction in the company income tax rate, the tax rate for widely-held savings vehicles, eg, superannuation funds and unit trusts, will also decrease from 33% to 30% and the maximum Portfolio Investment Entity (PIE) tax rate will be set at 30%.

International tax review – CFC changes

From 1 April 2009, active income of controlled foreign companies will be exempt from New Zealand income tax.

Inclusion of life insurance in the PIE rules

With effect from 1 October 2007, all life insurance savings products will be able to use the fair dividend rate method under the PIE regime. Unit-linked life products are to be allowed to obtain certain benefits of the PIE regime.

Charitable donations threshold

With effect from the 2009 income year, there will be no limit to the level of rebate that may be claimed in respect of charitable donations made by individuals and companies.

SSCWT exemption extension

The specified superannuation contribution withholding tax exemption for KiwiSaver has been extended to other superannuation schemes that have similar lock-in rules to KiwiSaver.

Indexation of personal income tax thresholds

The triennial indexation of personal income tax thresholds announced in the 2005 Budget will now not be proceeding.

Residual cash

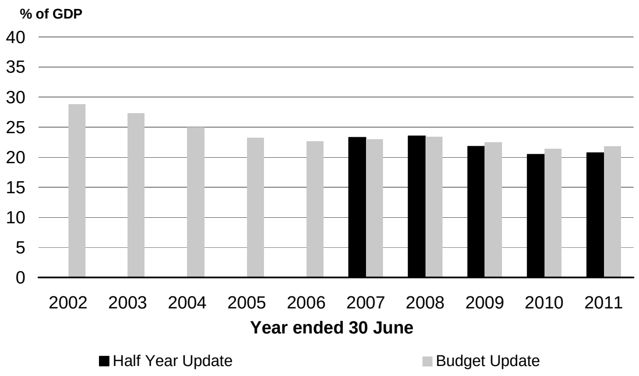
Over the forecast period residual cash is similar to the *Half Year Update.* In the short term the cash position is stronger owing to the increase in tax revenue. The cash position weakens and similar to the Half Year Update moves into a cash deficit as the full impact of the forecast increases in the Budget 2007 operating and capital allowance kick in.

Debt indicators

With the cash position ending up in a similar position to the *Half Year Update* there has been minimal change in the forecasts for the debt indicators.

By 2010/11, gross sovereign-issued debt is around 1% higher than at the *Half Year Update*. Net core Crown debt is 0.3% lower than forecast at the time of the *Half Year Update*.

Figure 2.14 – Gross sovereign-issued debt comparison



Source: The Treasury

Table 2.13 – 2007 *Budget Update* fiscal indicators

Fiscal indicators ($ million)	OLD GAAP 2006 Actual	OLD GAAP 2007 Forecast	NEW GAAP 2007 Forecast	NEW GAAP 2008 Forecast	NEW GAAP 2009 Forecast	NEW GAAP 2010 Forecast	NEW GAAP 2011 Forecast
	Year ended 30 June						
Revenue							
Total revenue	76,581	76,203	73,390	76,872	79,576	83,178	86,819
Core Crown revenue	59,170	59,501	57,006	59,402	61,172	63,825	66,993
Tax revenue	51,973	51,539	51,658	54,173	55,691	58,269	61,351
Expenses							
Total expenses	65,084	69,687	67,853	71,914	75,619	79,648	83,472
Core Crown expenses	49,900	53,775	52,783	56,096	58,819	61,677	64,898
Operating balance - Core Crown	9,270	5,717	5,801	4,463	3,667	3,630	3,781
Operating balance - Crown entities	1,593	469	225	1,241	1,169	974	960
Operating balance - SOEs	1,799	1,065	1,034	1,068	1,141	1,155	1,065
Dividend elimination	(1,189)	(683)	(733)	(341)	(408)	(449)	(440)
Total operating balance	11,473	6,568	6,327	6,431	5,569	5,310	5,366
OBEGAL			5,537	4,958	3,957	3,530	3,347
OBEGAL excluding NZS Fund revenue			5,654	4,860	3,862	3,438	3,260
Cash available/(shortfall to be funded)	2,985	1,720	1,720	(976)	(1,687)	(1,649)	(1,426)
Debt indicators							
Gross sovereign-issued debt	35,461	37,217	37,935	40,400	40,231	39,894	42,737
Total gross Crown debt	39,427	42,367	43,556	46,364	47,050	46,522	49,691
Net core Crown debt	7,745	4,611	5,039	4,655	5,529	6,217	6,860
Net core Crown debt with NZS Fund assets	(5,138)	(7,962)	(7,534)	(10,784)	(13,145)	(16,008)	(19,287)
Net worth	71,400	88,456	89,696	96,061	101,645	107,024	112,421
Domestic bond programme	2,375	2,511	2,511	2,520	2,500	2,483	2,515
Nominal GDP	156,562	164,868	164,868	173,187	179,132	186,985	196,177
Fiscal indicators as a % of GDP							
Revenue							
Total Crown revenue	48.9	46.2	44.5	44.4	44.4	44.5	44.3
Core Crown revenue	37.8	36.1	34.6	34.3	34.1	34.1	34.1
Tax revenue	33.2	31.3	31.3	31.3	31.1	31.2	31.3
Expenses							
Total Crown expenses	41.6	42.3	41.2	41.5	42.2	42.6	42.5
Core Crown expenses	31.9	32.6	32.0	32.4	32.8	33.0	33.1
Operating balance	7.3	4.0	3.8	3.7	3.1	2.8	2.7
OBEGAL			3.4	2.9	2.2	1.9	1.7
OBEGAL excluding NZS Fund revenue			3.4	2.8	2.2	1.8	1.7
Debt indicators							
Gross sovereign-issued debt	22.6	22.6	23.0	23.3	22.5	21.3	21.8
Total gross Crown debt	25.2	25.7	26.4	26.8	26.3	24.9	25.3
Net core Crown debt	4.9	2.8	3.1	2.7	3.1	3.3	3.5
Net core Crown debt with NZS Fund assets	(3.3)	(4.8)	(4.6)	(6.2)	(7.3)	(8.6)	(9.8)
Net worth	45.6	53.7	54.4	55.5	56.7	57.2	57.3
New Zealand Superannuation Fund							
Fund asset returns (after tax)	969	1,006	1,006	965	1,150	1,351	1,573
Fund contributions	2,337	2,049	2,049	2,103	2,194	2,312	2,458
Fund assets (year end)	9,861	12,918	12,910	15,977	19,321	22,984	27,015
% of GDP	6.3	7.8	7.8	9.2	10.8	12.3	13.8

Source: The Treasury

Table 2.14 – 2006 *Half Year Update* fiscal indicators

Fiscal indicators ($ million)	**Year ended 30 June 2006 Actual**	**2007 Forecast**	**2008 Forecast**	**2009 Forecast**	**2010 Forecast**	**2011 Forecast**
Revenue						
Total revenue	76,581	74,977	76,688	79,051	82,818	86,489
Core Crown revenue	59,170	59,020	59,917	61,577	64,746	67,895
Tax revenue	51,973	51,708	53,344	55,596	58,512	61,225
Expenses						
Total Crown expenses	65,084	68,790	70,688	73,926	77,064	80,583
Core Crown expenses	49,900	53,963	55,577	58,159	60,554	63,479
Operating balance - Core Crown	9,270	5,057	4,340	3,418	4,192	4,416
Operating balance - Crown entities	1,593	1,013	1,079	1,124	963	950
Operating balance - SOEs	1,799	776	993	1,055	1,091	1,062
Dividend elimination	(1,189)	(586)	(341)	(400)	(420)	(449)
Operating balance	11,473	6,260	6,071	5,197	5,826	5,979
OBERAC	8,648	6,656	6,071	5,197	5,826	5,979
OBERAC (excluding net NZS Fund asset returns)	8,068	5,981	5,231	4,170	4,588	4,511
Cash available/(shortfall to be funded)	2,985	107	(691)	(1,821)	(978)	(294)
Debt indicators						
Gross sovereign-issued debt	35,461	37,867	40,153	39,192	38,615	41,082
Total gross Crown debt	39,427	43,750	46,869	47,290	46,901	49,531
Net core Crown debt	7,745	6,382	5,923	7,187	7,697	7,525
Net core Crown debt with NZS Fund assets	(2,116)	(6,271)	(9,703)	(11,792)	(14,979)	(19,195)
Net worth	71,403	77,718	83,789	88,986	94,812	100,791
Domestic bond programme	2,375	2,456	2,517	2,476	2,472	2,465
Nominal GDP	156,562	162,667	170,633	179,817	188,764	198,068
Fiscal indicators as a % of GDP						
Revenue						
Total Crown revenue	48.9	46.1	44.9	44.0	43.9	43.7
Core Crown revenue	37.8	36.3	35.1	34.2	34.3	34.3
Tax revenue	33.2	31.8	31.3	30.9	31.0	30.9
Expenses						
Total Crown expenses	41.6	42.3	41.4	41.1	40.8	40.7
Core Crown expenses	31.9	33.2	32.6	32.3	32.1	32.0
Operating balance	7.3	3.8	3.6	2.9	3.1	3.0
OBERAC	5.5	4.1	3.6	2.9	3.1	3.0
OBERAC (excluding net NZS Fund asset returns)	5.2	3.7	3.1	2.3	2.4	2.3
Debt indicators						
Gross sovereign-issued debt	22.6	23.3	23.5	21.8	20.5	20.7
Total gross Crown debt	25.2	26.9	27.5	26.3	24.8	25.0
Net core Crown debt	4.9	3.9	3.5	4.0	4.1	3.8
Net core Crown debt with NZS Fund assets	(1.4)	(3.9)	(5.7)	(6.6)	(7.9)	(9.7)
Net worth	45.6	47.8	49.1	49.5	50.2	50.9
New Zealand Superannuation Fund						
Fund asset returns (after tax)	969	743	840	1,027	1,238	1,468
Fund contributions	2,337	2,049	2,133	2,326	2,459	2,576
Fund assets (year end)	9,861	12,653	15,626	18,979	22,676	26,720
% of GDP	6.3	7.8	9.2	10.6	12.0	13.5

Source: The Treasury

Risks to fiscal forecasts

The fiscal forecasts were finalised on 9 May 2007 in accordance with the forecast accounting policies. There are certain risks associated with the forecast results. To assist in evaluating such risks, the following chapters should be read in conjunction with the fiscal 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 the fiscal forecasts in particular, tax revenue and benefit expenses. *The Risks and Scenarios* chapter discusses the effect on the forecasts under different circumstances.
- *Specific Fiscal Risks* (Chapter 4) – The fiscal forecasts incorporate Government decisions up to 9 May 2006. 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.

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

The tax forecasts prepared for this *Budget Update* are based on current tax policy and on the macroeconomic central forecast. Sensitivities of tax revenue to changes in economic conditions are also presented in the *Risks and Scenarios* chapter on page 115.

KiwiSaver risks

IRD baselines incorporate an assumed take-up profile for the KiwiSaver regime. Actual take-up could be higher or lower than assumed, or faster or slower than assumed, representing an unquantified risk to the operating balance. This would decrease or increase the operating balance.

SOEs' and Crown entities' forecasts

The forecasts for large SOEs and CEs were provided in March 2007 based on their best assessments at that time.

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 NZ dollar (from 30 June 2007) 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 28 February and 31 March respectively. The liabilities will next be valued as at 30 June 2007. Any change in discount rates will affect the present fiscal forecast. For example, if the discount rate rises, the value of the liabilities will decrease.

Tertiary education institutes' accounting treatment

The forecast information presented in the 2007 *Budget Update* combined Tertiary Education Institutes (TEIs) on an equity accounting basis. This treatment has been under consideration by accounting standard setters. The Financial Reporting Standards Board has recently advised that the question of whether to consolidate autonomous and independent entities will be considered by delivering its deliberations of the International Accounting Standards Board (IASB) project on consolidation. The IASB plans to publish a discussion paper in 2007.

The combination method adopted in these forecasts is to equity account for the TEIs' net surpluses and net investment (ie, TEI revenues, expenses, assets and liabilities are not included on a line-by-line basis). This is consistent with the treatment adopted in the 2006 Financial Statements of the Government.

The key indicators are unchanged as a result of the combination approach for TEIs (refer page 60 of the 30 June 2006 Financial Statements of the Government).

Indicators of the Government's Fiscal Performance

This section aims to help readers better understand the Government's fiscal position.

Each indicator in this fact sheet gives valid insights into the government's historical, current and forecast fiscal position, but no one indicator gives a complete picture. Individual indicators do, however, come into greater or lesser focus as circumstances change.

When, for example, the New Zealand Government's net worth was low and net and gross debt levels were high, much of the focus of government and public commentary at that time was on eliminating annual operating deficits and on the need to attain, and later to lock in, annual operating surpluses.

However, as net worth has risen, and gross and net debt levels have fallen, the Government in more recent years has increasingly focused on how to maintain debt levels around current levels and, accordingly, has given more focus to the Government's annual cash balance.

Most of the indicators in this section may be useful regardless of the particular fiscal strategy being followed. In a few cases (such as the formulation of OBEGAL excluding NZS Fund revenue), the indicator is used to throw light on the impact of a particular strategy (in this case the build-up of financial assets in the NZS Fund).

Accounting Equations

Flow indicators (a worked example of how these flows interact is provided in the *Fiscal Outlook* chapter, see Table 2.2)

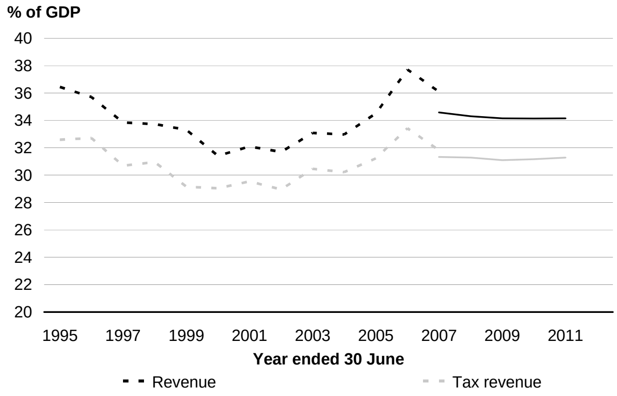
- Core Crown revenues – core crown expenses + net surplus of SOEs (ie, after dividends) and Crown entities + net gains and losses = **Operating balance.**
- Operating balance – net gains and losses = **Operating balance before gains and losses** (**OBEGAL).**
- OBEGAL – retained items (eg, net surplus of SOEs/CEs and revenues of the NZS Fund) – non-cash items (eg, depreciation) = **Net core Crown cashflow from operations.**
- Net core Crown cashflow from operations – net investing activities (eg, contributions to NZS Fund, purchases of assets, loans to others) = **Residual cash.**

Stock indicators

- **Gross sovereign-issued debt (GSID)** = debt issued by the core Crown.
- **Core Crown net debt** = gross sovereign-issued debt – core Crown's financial assets.
- **Net worth (NW)** = Crown's total assets – Crown's total liabilities. (Operating balance (OB) in any year largely drives the change in Net worth.)

Ratio of Core Crown Revenue (excluding NZS Fund revenue) to GDP

Ratio of core Crown revenue (excluding NZS Fund revenue) to GDP = the amount of revenue the core Crown receives as a percentage of GDP. Core Crown revenue mostly consists of tax revenue collected by the Government, but also includes investment income, sales of goods and services, and other receipts. Tax revenue is an accrual measure of taxation (ie, it is a measure of tax due, regardless of whether or not it has actually been paid).

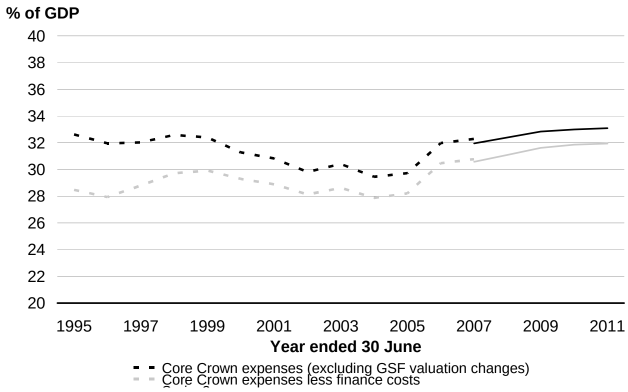


The revenue collected is used to meet the Government's spending needs. It is important to look at this alongside expenses, operating balance and gross debt indicators for insights into the sustainability of current policy settings.

Core Crown revenue (excluding NZS Fund revenue) to GDP is expected to be broadly stable at around 34% over the forecast period, while core Crown tax to GDP is expected to be remain relatively flat over the forecast period.

Ratio of Core Crown Expenses to GDP

Ratio of core Crown expenses to GDP = the day-to-day spending (on salaries, welfare benefit payments, running hospitals and schools, finance costs and maintaining national defence etc) that do not build physical assets for the Government. This is an accrual measure of expenses and includes items such as depreciation on physical assets.



This shows the day-to-day spending of the core Crown – ie, it excludes spending by SOEs and Crown entities – and highlights the size of Government in the economy and potential scope for crowding out the private sector.

The forecasts of operating expenses assume that the entire forecast operating allowance is allocated to spending.

By reducing gross debt, the Government has also reduced finance costs. However, in the years ahead, finance costs are likely to be fairly flat with gross debt forecast to be broadly stable.

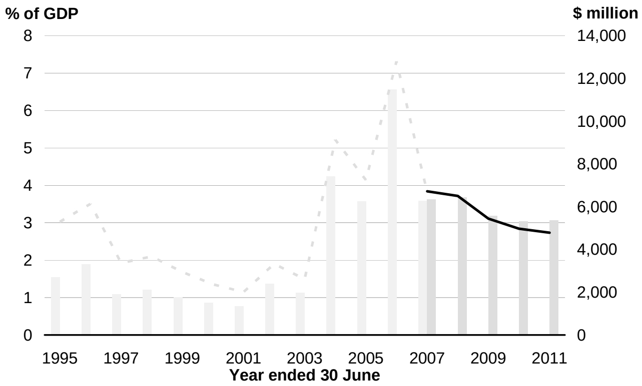
In the short-term core Crown expenses to GDP rise slightly before the trend stabilises as allocations for future Budgets are broadly consistent with forecast growth in the economy.

Operating Balance

Operating balance = revenues less expenses, plus net gains and losses.

The operating balance shows whether the government sector has generated enough revenues to cover its expenses in any given year.

This measure can be volatile from year to year owing to events outside of the Government's direct control (such as changes in interest rates and revaluations etc); therefore, it is generally not used as a measure of the Government's short-term fiscal stewardship.



The Government has been running operating surpluses since the early 1990s. The operating balance was just over 7% of GDP in 2006 and is expected to remain above 2% of GDP over the forecast period.

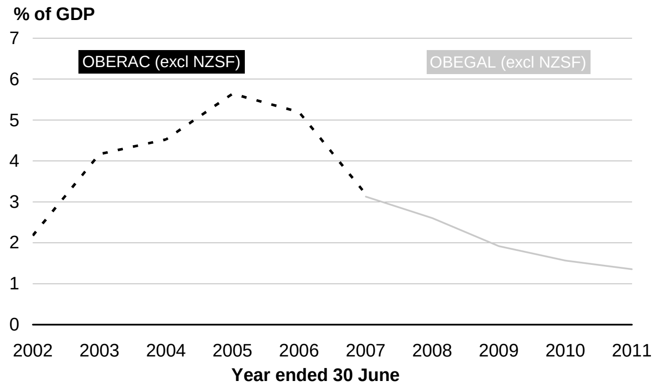
OBEGAL

OBEGAL = the operating balance before net gains and losses.

OBEGAL excluding NZS Fund revenue = OBEGAL less interest and dividend revenue earned by the NZS Fund.

By excluding net gains and losses the OBEGAL gives a more direct indication of the underlying stewardship of the Government.

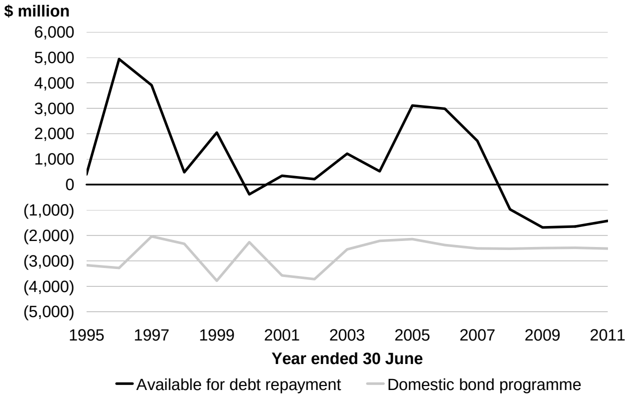
The current Government wishes to retain the NZS Fund investment returns in the Fund. Therefore, to ensure the Government is meeting its fiscal objectives, the Government has stated that it will be focusing on the OBEGAL excluding NZS Fund revenue.



Residual Cash and Domestic Bond Programme

Residual cash = the level of money the Government has available to repay debt or, alternatively, needs to borrow in any given year. Residual cash is alternatively termed "Cash available/(shortfall to be funded)".

Domestic bond programme = the amount of new government stock expected to be issued over the financial year.



The cash available measure includes capital investment and NZS Fund contributions; therefore, it is the flow contributing to changes in debt. This balance cannot be looked at independently from gross sovereign-issued debt.

The domestic bond programme raises term debt for the Government, the proceeds of which contribute to funding operating and investing activity, and the repayment of maturing debt. The programme tends to be different from the cash available figure in any given year as financing activity, such as the repayment of debt, needs to be considered.

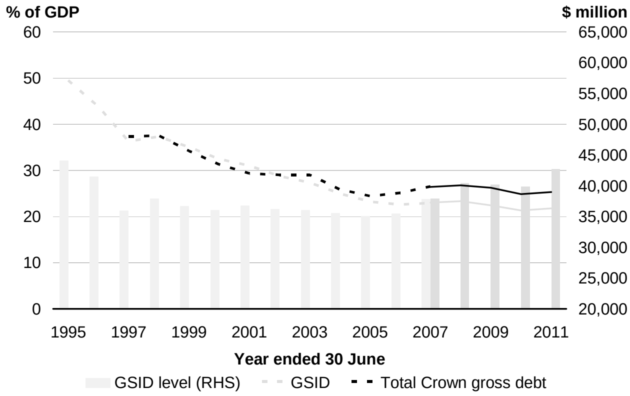
The Government is currently moving from a period of having cash available to repay debt, to a need, in subsequent years, to generate cash through borrowing and reductions in marketable securities.

Crown Gross Debt

Total Crown gross debt = the total borrowings (both sovereign-guaranteed and non-sovereign guaranteed) of the total Crown.

Gross sovereign-issued debt = debt issued by the sovereign (ie, core Crown) and includes Government stock held by the NZS Fund, GSF, ACC or EQC for example.

Total gross debt and GSID are often expressed as a percentage of GDP to put the level of debt into perspective, in terms of a country's ability to generate growth to repay the debt and/or income to service this debt.



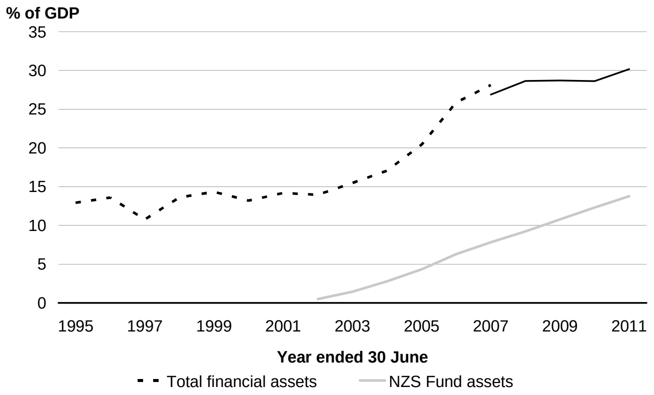
Total gross debt represents the complete picture of whole-of-government obligations to external parties. However, debt issued by SOEs and Crown entities is not explicitly guaranteed by the Crown. The debt that is issued by the sovereign and guaranteed by the sovereign is in GSID. The Government's long-term debt objective is formulated in terms of GSID.

A high ratio of debt to GDP can have an adverse impact on credit ratings and perceived sustainability of current policy settings. So as a general rule, a relatively low ratio is considered to be prudent. A low ratio of debt to GDP can also provide the Government with more flexibility in their accounts to respond to adverse shocks through increasing debt.

GSID has been steadily declining since the early 1990s and is expected to remain broadly stable around 20% of GDP in the forecast period.

Core Crown Financial Assets

Core Crown financial assets = the financial assets of the core Crown. These are either cash or shares (equity) or a right to receive a financial instrument, which can be converted to cash. The assets of the NZS Fund are becoming the dominant feature of the Crown's financial assets. The NZS Fund is the Government's means of building up assets to partially pre-fund future New Zealand Superannuation expenses. The Government's contributions to the NZS Fund are calculated over a 40-year rolling horizon to ensure superannuation entitlements over the next 40 years can be met.



Established under the New Zealand Superannuation and Retirement Income Act 2001, the NZS Fund was created to partially provide for the future cost of New Zealand Superannuation, which is expected to almost double in cost due to population ageing.

The Government plans to allocate around $2 billion a year to the NZS Fund over the next 20 years. The NZS Fund's mandate is to invest money in a way that maximises its returns, without undue risks.

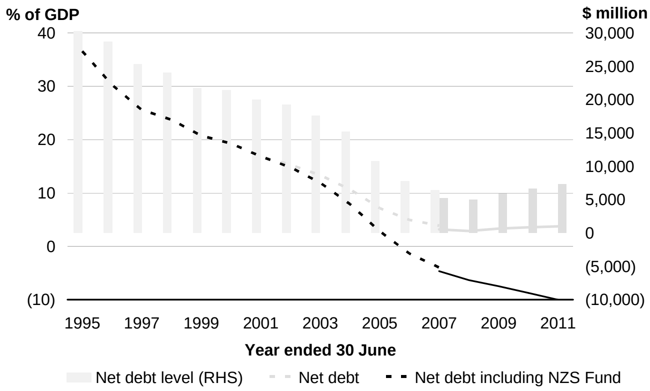
As the cost of providing New Zealand Superannuation increases, future governments will draw on the NZS Fund to help smooth the impact of the cost of New Zealand Superannuation on their finances.

For the year ended June 2006, NZS Fund assets totalled $9.86 billion or around 6% of GDP. The NZS Fund is expected to grow to around $27 billion or 14% of GDP by the end of the forecast period.

Core Crown Net Debt

Core Crown net debt = borrowings (financial liabilities) less cash and bank balances, marketable securities and deposits, and advances (financial assets). Net debt excludes the assets of the NZS Fund and GSF.

By including financial assets, net debt can provide additional information about the sustainability of the Government's accounts. Many international agencies believe the quantity of off setting financial assets is important when determining the credit-worthiness of a country. That is, if a country has a high ratio of financial assets to GDP, they are better able to justify a high ratio of debt to GDP.



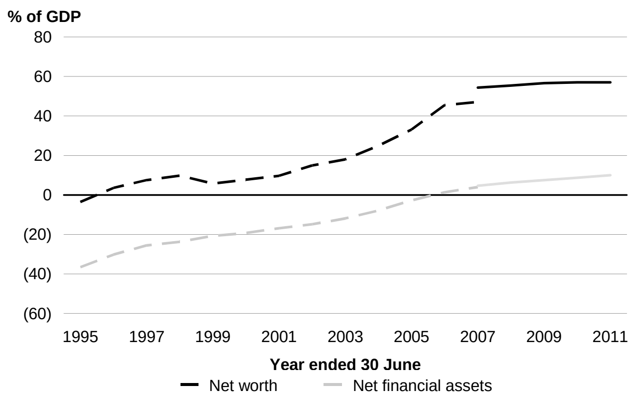
However, as some financial assets are not very liquefiable (or easily converted into cash), it is important to view net debt alongside GSID.

After declining steadily since the early 1990s, net debt is projected to consolidate in the years ahead at around 3% of GDP, rising slightly towards the end of the forecast period. If the assets of the NZS Fund are included, the Government's net debt position is in a net financial asset position.

Net Worth

Net worth = assets less liabilities (also referred to as the Crown balance). The change in net worth in any given forecast year is largely driven by the operating balance.

Total Crown net worth is one indicator of the degree to which current government activities are sustainable. This indicator should be considered alongside the Crown's debt position, as relatively high debt to GDP ratios may still be considered sustainable if the Crown has relatively high ratios of saleable or commercial assets to GDP.



Building up net worth is also consistent with preparing for population ageing.

Net worth is projected to continue to rise, moving from around 45% in 2006 to around 57% at the end of the forecast period.
