

6 October 2008

B.16



Pre-election Economic and Fiscal Update

2008

Hon Dr Michael Cullen
MINISTER OF FINANCE

978-0-478-33020-5 (Print)
978-0-478-33021-2 (Online)

The *2008 Pre-election Update* sets out the Treasury's latest economic and fiscal forecasts for the current year and the next four years. The document is organised as follows:

- A **Statement of Responsibility** from the Secretary to the Treasury and the Minister of Finance is included on page 1.
- A **Ministerial Statement** from the Minister of Finance is provided on page 3.
- The **Executive Summary** (page 5) provides a short summary of the economic and fiscal forecasts.
- The **Economic and Tax Outlook** chapter (page 11) sets out the Treasury's economic and tax forecasts, including forecasts of major economic aggregates (eg, output, inflation, employment and the current account), and a statement of significant assumptions.
- The **Fiscal Outlook** chapter (page 21) sets out the Treasury's fiscal forecasts, including forecasts of revenue and expenses, operating results, the cash position, debt and the NZS Fund. It also contains projections of key fiscal indicators for the ten years following the forecast period. In previous *Pre-election Updates* these ten-year projections, which by their nature are less precise than the forecasts, have been published separately on the Treasury website. They are now incorporated into the document to make this information easier to access and to provide a fuller picture.
- The **Risks and Scenarios** chapter (page 49) describes some of the key risks to Treasury's central economic forecasts, and sets out two alternative scenarios for how the economy might develop.
- The **Specific Fiscal Risks** chapter (page 57) sets out material risks and contingent liabilities that could have an impact on the fiscal forecasts if decisions being considered by ministers are taken, or if particular circumstances eventuate. This chapter also discloses commitments that have been made against future budget allowances.
- The **Generally Accepted Accounting Practice (GAAP) Series Tables** chapter (page 83) provides a set of forecast financial statements, and a statement of accounting policies and assumptions.
- The **Core Crown Expense Tables** chapter (page 113) provides information on core Crown expenses broken down into functional classifications; a glossary of terms; and a time series of fiscal and economic indicators.

© Crown Copyright Reserved

ISBN - 978-0-478-33020-5 (Print)
ISBN - 978-0-478-33021-2 (Online)

Internet

This document is available on the New Zealand Treasury's Internet site. The URL for this site is <http://www.treasury.govt.nz>

The dates on which particular elements of this *Pre-election Update* were finalised are set out below.

Economic and fiscal forecasts – finalisation dates

Text finalised	26 September
Economic data	28 August
Economic forecasts (refer <i>Chapter 1</i>)	28 August
Tax revenue forecasts	4 September
Fiscal forecasts (refer <i>Chapter 2</i>), including:	17 September
• Government decisions and circumstances	17 September
• Actual asset revaluations	30 June
• Foreign exchange rates	30 June
Specific fiscal risks (refer <i>Chapter 4</i>)	23 September
Contingent liabilities and commitments (refer <i>Chapter 4</i>)	30 June

Between the finalisation of the economic forecasts on 28 August and the finalisation of the text of the *Pre-election Update* on 26 September, a number of developments have taken place, including:

- The international financial crisis has continued to develop, with the US government taking control of Fannie Mae and Freddie Mac; US investment bank Lehman Brothers filing for bankruptcy protection; retail brokerage Merrill Lynch being bought by Bank of America; the US Federal Reserve announcing a rescue package for insurance company AIG; and the US Treasury developing a comprehensive plan to purchase “troubled assets” in order to stem further financial collapse.
- On 11 September the Reserve Bank of New Zealand cut the official cash rate by 50 basis points to 7.5%.
- The price of oil (West Texas Intermediate) fell to a low of US\$91/barrel on 16 September, but increased again to US\$111 on 25 September, just below its close of US\$116 on 28 August.
- The NZ dollar fell to 61.9 on the Trade Weighted Index on 16 September but strengthened again to 64.2 on 26 September.

These international financial crisis developments, while not leading us to change our overall view of the economy, have increased the risks of a sharper downward correction.

Contents

Statement of Responsibility	1
Ministerial Statement	3
Executive Summary	5
Economic and Tax Outlook	11
Introduction.....	11
Economic Growth and Tax Revenue Lower than Previously Forecast	11
<i>Assumptions for the Forecasts</i>	12
Weaker Growth as Global Economy Adjusts to Imbalances	14
Domestic Imbalances Lead to Protracted Downturn	17
Fiscal Outlook	21
Introduction.....	21
Short-Term Outlook.....	22
Revenue and Expenses.....	23
Operating Results	29
Cash Position.....	32
Debt	36
NZS Fund	39
Medium-Term and Long-Term Outlook	40
Risks to Fiscal Forecasts	47
Risks and Scenarios	49
Introduction.....	49
Economic Risks.....	50
Economic Scenario	53
Fiscal Scenarios	55
Fiscal Sensitivities	56

Specific Fiscal Risks **57**

Introduction.....	57
Charges against Future Budgets.....	59
Time Limited Funding.....	62
Specific Fiscal Risks.....	67
Contingent Liabilities	80

Generally Accepted Accounting Practice (GAAP) Series Tables **83**

Forecast Financial Statements.....	83
------------------------------------	----

Core Crown Expense Tables **113**

Glossary of Terms	118
Times Series of Fiscal and Economic Indicators.....	122

Other Information

On the Treasury's website is a series of other information that contains detailed economic forecast tables and additional financial information. This information provides users of the *Pre-Election Economic and Fiscal Update 2008* with further detail and should be read in conjunction with the published document. It can be accessed at:

<http://www.treasury.govt.nz/budget/forecasts/prefu2008>

Statement of Responsibility

On the basis of the economic and fiscal information available to it, the Treasury has used its best professional judgement in supplying the Minister of Finance with this Economic and Fiscal Update. The Update incorporates the fiscal and economic implications both of Government decisions and circumstances as at 17 September 2008 that were communicated to me, and of other economic and fiscal information available to the Treasury in accordance with the provisions of the Public Finance Act 1989.



John Whitehead
Secretary to the Treasury

24 September 2008

This Economic and Fiscal Update has been prepared in accordance with the Public Finance Act 1989. I accept overall responsibility for the integrity of the disclosures contained in this Update, and the consistency and completeness of the Update information in accordance with the requirements of the Public Finance Act 1989.

To enable the Treasury to prepare this Update, I have ensured that the Secretary to the Treasury has been advised of all Government decisions and other circumstances as at 17 September 2008 of which I was aware and that had material economic or fiscal implications.



Hon Dr Michael Cullen
Minister of Finance

24 September 2008

Ministerial Statement

In the time between the publication of Budget 2008 and the preparation of this Pre-election Economic and Fiscal Update there have been a series of significant events in world financial markets. The fallout on New Zealand's housing market and on business and household incomes arising from higher international credit costs has compounded the effects of a weakening domestic economy. This has resulted in a Pre-EFU noticeably weaker than at Budget time.

Nine years of prudent fiscal management and sustained economic growth means that New Zealand is well placed to deal with these challenging times. Despite calls to spend the surpluses in recent years this government has adhered to our fiscal objectives and has reduced Gross Sovereign Issued Debt (GSID) so that we can meet the economic challenges ahead, while still delivering tax cuts and support for families.

While the international position has worsened over recent months New Zealand has been in what is forecast to be a short and relatively shallow recession. Treasury is forecasting a return to positive growth in the last quarter of 2008. These forecasts, however, do highlight the importance of fiscal restraint during favourable economic times to enable us to have room to respond in less favourable times.

New Zealand is well placed to manage the external shock that our economy has endured. So while today's report card highlights how critically important it was to utilise more favourable international and domestic economic times to save for a rainy day, it also tells us that the rainy day has arrived and that the Crown's fiscal position has taken a big hit. Changes in the operating balance from the Budget forecasts are predominantly driven by the weaker economic outlook (reductions in revenue and associated finance costs).

The New Zealand economy has come a long way since 1999:

- the 1999 Pre-EFU forecast an unemployment rate of 7.0% in the March 2000 quarter compared with this Pre-EFU forecast of 4.4% unemployment in the March 2009 quarter
- real gross domestic product (GDP) growth averaged 2.9% from 1990 to 1999 compared with 3.5% from 1999 to 2007
- in 1999 net core Crown debt sat at 21.8% of GDP but this moved into a positive net financial asset position (including NZ Super Fund assets) since 2006, and
- in 1999, GSID was above 35% of GDP but it has been brought down to below the government's medium-term target.

And we have achieved all this while enhancing social equality and while delivering significant gains for New Zealanders including:

- the longest period of economic expansion since WWII
- strong investment in New Zealand's infrastructure after the 1990s decade of neglect
- lower primary health care costs
- restoring and lifting entitlements in superannuation
- tax relief for businesses, savers and families with children, and
- personal tax cuts for all workers.

This Government is proud of what it has achieved during the past three terms. The New Zealand economy of 2008 is much stronger and more sustainable than that of 1999 and it is also fairer.