

2

Fiscal Outlook

Overview

- Tax revenue is forecast to increase slightly, while expenses decline, as a share of GDP over the next four years.
- Operating deficits narrow and a surplus of \$75 million is forecast in 2014/15 after taking into account the proposed reduction in ACC levies.
- Net core Crown debt peaks as a share of GDP at 28.7% in 2014/15.
- The Crown's balance sheet strengthens and fiscal buffers begin to be rebuilt.

Table 2.1 – Fiscal indicators

Year ended 30 June	2012 Actual	2013 Forecast	2014 Forecast	2015 Forecast	2016 Forecast	2017 Forecast
\$billions						
Total Crown OBEGAL ¹	(9.2)	(6.3)	(2.0)	0.1	0.8	2.6
Net core Crown debt ²	50.7	57.9	64.8	68.2	69.7	70.3
Gross debt ³	79.6	78.6	87.7	83.2	87.5	93.9
Net worth attributable to the Crown	59.3	61.5	62.0	64.8	68.5	73.9
% of GDP						
Total Crown OBEGAL ¹	(4.4)	(2.9)	(0.9)	0.0	0.3	1.0
Net core Crown debt ²	24.3	27.1	28.4	28.7	28.1	27.3
Gross debt ³	38.2	36.8	38.5	34.9	35.3	36.5
Net worth attributable to the Crown	28.5	28.7	27.2	27.3	27.6	28.7

Notes:

- 1 Operating balance before gains and losses
- 2 Net core Crown debt excluding the New Zealand Superannuation Fund (NZS Fund) and advances
- 3 Gross sovereign-issued debt excluding Reserve Bank bills and settlement cash

Source: The Treasury

Overall, growth in the economy, and managed spending levels, sees the Crown return to surplus, slow the pace of growth in debt and increase the size of net worth, helping the Crown to begin rebuilding fiscal buffers to absorb future shocks.

The fiscal forecasts shows the Government is expected to achieve its fiscal objective of a return to surplus in 2014/15 with \$75 million forecast.

Tax revenue increases in each year of the forecasts reflecting the expected growth in the economy, as discussed in the *Economic Outlook* chapter.

Core Crown expenses are expected to increase by \$5.5 billion over the next four years, largely owing to new spending announced in Budget 2013 and Budget allowances set aside for future spending. Budget 2013 decisions have increased expenses by around \$1.0 billion per annum. Coupled with revenue initiatives, the net spending in Budget 2013 reduces to \$900 million per annum. As in previous years, most of the new funding is allocated to the priority areas of education, health and welfare.

Including allocations from the operating allowance and the Future Investment Fund, total Canterbury earthquake expenses are now forecast to reach \$15.2 billion by 2016/17 (refer to page 33).

The improving fiscal position has provided enough headroom for the Government to signal reductions in ACC levies from 2014/15 onwards, with the expected impacts built into these forecasts (refer to page 35).

Net debt peaks as a share of GDP in 2014/15 at 28.7%, although nominal net debt continues to increase until 2017/18, one year following the end of these forecasts.

The partial share offers are expected to provide proceeds that the Government will invest largely in social assets, managed through the Future Investment Fund that was established in Budget 2012 (refer to page 38).

Table 2.2 – Reconciliation between OBEGAL and net debt

Year ending 30 June \$billions	2012 Actual	2013 Forecast	2014 Forecast	2015 Forecast	2016 Forecast	2017 Forecast
Core Crown revenue	60.6	63.8	68.4	72.3	75.8	79.5
Core Crown expenses	(69.1)	(71.6)	(72.4)	(73.5)	(75.2)	(77.2)
Net surpluses/(deficits) of SOEs and CEs	(0.7)	1.5	2.0	1.3	0.2	0.3
Total Crown OBEGAL	(9.2)	(6.3)	(2.0)	0.1	0.8	2.6
Net retained surpluses of SOEs, CEs and NZS Fund	0.4	(1.2)	(2.1)	(1.4)	(0.3)	(0.5)
Non-cash items and working capital movements	1.6	1.6	0.9	0.7	1.3	1.8
Net core Crown cash flow from operations	(7.2)	(5.9)	(3.2)	(0.6)	1.8	3.9
Net purchase of physical assets	(1.3)	(1.5)	(2.6)	(1.9)	(1.3)	(1.5)
Advances and capital injections	(2.1)	(1.9)	(2.1)	(2.0)	(2.6)	(2.0)
Forecast for future new capital spending	-	-	(0.5)	(0.7)	(0.9)	(1.0)
Proceeds from Government share offers	-	1.5	1.5	1.5	1.5	-
Core Crown residual cash deficit	(10.6)	(7.8)	(6.9)	(3.7)	(1.5)	(0.6)
Opening net debt	40.1	50.7	57.9	64.8	68.2	69.7
Core Crown residual cash deficit	10.6	7.8	6.9	3.7	1.5	0.6
Valuation changes in financial instruments	-	(0.6)	-	(0.3)	-	-
Closing net debt	50.7	57.9	64.8	68.2	69.7	70.3
As a percentage of GDP	24.3%	27.1%	28.4%	28.7%	28.1%	27.3%

Source: The Treasury

Core Crown Tax Revenue

Tax revenue increases by around 5% per annum on average over the next four years...

Core Crown tax revenue is forecast to increase by \$14.5 billion over the next four years, reaching \$72.8 billion in 2016/17. These increases outpace the growth in the economy and see tax revenue rise as a share of GDP each year, reaching 28.3% by the end of the forecast period, but still below levels of the last decade (Figure 2.1).

The tax revenue forecasts assume the underlying strength recorded this year remains and that this base then continues to grow. The strength in this year's tax take is owing to a faster growing economy and a shift in income distribution. While there has been recent weakness in the labour market, this has been concentrated at the lower end of the income scale and resulted in a higher average tax rate, owing to the progressive nature of PAYE tax. Coupled with this, strong international equity markets and base-broadening measures have boosted other persons tax. Moderate growth in the nominal economy and earnings is expected to continue across the forecast period, and translate into growth in all types of tax revenue.

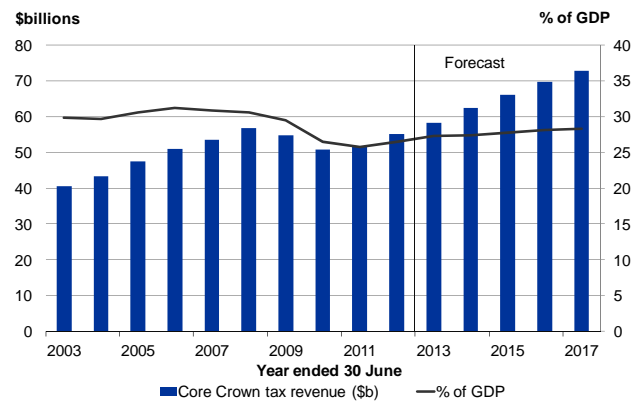
In total, the growth in tax revenue is expected to be above the forecast rate of nominal GDP growth (as shown in Figure 2.2). All tax types are expected to increase across the forecast period, with particular strength in tax from employees, as shown in Table 2.3.

Labour earnings growth is the key contributor to the growth in tax revenue across the forecast period. Earnings growth and the progressive nature of the personal tax scale contribute to add \$5.1 billion to source deductions over the next four years.

The level of residential investment is forecast to double over the forecast period, mainly as a result of rebuilding in Canterbury. The higher investment is expected to add \$1.3 billion to GST by 2016/17 (over the next four years) and is the main reason why GST is forecast to grow faster than private consumption.

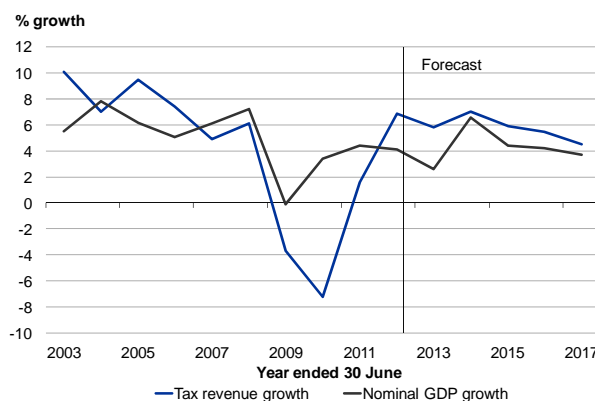
Corporate tax is expected to rise over the forecast period as business profitability continues to improve as growing domestic activity allows firms to rebuild margins which have been compressed in recent years. In addition, an assumed running down of tax losses that built up over the recession contributes to the forecast growth in corporate tax.

Figure 2.1 – Core Crown tax revenue



Source: The Treasury

Figure 2.2 – Core Crown tax revenue growth



Source: The Treasury

These forecasts also see an expected rise in 90-day interest rates from 2.7% in 2012/13 to 4.7% by 2016/17, with flow on impacts to increased tax on interest earned on residents' savings (RWT).

Budget 2013 announces revenue initiatives, largely in relation to increased funding for the enforcement of tax law in the property sector.⁴ This increased enforcement is expected to raise an additional \$45 million of tax revenue from 2016/17 onwards.

Table 2.3 – Reconciliation of change in core Crown tax revenue over the forecast period

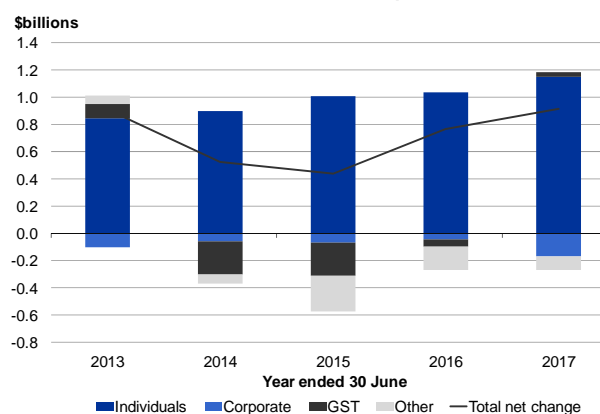
Year ending 30 June \$billions	2013 Forecast	2014 Forecast	2015 Forecast	2016 Forecast	2017 Forecast
Movement in core Crown tax owing to:					
Employees' compensation	0.5	1.1	1.0	1.0	1.2
Entrepreneurial income	0.1	0.2	0.3	0.1	0.1
Corporate profits	0.3	1.1	0.2	0.4	0.2
Private consumption	0.5	0.7	0.8	0.8	0.7
Residential investment	0.3	0.5	0.4	0.3	0.1
Interest rates	(0.1)	-	0.2	0.3	0.3
Fiscal drag	0.2	0.2	0.2	0.2	0.3
Tax loss offsets	-	0.4	-	0.1	-
Timing and other factors	1.4	(0.1)	0.6	0.4	0.2
Total movement in core Crown tax revenue	3.2	4.1	3.7	3.6	3.1
Plus: previous year's tax base	55.1	58.3	62.4	66.1	69.7
Core Crown tax revenue	58.3	62.4	66.1	69.7	72.8
as a % of GDP	27.3%	27.4%	27.8%	28.1%	28.3%

Source: The Treasury

...and is higher than the Half Year Update

The *Half Year Update* forecast tax revenue of \$71.9 billion by 2016/17, while Budget 2013 expects an additional \$0.9 billion, taking the total to \$72.8 billion in 2016/17. The reason for the increase is largely owing to the strength of the current year's outturn. While the *Half Year Update* included increases in both other persons tax and PAYE, the actual outturn for these tax types has outstripped those forecasts. The forecasts assume that most of the current strength will remain and the base will grow.

Figure 2.3 – Movement in core Crown tax revenue since the *Half Year Update*



Source: The Treasury

The signalled reductions in ACC levies (refer to page 35) also impact the tax take. With lower levies there is an increase in disposable income, which has flow on impacts to the forecasts in the form of increased tax from consumption and interest on savings.

⁴ Refer to the *Additional Information* on Treasury's website for further details on tax policy changes.

Core Crown Expenses

Growth in core Crown expenses slows over the forecast period...

While core Crown expenses are forecast to increase in nominal terms by \$5.5 billion in total over the next four years (Figure 2.5), this increase is relatively modest compared to the previous 10 years' growth. The annual average increase in core Crown expenses (excluding earthquake costs) from 2003 through 2012 was 6.1%. These forecasts see the annual average increase in expenses fall to 2.7%, as shown in Figure 2.4.

The lower expenditure growth is largely owing to smaller allowances for new spending in recent Budgets and the Government's decisions to reduce future operating allowances from Budget 2014 onwards by around \$0.2 billion per Budget.

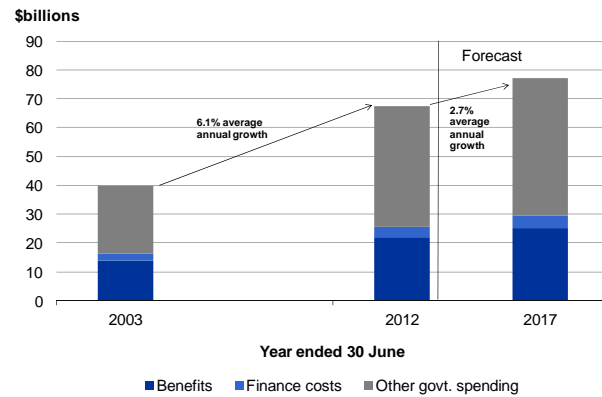
Budget 2013 decisions have increased spending by \$1.0 billion⁵ per year and include spending of \$0.4 billion for health, \$0.2 billion for education, \$0.1 billion for earthquake recovery and \$0.1 billion for growth-related initiatives. For more details about the Budget 2013 package, including reprioritisation, refer to the Minister's *Executive Summary*.

The forecasts include operating allowances for new spending of around \$1.0 billion for the next three Budgets, which in total increase the level of expenses by \$3.0 billion by 2016/17.

Social assistance spending increases by \$2.4 billion by 2016/17, with the increase owing to payments being indexed to inflation and increasing recipient numbers. New Zealand Superannuation increases by \$2.5 billion over that period with other benefit types reducing slightly.

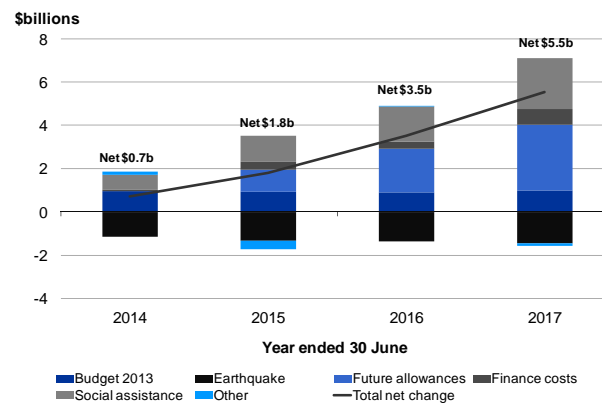
Finance costs also increase over the next four years as gross debt continues to grow and interest rates are forecast to rise.

Figure 2.4 – Core Crown expenses growth (excluding earthquake costs)



Source: The Treasury

Figure 2.5 – Increase in core Crown expenses



Source: The Treasury

⁵ While the Budget 2013 package was \$1.0 billion in 2016/17, on average Budget 2013 has a net impact of \$0.9 billion, comprising of \$1.0 billion new spending offset by \$0.1 billion of revenue initiatives.

Partially offsetting the increases, earthquake costs reduce over the forecast period; refer to page 33 for details of the profile of earthquake expenses.

...as a result, they fall as a share of GDP...

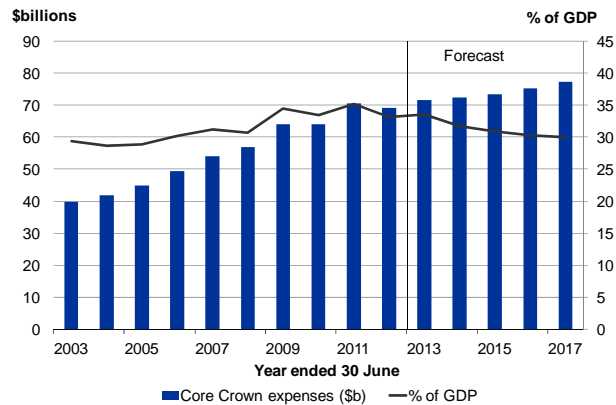
While expenses continue to increase in nominal terms over the forecast period, the growth is expected to be at a slower rate than economic growth, as shown in Figure 2.6.

Core Crown expenses are forecast to fall from 33.5% of GDP in 2012/13 to 30.0% of GDP by 2016/17.

...and have declined since the Half Year Update

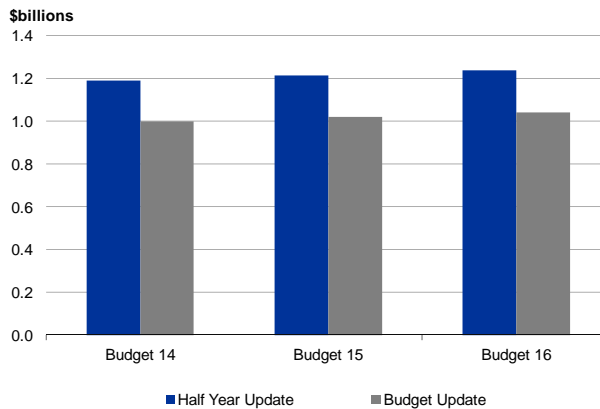
By 2016/17 expenses are \$0.8 billion less than forecast in the *Half Year Update*, falling from \$78.0 billion to \$77.2 billion. As shown in Figure 2.7, the main driver of the decrease is the reduction in future Budget allowances from Budget 2014 onwards.

Figure 2.6 – Core Crown expenses



Source: The Treasury

Figure 2.7 – Future Budget allowances



Source: The Treasury

Cost to the Crown of Canterbury Earthquakes

The Government continues to make significant contributions to the rebuild of Canterbury, with latest estimates for the total cost to the Crown at \$15.2 billion. This latest estimate adds \$2.1 billion for key projects in the Canterbury region to the \$5.5 billion the Government previously set aside for earthquake recovery on top of \$7.6 billion for costs relating to the Earthquake Commission (EQC) and other Crown entities.

Budget 2013 has allocated over \$0.9 billion from the Future Investment Fund for the Christchurch hospitals redevelopment, the Justice and Emergency Services Precinct and to tertiary education institutions in the Canterbury region. Just over \$0.3 billion of operating funding has been set aside in the Budget as part of the Crown's contribution to anchor projects in the central city. The remainder of the increase relates to commitments for final land zoning decisions, school property portfolio expenditure and other education initiatives and funding for CERA.

Table 2.4 below outlines the latest estimates of the net impact of the earthquake included in these forecasts, the operating/capital split and the expected cash profile of earthquake costs.

Table 2.4 – Net earthquake expenses (operating and capital)

Year ending 30 June	2011 & 2012	2013	2014	2015	2016	2017	Total	Total
\$millions	Actual	Forecast	Forecast	Forecast	Forecast	Forecast	BEFU	HYEFU
Local infrastructure	881	1,164	100	100	100	50	2,395	1,549
Crown assets ¹	12	21	230	437	500	379	1,579	33
Land zoning	920	189	109	-	-	-	1,218	1,120
Christchurch central rebuild	-	187	708	117	(174)	63	901	588
Welfare support	243	32	24	6	-	-	305	307
Southern Response support package	511	(49)	(84)	(41)	(34)	(2)	301	300
Estimation contingency	-	-	-	-	-	-	-	793
Other costs	318	242	137	77	76	18	868	817
Canterbury earthquake recovery costs	2,885	1,786	1,224	696	468	508	7,567	5,507
EQC (net of reinsurance proceeds)	8,133	(164)	(255)	(68)	(114)	-	7,532	7,532
Other Crown entities	(18)	40	(124)	77	53	38	66	49
Total Crown	11,000	1,662	845	705	407	546	15,165	13,088
Operating and capital expenses								
Operating expenditure (OBEGAL)	10,987	1,395	10	209	119	132	12,852	12,500
Capital expenditure	13	267	835	496	288	414	2,313	588
Total Crown	11,000	1,662	845	705	407	546	15,165	13,088
Total cash payments	5,247	1,597	3,283	2,778	1,722	538	15,165	13,038

Note:

1. Crown assets includes capital expenditure on Canterbury hospitals, schools, tertiary education institutions and the Justice and Emergency Services Precinct

Source: The Treasury

While the expenses are largely recognised up front and indicate the Crown's obligation, the cash profile reflects the expected timing of payments to settle these obligations.

These are the latest estimates of the cost of the earthquake to the Crown; the *Specific Fiscal Risks* chapter includes discussion on the risks associated with the Canterbury earthquakes (page 59).

A discussion about investment spending associated with the Canterbury rebuild can be found in the *Economic Outlook* chapter on page 15. The box in the *Economic Outlook* chapter focuses on aggregate investment levels, including both government and private sector spending.

Operating Surplus

The Crown is forecast to return to surplus in 2014/15...

With the increase in tax revenue outstripping spending growth, the Crown's OBEGAL is forecast to return to surplus in 2014/15 at \$75 million.

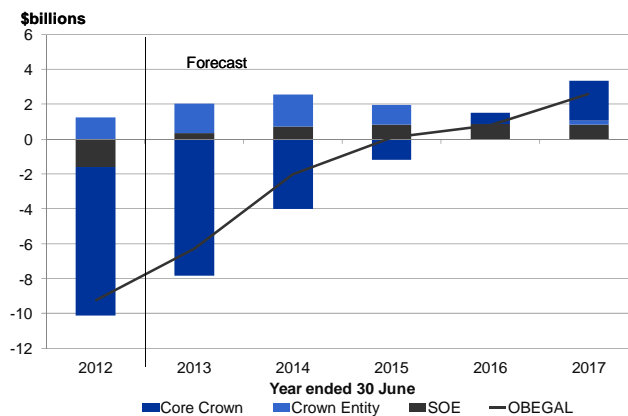
The outlook has improved since the *Half Year Update* particularly in relation to tax revenue, which has enabled the Government to signal reductions in ACC levy rates (refer to the box on the next page). As a result of the levy reductions, OBEGAL grows at a slower rate than forecast in the *Half Year Update*.

State-owned Enterprise (SOE) and Crown Entity (CE) sectors contribute \$2.0 billion to the surplus in 2012/13 falling to \$1.1 billion by the end of the forecasts.

The fall is mainly owing to the reduction in ACC levy rates and forgone profits from the Government share offers (partially offset by reduced borrowing costs). Figure 2.8 shows the composition of OBEGAL from the different sectors of the Government.

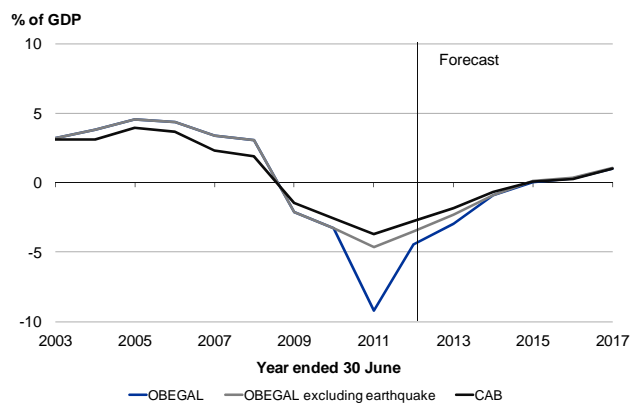
The underlying nature of OBEGAL can be seen using the cyclically adjusted balance (CAB). This measure adjusts for the state of the economy and significant one-off expenses. Figure 2.9 shows that CAB has been close to OBEGAL in recent years, indicating that the recent operating deficits have been largely structural. The projected size of the economy reduced following the recession, implying a smaller tax base while, in contrast, expenses continued to grow. In these forecasts, tax is expected to grow faster than expenses, seeing CAB move to surplus in 2014/15.⁶

Figure 2.8 – Components of OBEGAL by sector



Source: The Treasury

Figure 2.9 – OBEGAL and CAB



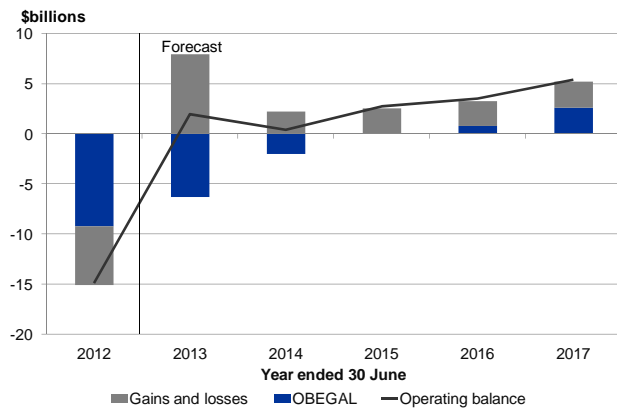
Source: The Treasury

⁶ For more details, see the *Additional Information* on the Treasury website www.treasury.govt.nz.

...while current strength in equity markets lifts the operating balance

When gains and losses are included, the total Crown operating balance is forecast to be in surplus this year, then declines next year before growing each subsequent year of the forecasts (Figure 2.10). The current year's surplus is a result of gains made by Crown financial institutions (CFIs), largely ACC and the NZS Fund, and reflects strong global equity returns (for example, by 31 March 2013 the New Zealand Superannuation Fund had made year-to-date gains of \$3.8 billion, a return of 19.9%). While the current year reflects strong market growth, the forecast gains in future years assume a long-term rate of return, resulting in more subdued growth in these years. These gains play a part in increasing the Government's financial assets, and the Crown's net worth (discussed on page 37).

Figure 2.10 – Components of operating balance



Source: The Treasury

ACC Levy Reductions

As part of Budget 2013, the Government has signalled reductions in ACC levy rates of around \$300 million in 2014/15 and \$1.0 billion from 2015/16 onwards. When combined with the consequential impact on investment revenue and insurance expenses, the fiscal impact on OBEGAL of the levy reductions is expected to be approximately \$0.4 billion in 2014/15, \$1.5 billion in 2015/16 and \$1.1 billion in 2016/17 (refer to Table 2.5).

The impact on specific levy rates has yet to be agreed; therefore, the fiscal forecasts include revenue and expense contingencies to reflect the expected fiscal impact of the reductions.

Investment revenue has been adjusted to reflect any consequential forgone investment returns from ACC's asset portfolio.

Insurance expenses have also increased in the forecasts to reflect the expected flow-on impacts on the valuation of the claims liability. An expense is required in order to rebalance the risk of meeting future claims with reduced revenue.

Table 2.5 – Fiscal impact of reducing ACC levies

Year ending 30 June \$billions	2013 Forecast	2014 Forecast	2015 Forecast	2016 Forecast	2017 Forecast
Decrease in levy revenue	-	-	(0.3)	(1.0)	(1.0)
Forgone investment revenue	-	-	-	-	(0.1)
Increase in insurance expenses	-	-	0.1	0.5	-
Impact on OBEGAL	-	-	(0.4)	(1.5)	(1.1)

Source: The Treasury

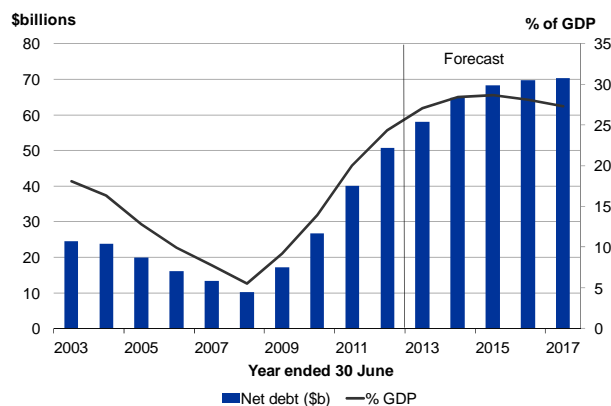
Net Debt

Net debt peaks as a share of GDP in 2014/15...

While the Crown returns to operating surplus in 2014/15, core Crown operating cash flows⁷ remain in deficit a further year, not reaching surplus until 2015/16. By 2016/17, the core Crown cash surplus is expected to reach \$3.9 billion.

While operating cash flows are positive by 2015/16, net capital spending is expected to exceed these cash flows. As a result, residual cash remains in deficit for each year of the forecast period. These deficits are funded by an increase in net debt. In nominal terms, net debt is expected to peak in 2016/17 at \$70.3 billion before beginning to decline. However, net debt peaks as a share of GDP in 2014/15 at 28.7% (Figure 2.11) as the growth in the economy is expected to outpace the increase in net debt.

Figure 2.11 – Net debt



Source: The Treasury

...with residual cash deficits mostly funded by issuing government bonds

Over the next four years residual cash deficits are expected to total \$12.7 billion. In order to fund these deficits the bond programme is expected to raise funds of \$30.8 billion, with \$14.3 billion of existing debt due to be repaid, providing net cash proceeds of \$16.5 billion (Table 2.6). The bond programme includes some pre-funding to meet debt maturing just outside the forecast period (December 2017).

Table 2.6 – Net increase in government bonds

Year ending 30 June \$billions	2014 Forecast	2015 Forecast	2016 Forecast	2017 Forecast	4-year Total
Face value of government bonds issued (market)	10.0	8.0	7.0	7.0	32.0
Cash proceeds from government bond issue					
Cash proceeds from issue of market bonds	10.2	7.8	6.4	6.4	30.8
Repayment of market bonds	-	(11.0)	(1.8)	-	(12.8)
Net proceeds from market bonds	10.2	(3.2)	4.6	6.4	18.0
Repayment of non-market bonds	(0.8)	(0.7)	-	-	(1.5)
Net repayment of non-market bonds	(0.8)	(0.7)	-	-	(1.5)
Net cash proceeds from bond issuance	9.4	(3.9)	4.6	6.4	16.5

Source: The Treasury

The forecast issuance over the next four years is \$2.0 billion lower than was forecast at the *Half Year Update*, largely owing to the improvement in core Crown tax revenue and core Crown expenses.

⁷ Net debt and residual cash indicators are measured on a core Crown basis. Residual cash includes both operating and capital activity. This differs from OBEGAL, which is measured at a total Crown level and includes operating activity only.

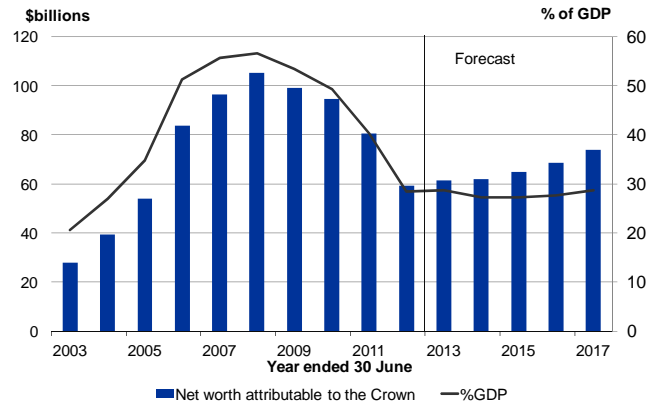
Total Crown Balance Sheet

Operating balance surpluses result in increasing net worth...

Net worth attributable to the Crown is expected to increase in 2012/13 for the first time since the global financial crisis and the Canterbury earthquakes. At its height, net worth peaked at \$105.1 billion in 2007/08, but has since nearly halved to stand at \$59.3 billion as at 30 June 2012.

This year, net worth attributable to the Crown is forecast to increase by \$2.2 billion, largely owing to the operating balance surplus (of which \$5.9 billion is attributable to gains on the Crown’s investment portfolio), and reach \$61.5 billion. Net worth is expected to grow another \$12.4 billion to stand at \$73.9 billion by 2016/17, as shown in Figure 2.12. As a share of GDP this is 28.7%, roughly half the level of the peak 56.6% of GDP in 2007/08.

Figure 2.12 – Net worth attributable to the Crown



Source: The Treasury

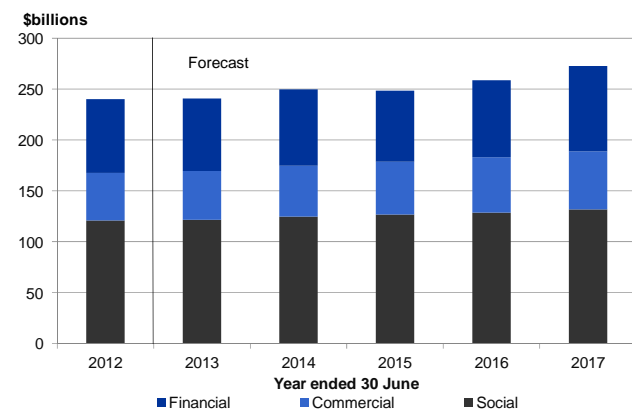
...with assets increasing \$32.8 billion over the forecast period...

Assets are forecast to increase by \$32.8 billion, with the growth over the forecast period made up of investment of \$79.3 billion offset by reductions of \$46.5 billion, as shown in Table 2.7.

The largest asset growth over the forecast period is in the financial portfolio, and reflects investment growth in CFIs such as the NZS Fund and ACC. Much of this growth is recognised as gains in the operating balance; however, there is also growth in the asset base from reinvestment. For example, this year, ACC and NZS

Fund financial assets grow by \$8.2 billion, with roughly \$5.3 billion coming from holding gains with the remaining \$2.9 billion being new investments.

Figure 2.13 – Total Crown assets



Source: The Treasury

Commercial assets increase \$9.1 billion over the forecast period, which is largely attributable to growth in the Kiwibank mortgage assets (that grow as their deposits from customers grow) and as SOEs increase their investment in physical assets.

The social asset portfolio increases as a result of new capital spending (funded by the Future Investment Fund, as detailed below), and as existing assets are replaced and student loans are issued.

Table 2.7 – Asset growth by portfolio

Year ending 30 June \$billions	2013 Forecast	2014 Forecast	2015 Forecast	2016 Forecast	2017 Forecast	Total Forecast
Opening commercial assets	46.6	47.9	50.0	52.2	54.5	46.6
Gross investment	3.2	3.6	3.5	3.8	4.3	18.4
Gross reductions	(1.9)	(1.5)	(1.3)	(1.5)	(1.8)	(8.0)
Closing commercial assets ¹	47.9	50.0	52.2	54.5	57.0	57.0
Opening financial assets	72.5	70.9	75.1	69.8	75.6	72.5
Gross investment - CFIs	8.2	3.7	4.2	4.7	5.0	25.8
Other investments ²	(9.8)	0.5	(9.5)	1.1	3.9	(13.8)
Closing financial assets	70.9	75.1	69.8	75.6	84.5	84.5
Opening social assets	121.2	121.9	125.1	126.9	128.8	121.2
Gross investment	5.5	7.7	7.4	7.1	7.4	35.1
Gross reductions	(4.8)	(4.5)	(5.6)	(5.2)	(4.6)	(24.7)
Closing social assets	121.9	125.1	126.9	128.8	131.6	131.6
Opening total assets	240.3	240.7	250.2	248.9	258.9	240.3
Gross investment	16.9	15.0	15.1	15.6	16.7	79.3
Gross reductions	(16.5)	(5.5)	(16.4)	(5.6)	(2.5)	(46.5)
Closing total assets	240.7	250.2	248.9	258.9	273.1	273.1

Notes:

- 1 The full value of the assets in the companies involved in the Government's partial share sales remain on the Crown's balance sheet after the sale. The ownership of those assets does change, and this is reflected in the increase in minority interests
- 2 Other investments include assets managed by the Debt Management Office, which fluctuate with the borrowing programme (discussed on page 36)

Source: The Treasury

...including \$1.5 billion allocated from the Future Investment Fund...

In Budget 2012 the Future Investment Fund was established to allocate the estimated proceeds from the partial share sales of certain SOEs (as discussed on page 40) to fund new capital, rather than issuing debt. Budget 2012 allocated \$0.6 billion of the Fund, while this Budget allocates another \$1.5 billion. A large portion of this allocation is expected to be spent on the Canterbury rebuild as well as investments in technology, irrigation and KiwiRail.

Table 2.8 – Future Investment Fund

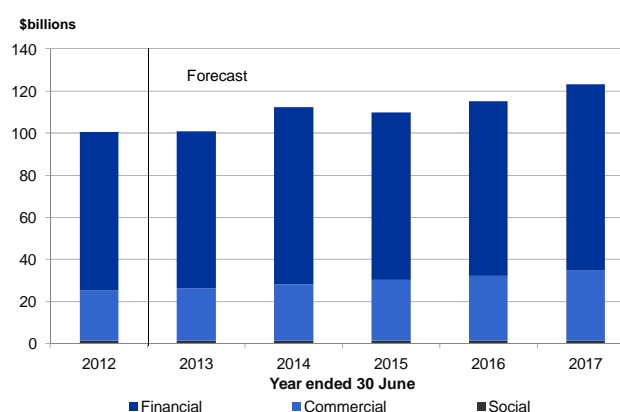
\$billions	Total Forecast
Proceeds from partial share sales	6.0
Allocated in Budget 2012	(0.6)
Allocated in Budget 2013	(1.5)
To be allocated	3.9

Source: The Treasury

...while liabilities increase at a slower rate...

The Crown's liabilities are expected to increase by \$15.6 billion over the next four years, largely driven by increased borrowing. Borrowings are forecast to increase \$22.3 billion to \$123.1 billion by 2016/17.

As shown in Figure 2.14, borrowing is mostly held in the financial portfolio (by Treasury, through the Debt Management Office, and RBNZ).

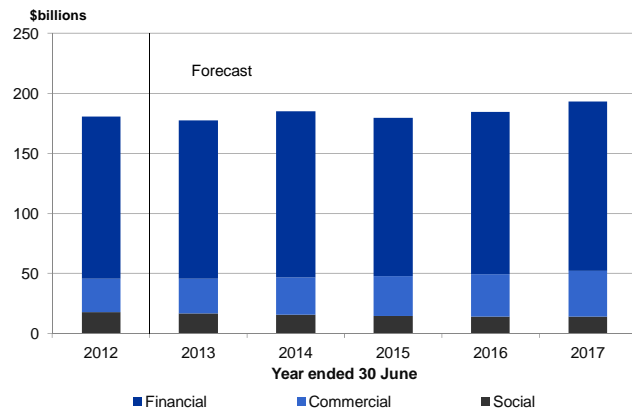
Figure 2.14 – Total Crown borrowings

Source: The Treasury

Borrowings in this portfolio increase \$13.6 billion over the next four years to meet the Crown’s cash deficits (refer to page 36 for discussion of the bond programme). The remainder of borrowing is in the commercial portfolio, and is largely made up of Kiwibank deposits, which grow in line with the bank’s mortgage assets.

Partially offsetting the growth in borrowings are reductions in liabilities as a result of settling obligations related to the Canterbury earthquakes. The Crown’s earthquake-related insurance liabilities held in the financial portfolio (EQC and Southern Response) are forecast to decrease \$8.4 billion as all claims are expected to be settled by 2016/17. Similarly, the Crown’s social liabilities are expected to reduce by \$2.4 billion to \$14.2 billion as the earthquake-related liabilities are settled.

Figure 2.15 – Total Crown liabilities



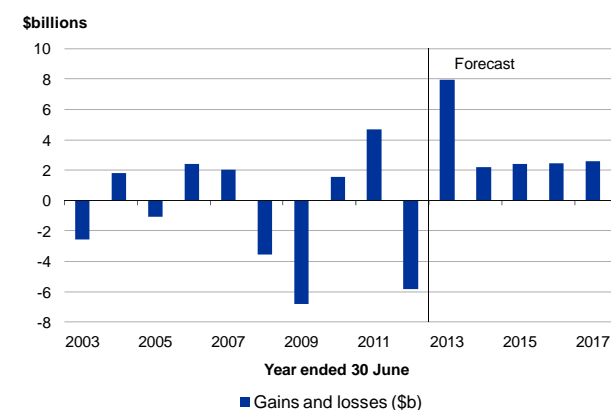
Source: The Treasury

...which is critical in order to rebuild the fiscal buffer to absorb future shocks

With the recent deterioration in the Crown’s net worth it is important the fiscal buffer is rebuilt to allow headroom for the Government to be able to respond to future shocks, manage volatility and meet contingent liabilities and fiscal risks if they eventuate.

A significant source of balance sheet risk is volatility in asset and liability values owing to movements in external factors such as interest rates, exchange rates and equity prices. This volatility is illustrated by the level of gains and losses being recognised in the operating balance; as shown in Figure 2.16. The CFIs are particularly susceptible to market risk.

Figure 2.16 – Volatility of gains and losses



Source: The Treasury

The long-term liabilities for ACC and the Government Superannuation Fund (GSF) are sensitive to changes in discount rates as their value is based on cash flows up to 80 years into the future, discounted to estimate the current obligation. As an example of this sensitivity, losses on GSF and ACC liabilities totalled \$6.8 billion in 2011/12, mostly owing to changes in the discount rate, and if the discount were to reduce by 1.0%, the liabilities would increase by around \$7.5 billion.

The Crown is also exposed to risks that may eventuate if certain events occur, or if present liabilities that cannot currently be measured are quantified.⁸ For example, the Crown has issued a number of guarantees and indemnities. If events occur that require

⁸ Refer to the *Specific Fiscal Risks* chapter for definitions of contingent liabilities and a full list of those that the Crown is currently exposed to.

the Crown to meet any of these guarantees, there will be associated fiscal costs with negative impacts on the operating balance (eg, the Deposit Guarantee Scheme that was established in the wake of the global financial crisis).

Contingent liabilities also include capital that the Crown has subscribed to in International financial institutions, such as the World Bank and the International Monetary Fund (IMF), which is callable by them. If called, the Crown's assets will increase but debt will also rise to fund the increase in capital.

A full description of the Crown's fiscal risks and contingent liabilities is provided in the *Specific Fiscal Risks* chapter.

Partial Share Sales

The forecast fiscal impact of the Government share offers remains similar to the *Half Year Update*. However, it is now assumed that there will be no proceeds from a partial sale of Solid Energy over the forecast period. As Solid Energy was a small component of total forecast proceeds the parameters of the expected proceeds have not changed. Forecast forgone dividends and forecast forgone profits have been updated with the latest forecasts from the companies.

Table 2.9 outlines the fiscal impact of the share offers and further details about the assumptions surrounding the forecasts can be found in the assumptions note on page 42. At the time these assumptions were made the outcome of the Mighty River Power offer was not known.

Table 2.9 – Estimated fiscal impact of the Government share offers

Year ending 30 June	2013	2014	2015	2016	2017	5-year
\$millions	Forecast	Forecast	Forecast	Forecast	Forecast	Total
Cash/Debt impact						
Forecast cash proceeds	1,500	1,500	1,500	1,500	-	6,000
Forecast forgone dividends	-	(120)	(170)	(230)	(290)	(810)
Estimated finance cost savings	7	79	158	245	291	780
Reduction in net debt	1,507	1,459	1,488	1,515	1	5,970
Accrual impact						
Forecast forgone profits	(10)	(140)	(200)	(270)	(340)	(960)
Estimated finance cost savings	7	79	158	245	291	780
Net decrease in OBEGAL	(3)	(61)	(42)	(25)	(49)	(180)
Forecast gain on disposal recorded in taxpayers' funds	175	175	175	175	-	700
Increase in net worth attributable to the Crown	172	114	133	150	(49)	520

Source: The Treasury

Fiscal Forecast Assumptions

The fiscal forecasts are based on assumptions and judgements developed from the best information available on 29 April 2013, when the forecasts were finalised. Actual events are likely to differ from these assumptions and judgements. Furthermore, uncertainty around the forecast assumptions and judgements increases over the forecast period. The Canterbury earthquakes add further uncertainty to the economic and fiscal forecasts.

The fiscal forecasts are prepared on the basis of underlying economic forecasts. Such forecasts are critical for determining revenue and expense estimates. For example:

- A nominal GDP forecast is needed in order to forecast tax revenue.
- A forecast of CPI inflation is needed because social assistance benefits are generally indexed to inflation.
- Forecasts of interest rates are needed to forecast finance costs, interest income and discount rates.

A summary of the key economic forecasts that are particularly relevant to the fiscal forecasts is provided in Table 2.10 below (on a June-year-end basis to align with the Government's balance date).

Table 2.10 – Summary of key economic forecasts used in fiscal forecasts

Year ended 30 June	2012 Actual	2013 Forecast	2014 Forecast	2015 Forecast	2016 Forecast	2017 Forecast
\$billions						
Real GDP ¹ (ann avg % chg)	2.4	2.5	2.5	2.9	2.5	2.2
Nominal GDP ² (\$m)	208,467	213,844	227,892	237,954	248,004	257,219
CPI (ann avg % chg)	2.2	0.9	1.7	1.9	2.0	2.2
Govt 10-year bonds (ann avg, %)	4.1	3.6	4.1	4.5	4.9	5.1
5-year bonds (ann avg, %)	3.5	2.9	3.3	4.1	4.8	5.0
90-day bill rate (ann avg, %)	2.7	2.7	2.8	3.4	4.2	4.7
Unemployment rate (ann avg, %)	6.6	7.0	6.2	5.9	5.6	5.3
Employment (ann avg % chg)	1.0	(0.8)	2.5	2.2	1.3	1.2

Notes:

- 1 Production measure
- 2 Expenditure measure

Source: The Treasury

In addition, there are a number of other key assumptions that are critical in the preparation of the fiscal forecasts.

Government decisions	Incorporate government decisions and other circumstances known to the Government up to 29 April 2013.																		
Tax revenue	Tax policy changes enacted and announced by the Government will take place as planned and will affect tax revenue and receipts as calculated and agreed between IRD and the Treasury.																		
Earthquake costs	Expenditure (accrual measure) is forecast based on estimates on when key decisions will be taken. The timing of cash payments is based on estimates of when actual spending will take place. Refer to page 33 for further discussion.																		
Operating allowance	Net \$1.0 billion from Budget 2014 growing at a rate of 2.0% per annum for subsequent Budgets.																		
Provision for new capital spending	Net \$3.7 billion over the next four Budgets with \$1.0 billion in Budget 2014, \$0.9 billion in Budget 2015, Budget 2016 and Budget 2017. For further details, see note 8 of the <i>Forecast Financial Statements</i> .																		
Government share offers	<p>Sale programme spread evenly across the four years from 2012/13 to 2015/16.</p> <p>Net sale proceeds of \$6 billion (based on a mid-point estimate of between \$5 billion and \$7 billion).</p> <p>Net assets of the entities as at 30 June 2012 (\$5.3 billion) were used to determine the gain on sale.</p> <p>Forgone profits and dividends are based on an average of the fiscal forecasts provided by the companies for the <i>Budget Update</i>.</p>																		
Finance cost on new bond issuances	Based on 5-year rate from the main economic forecasts and adjusted for differing maturity.																		
Top-down adjustment	<p>A top-down adjustment is made to compensate for departments that tend to forecast upper spending limits (appropriations) rather than best estimates.</p> <p>Top-down adjustment to operating and capital as follows:</p> <table border="1"> <thead> <tr> <th>Year ending 30 June \$billions</th> <th>2013 Forecast</th> <th>2014 Forecast</th> <th>2015 Forecast</th> <th>2016 Forecast</th> <th>2017 Forecast</th> </tr> </thead> <tbody> <tr> <td>Operating</td> <td>0.3</td> <td>0.6</td> <td>0.3</td> <td>0.3</td> <td>0.3</td> </tr> <tr> <td>Capital</td> <td>0.3</td> <td>0.1</td> <td>-</td> <td>-</td> <td>-</td> </tr> </tbody> </table>	Year ending 30 June \$billions	2013 Forecast	2014 Forecast	2015 Forecast	2016 Forecast	2017 Forecast	Operating	0.3	0.6	0.3	0.3	0.3	Capital	0.3	0.1	-	-	-
Year ending 30 June \$billions	2013 Forecast	2014 Forecast	2015 Forecast	2016 Forecast	2017 Forecast														
Operating	0.3	0.6	0.3	0.3	0.3														
Capital	0.3	0.1	-	-	-														
Borrowing requirements	Forecast cash deficits will be met by reducing financial assets and issuing debt.																		
Property, plant and equipment	For the purposes of the forecast financial statements, no revaluations of property, plant and equipment are projected beyond the current year. Valuations as recorded for the 2012 annual financial statements and any additional valuations that have occurred up to 31 March 2013 are included in these forecasts.																		

Student loans	<p>The carrying value of student loans is based on a valuation model adapted to reflect current student loans policy. As such, the carrying value over the forecast period is sensitive to changes in a number of underlying assumptions, including future income levels, repayment behaviour and macroeconomic factors such as inflation and discount rates used to determine the effective interest rate for new borrowers. Any change in these assumptions would affect the present fiscal forecast.</p>															
Investment rate of returns	<p>Incorporate the actual results to 31 March 2013. Beyond this time, gains on financial instruments are based on long-term benchmark rates of return for each portfolio.</p>															
GSF and ACC liabilities	<p>The GSF and ACC liabilities included in these forecasts have been valued as at 28 February 2013 and 31 December 2012 respectively. The ACC liability has also been adjusted for the 31 March 2013 discount rate. Both liabilities are valued by projecting future cash payments, and discounting them to present value. These valuations rely on historical data to predict future trends and use economic assumptions such as inflation and discount rates. Any change in actual payments or economic assumptions would affect the present fiscal forecast. For example, if the discount rate decreases, the value of the liabilities would increase.</p> <p>GSF's assets are offset against the gross liability and have been updated to reflect market values. The value of assets over the forecast period reflects long-run rate of return assumptions appropriate to the forecast portfolio mix.</p>															
NZS Fund contributions	<p>No contribution is assumed in the forecast period.</p> <table border="1" data-bbox="470 1120 1402 1265"> <thead> <tr> <th data-bbox="470 1120 877 1187">Year ending 30 June \$billions</th> <th data-bbox="877 1120 997 1187">2014 Forecast</th> <th data-bbox="997 1120 1117 1187">2015 Forecast</th> <th data-bbox="1117 1120 1236 1187">2016 Forecast</th> <th data-bbox="1236 1120 1402 1187">2017 Forecast</th> </tr> </thead> <tbody> <tr> <td data-bbox="470 1187 877 1220">Required contribution</td> <td data-bbox="877 1187 997 1220">2.4</td> <td data-bbox="997 1187 1117 1220">2.2</td> <td data-bbox="1117 1187 1236 1220">2.1</td> <td data-bbox="1236 1187 1402 1220">2.1</td> </tr> <tr> <td data-bbox="470 1220 877 1265">Actual contribution</td> <td data-bbox="877 1220 997 1265">-</td> <td data-bbox="997 1220 1117 1265">-</td> <td data-bbox="1117 1220 1236 1265">-</td> <td data-bbox="1236 1220 1402 1265">-</td> </tr> </tbody> </table> <p>The underlying assumptions in calculating the required contribution in each year are the previous year's NZS Fund balance and projected series, over the ensuing forty years of nominal GDP, net (after-tax) New Zealand superannuation expenses and the Government 5-year bond rate. The latter is used in calculating the Fund's expected long-run after-tax annual return. Over the forecast years all Fund variables, apart from the capital contributions, are provided by the NZS Fund itself.</p> <p>Refer to the Treasury's website for the NZS Fund model.</p>	Year ending 30 June \$billions	2014 Forecast	2015 Forecast	2016 Forecast	2017 Forecast	Required contribution	2.4	2.2	2.1	2.1	Actual contribution	-	-	-	-
Year ending 30 June \$billions	2014 Forecast	2015 Forecast	2016 Forecast	2017 Forecast												
Required contribution	2.4	2.2	2.1	2.1												
Actual contribution	-	-	-	-												