
Fiscal Outlook

Overview

- The fiscal outlook for the Crown is expected to continue to strengthen.
- The strengthening outlook reflects both expenditure restraint and a growing economy which is driving growth in tax revenue. While forecasts of expenditure are largely unchanged overall, tax revenue forecasts have generally been revised down since the *Half Year Update* primarily owing to weaker inflation and lower interest rates.
- Core Crown expenditure as a percentage of GDP is expected to be 30.5% in 2014/15, falling across the forecast period to be 29.2% in 2018/19.
- The Budget 2015 operating package of about \$1.0 billion a year on average over the next four years is in line with that signalled in the Budget Policy Statement. Future operating allowances remain at \$1.0 billion for Budget 2016, \$2.5 billion in Budget 2017 and \$1.5 billion in Budget 2018.
- In addition to the Budget 2015 package, the Government has also signalled further reductions in ACC levy rates, resulting in a structural reduction in OBEGAL of around \$0.6 billion from 2016/17.
- The total Crown OBEGAL deficit has reduced from \$18.4 billion in 2010/11 to a forecast of \$684 million in 2014/15, with growing OBEGAL surpluses forecast thereafter, reaching \$3.6 billion in 2018/19.
- Capital spending by the core Crown is estimated to be \$24.0 billion over the forecast period. This is an increase of \$1.0 billion since the *Half Year Update*, mainly owing to new spending decisions. Capital allowances of \$0.7 billion are forecast in Budget 2016 before rising to \$0.9 billion in Budget 2017 and then growing at a rate of 2.0% per year for subsequent budgets.
- Net core Crown debt is now expected to peak at 26.3% of nominal GDP in 2015/16, before dropping to 22.9% of nominal GDP by 2018/19. Overall, forecast net core Crown debt is similar to the *Half Year Update*.
- The Crown's net worth is expected to increase over the forecast period, reaching around \$93.6 billion by 2018/19, following surpluses from 2015/16 as the growth in assets outpaces liabilities.

- Within the balance sheet, total assets are forecast to be \$296.3 billion by 2018/19, with financial assets (particularly the Crown's investment portfolios) forecast to increase by \$12.9 billion to \$87.9 billion. Liabilities begin to fall in nominal terms by the end of the forecast period as earthquake obligations are settled and the Crown begins to pay down debt. Total liabilities are expected to stand at \$197.3 billion at the end of 2018/19, with borrowings making up \$115.6 billion of that.
- These forecasts are sensitive to a number of assumptions and should be read in conjunction with the Risks and Scenarios and Specific Fiscal Risks chapters.

Table 2.1 – Fiscal indicators

Year ended 30 June	2014 Actual	2015 Forecast	2016 Forecast	2017 Forecast	2018 Forecast	2019 Forecast
\$billions						
Total Crown OBEGAL ¹	(2.9)	(0.7)	0.2	1.5	2.0	3.6
Core Crown residual cash	(4.1)	(2.7)	(4.2)	(1.6)	(0.2)	1.7
Net core Crown debt ²	59.9	61.7	65.6	67.1	67.2	65.5
Net worth attributable to the Crown	75.6	74.8	77.8	82.1	87.0	93.6
% of GDP						
Total Crown OBEGAL ¹	(1.3)	(0.3)	0.1	0.6	0.7	1.3
Core Crown residual cash	(1.8)	(1.1)	(1.7)	(0.6)	(0.1)	0.6
Net core Crown debt ²	25.6	25.7	26.3	25.5	24.4	22.9
Net worth attributable to the Crown	32.3	31.2	31.1	31.2	31.6	32.8

Notes: 1 Operating balance before gains and losses.

2 Net core Crown debt excluding the New Zealand Superannuation Fund (NZS Fund) and advances.

Source: The Treasury

Table 2.2 – Reconciliation between OBEGAL and net core Crown debt

Year ending 30 June	2014 Actual	2015 Forecast	2016 Forecast	2017 Forecast	2018 Forecast	2019 Forecast
\$billions						
Core Crown revenue	67.3	71.9	74.9	78.9	83.5	87.4
Core Crown expenses	(71.5)	(73.1)	(74.9)	(77.1)	(80.8)	(83.4)
Net surpluses/(deficits) of SOEs and CEs	1.3	0.5	0.2	(0.3)	(0.7)	(0.4)
Total Crown OBEGAL	(2.9)	(0.7)	0.2	1.5	2.0	3.6
Net retained surpluses of SOEs, CEs and NZS Fund	(0.8)	(0.6)	(0.1)	0.4	0.7	0.4
Non-cash items and working capital movements	0.7	2.3	2.0	1.8	1.2	1.8
Net core Crown cash flow from operations	(3.0)	1.0	2.1	3.7	3.9	5.8
Net purchase of physical assets	(1.9)	(2.1)	(2.6)	(2.5)	(1.6)	(1.5)
Advances and capital injections	(1.5)	(2.2)	(3.4)	(2.4)	(1.8)	(1.7)
Forecast for future new capital spending	-	-	(0.3)	(0.4)	(0.7)	(0.9)
Proceeds from government share offers	2.3	0.6	-	-	-	-
Net core Crown capital cash flows	(1.1)	(3.7)	(6.3)	(5.3)	(4.1)	(4.1)
Core Crown residual cash (deficit)/surplus	(4.1)	(2.7)	(4.2)	(1.6)	(0.2)	1.7
Opening net core Crown debt	55.8	59.9	61.7	65.7	67.2	67.4
Core Crown residual cash deficit/(surplus)	4.1	2.7	4.2	1.6	0.2	(1.7)
Valuation changes in financial instruments	-	(0.9)	(0.2)	(0.1)	-	-
Closing net core Crown debt	59.9	61.7	65.7	67.2	67.4	65.7
As a percentage of GDP	25.6%	25.7%	26.3%	25.5%	24.4%	22.9%

Source: The Treasury

Key judgements and assumptions

The fiscal forecasts are based on assumptions and judgements developed from the best information available at the time they were prepared. Actual events are likely to differ from these assumptions and judgements. Uncertainty around the forecast assumptions and judgements increases over the forecast period.

In addition to the key assumptions underpinning the economic forecasts, the following key judgements and assumptions supporting the fiscal forecasts were made:

- Tax policy changes enacted and announced by the Government will take place as planned and will affect tax revenue and receipts.
- Any additional future new spending or revenue reductions will be limited to the operating and capital allowances set by the Government.
- Reductions to ACC levies will be implemented (refer page 37).
- Departments will continue to spend less than the upper limits of approved spending (referred to as appropriations).
- The form and timing of any significant divestment of social housing assets is uncertain and therefore not included in the forecasts, with the exception of funding to the Tāmaki Redevelopment Company, which is included.
- Forecast returns of the large investment portfolios managed by ACC and the NZS Fund are based on long-term benchmark rates of return for each portfolio.
- The valuations of the student loan portfolio, ACC claims liability and the Government Superannuation Fund (GSF) retirement liability are based on underlying assumptions made at the time the valuations were prepared.

Further information on the fiscal forecast assumptions can be found on pages 49 to 51.

Core Crown Tax Revenue

Tax revenue grows over the forecast period...

Core Crown tax revenue (Table 2.3) is forecast to rise in each year of the forecast period. By 2018/19, core Crown tax revenue is expected to reach \$80.5 billion, \$19.0 billion higher than in 2013/14. Forecast tax revenue increases as a percentage of nominal GDP, from 26.3% in 2013/14 to 28.2% at the end of the forecast period (Figure 2.1).

The main driver for the increase in tax revenue is forecast growth in nominal GDP (Figure 2.2). Factors that influence tax revenue are the composition of GDP growth, fiscal drag (being the additional personal income tax generated as an individual’s average tax rate increases as their income increases), the interest rate forecast (affecting Resident Withholding Tax (RWT)), Consumers Price Index (CPI) indexation of excise rates and assumptions regarding such things as the timing of tax revenue recognition and the accumulation, and subsequent utilisation, of tax losses.

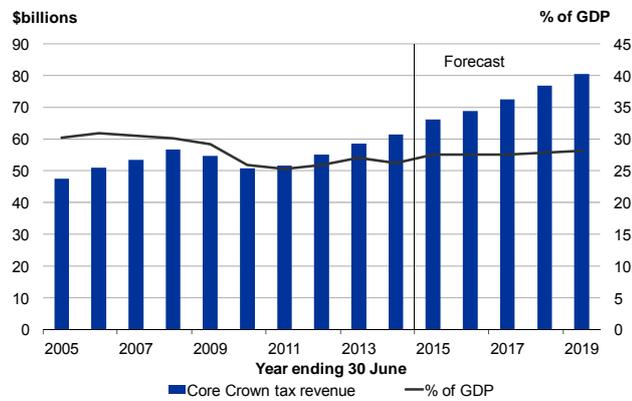
...with 2014/15 particularly strong...

Year-to-date core Crown tax outturns to March 2015 are around 8.0% up on last year, mainly owing to growth in:

- source deductions, caused in roughly equal parts by growth in employment and wages, and with a contribution from fiscal drag too
- corporate tax, in which unusually large terminal tax from the 2014 tax year is boosting the growth rate, and
- goods and services tax (GST), where strong growth in residential investment, partly owing to the Canterbury rebuild, is complementing growth in nominal private consumption.

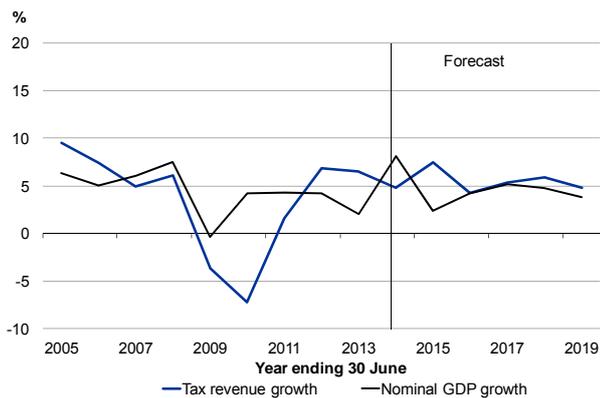
The year-on-year growth in core Crown tax revenue in 2014/15 is expected to reduce to around 7.5% by June, as some of the strength in year-to-date results is expected to soften, mainly owing to seasonal variation in PAYE and the timing of corporate tax. However, some upside risk to the 2014/15 tax revenue outturn remains, particularly as the June quarter is typically the largest quarter for tax revenue each year. Individually, small variations in tax returns that are due in the June quarter (eg, annual income tax returns

Figure 2.1 – Core Crown tax revenue



Source: The Treasury

Figure 2.2 – Core Crown tax revenue and nominal GDP growth



Source: The Treasury

from most large corporate and Portfolio Investment Entities (PIE) annual tax returns), can accumulate to large variances from forecast, presenting risks to the 2014/15 tax revenue outturn, both positive and negative.

The expected 7.5% growth in tax revenue in 2014/15 is higher than the 2.4% forecast for growth in nominal GDP. The main reasons for this difference are:

- the components of nominal GDP that drive the underlying taxable bases for tax revenue are growing faster than total nominal GDP, for example, total employees' compensation is forecast to grow by 5.2%, nominal private consumption is forecast to grow by 4.5% and nominal residential investment is forecast to grow by 18.2%
- tax revenue in the 2014/15 fiscal year has been boosted by higher-than-usual terminal tax, mainly from the 2014 tax year, and
- excise rate increases and fiscal drag have also added to tax revenue growth.

...while nominal GDP growth drives tax revenue growth in future years

Through 2015/16 and 2016/17, total tax revenue is forecast to grow in line with nominal GDP, although there is considerable variation across the tax types:

- source deductions and GST are forecast to grow faster than nominal GDP owing to fiscal drag and to continued strong residential investment growth, but
- corporate tax and other persons tax are forecast to grow more slowly than nominal GDP (in fact, other persons tax is forecast to decline in 2015/16) owing to relatively weak growth in the underlying income drivers (operating surplus and entrepreneurial income) and an assumption that terminal tax will return to a more "normal" level in 2015/16.

Through 2017/18 and 2018/19, tax revenue growth is forecast to outstrip nominal GDP growth owing to (in approximate decreasing order of significance):

- fiscal drag adding to the growth rate of source deductions
- increasing deposit interest rates providing a boost to interest RWT
- CPI indexation of excise rates, and
- an assumed tailing-off of earthquake-related GST refunds.

Table 2.3 shows a complete breakdown of the drivers of growth in forecast tax revenue.

Table 2.3 – Composition of growth in core Crown tax revenue over the forecast period

Year ending 30 June \$billions	2015 Forecast	2016 Forecast	2017 Forecast	2018 Forecast	2019 Forecast	Total
Movement in core Crown tax owing to:						
Employees' compensation	1.3	1.0	1.1	1.2	1.3	5.9
Private consumption	0.9	0.8	0.9	0.9	0.9	4.4
Corporate profits	0.1	0.3	0.6	0.6	0.4	2.0
Fiscal drag	0.2	0.2	0.3	0.3	0.3	1.3
Residential investment	0.3	0.4	0.2	0.3	-	1.2
Indirect tax CPI inflation indexation	0.1	0.1	0.1	0.1	0.1	0.5
Entrepreneurial income	(0.1)	-	0.5	0.2	0.1	0.7
Interest rates	0.1	-	-	0.1	0.3	0.5
Interest bearing deposit base	0.1	0.1	0.1	0.1	0.1	0.5
Budget 2015 policy initiatives	-	0.1	0.1	0.1	-	0.3
Other factors	1.6	(0.2)	(0.3)	0.4	0.2	1.7
Total movement in core Crown tax revenue	4.6	2.8	3.6	4.3	3.7	19.0
Plus: previous year's tax base	61.5	66.1	68.9	72.5	76.8	61.5
Core Crown tax revenue	66.1	68.9	72.5	76.8	80.5	80.5
Percentage of GDP	27.6%	27.6%	27.6%	27.9%	28.2%	

Note: "Other factors" in 2014/15 includes additional 2013/14 terminal tax recognised in 2014/15.

Source: The Treasury

Tax policy changes made by the Government have been included in these forecasts, with the largest effect being the provision of additional audit funding to Inland Revenue (IRD), which is expected to raise an additional \$65 million of tax revenue in 2015/16 rising to \$257 million in 2018/19.

Table 2.4 – Significant tax policy changes

Year ending 30 June \$millions	2015 Forecast	2016 Forecast	2017 Forecast	2018 Forecast	2019 Forecast	Total 5 years
Tax policy changes:						
Inland Revenue audit funding – 2015 Budget bid	-	65	144	144	144	497
Inland Revenue audit funding – extension of 2012 Budget bid	-	-	-	113	113	226
Child hardship package (PAYE effect)	-	7	26	26	26	85
Total	-	72	170	283	283	808

Inland Revenue has also prepared a set of tax forecasts based on the Treasury's macroeconomic forecasts. Inland Revenue's forecasts are close to Treasury's forecasts, with all the differences in the forecasts of total core Crown tax in any one year being less than \$250 million (0.1% of GDP). This comparison is included in the Additional Information on the Treasury website <http://www.treasury.govt.nz/budget/forecasts/befu2015>

Impact of low inflation on the fiscal outlook

As outlined in the Economic Outlook chapter, recent price inflation outturns have been lower than previously forecast (refer pages 22 and 23). Price inflation is an important component of a number of economic indicators (eg, nominal GDP, wages) that are used to prepare the Government's fiscal forecasts.

A lower inflation track impacts on both the revenue and expenses of the Government. However, revenue is more sensitive to price inflation changes than expenses are, which means the impact on OBEGAL is not symmetrical. In addition, the impact on the fiscal outlook from low inflation will be influenced by the factors contributing to slow price growth. For example price movements such as dairy prices, can have significant impacts on the fiscal outlook but will not have much impact on price inflation since they represent only a small fraction of domestic consumers' spending. Other price changes, such as sharp movements in the price of oil, can have a large impact on price inflation but only modest impacts on the fiscal outlook as consumers can switch their spending to other goods.

It is difficult to quantify the effect low inflation has on the fiscal outlook, given the intricacy of its relationship with economic and fiscal aggregates. This box looks at summarising the fiscal impact we would expect from lower forecast price inflation, which is expected to be associated with weaker growth in nominal income and spending. Broadly speaking, at present the negative impact of lower inflation on revenue is larger than the positive impact on expenses, contributing to OBEGAL being lower than previously forecast.

Core Crown tax revenue is forecast to be \$66.1 billion for the year ended 30 June 2015. Most types of tax revenue are in some way sensitive to inflation either directly or indirectly. In an environment of low inflation, we would expect the following impacts on the critical economic indicators that underpin our tax revenue forecasts:

- Nominal consumption growth would be weaker, which in turn will result in a reduction in GST revenue.
- Nominal business profits may be marginally lower in a low-inflation environment, resulting in slower growth of business income taxes such as company tax and other persons' tax.
- Interest rates will generally be low when inflation is low, thereby resulting in lower returns for depositors, which in turn reduces the level of taxable interest income and, hence, RWT on interest.
- Excise rates are CPI-indexed, so lower inflation would result in slower growth in excise duties.
- Wage growth would be lower and, as a result, the amount of source deductions collected by the Government would reduce. In addition, reduced wage growth also results in a slower rate of fiscal drag, reducing source deductions further. There will be a lag before low inflation effects source deductions, owing to timing of wage rounds.

There are other revenue sources (eg, petroleum royalties resulting from lower oil prices and interest revenue owing to lower interest rates) also impacted by inflation, albeit to a lesser extent.

There are some positive impacts on the fiscal outlook from low inflation and consequential low interest rates through reductions in core Crown expenses. However, unlike core Crown tax revenue, only a portion of core Crown expenses, namely benefit expenses and finance costs, are particularly sensitive to price inflation. In some cases, expenses are impacted later than revenue. For the year ended 30 June 2015, benefit expenses and finance costs are expected to total \$27.8 billion, which is just over a third of total core Crown expenses. Department baselines and new operating allowances are fixed in nominal terms, so are not sensitive to price inflation, but lower inflation should increase the Government's purchasing power. Specific impacts are as follows:

- New Zealand Superannuation (NZS) payments (forecast to be \$11.6 billion in 2015) are indexed to at least 66% of the net average wage, so are not directly impacted by inflation. However, to the extent that lower inflation is reflected in lower wage growth, NZS payments would be expected to be lower. Given the indirect impact there will be a lag before inflation starts to influence net average wages.
- Most other benefits are indexed directly to CPI inflation (excluding the impact of tobacco product price increases), so low inflation would reduce benefit costs. However, although family tax credits are indexed to inflation, payments are fixed until the cumulative impact of inflation reaches 5%, so the increase in expenses is later.
- The yields on inflation-indexed bonds (approximately 20% of government stock) are linked directly to inflation, so lower inflation reduces finance costs.
- Lower interest rates result in a reduction in both finance costs and interest revenue. The majority of interest-bearing financial assets are short-term in nature, so are quick to respond to interest rate changes. In contrast, borrowings are generally longer term, so there is a lag before the impact of interest rates flows through to finance costs, as the existing stock of bonds are replaced by new bonds with lower yields.

Core Crown Expenses

Core Crown expenses as a percentage of nominal GDP reduces...

Growth in core Crown expenses is forecast to be at a slower rate than growth in the nominal economy, falling from 30.5% of GDP in 2013/14 to 29.2% of GDP at the end of the forecast period (Figure 2.3).

...although nominal spending increases

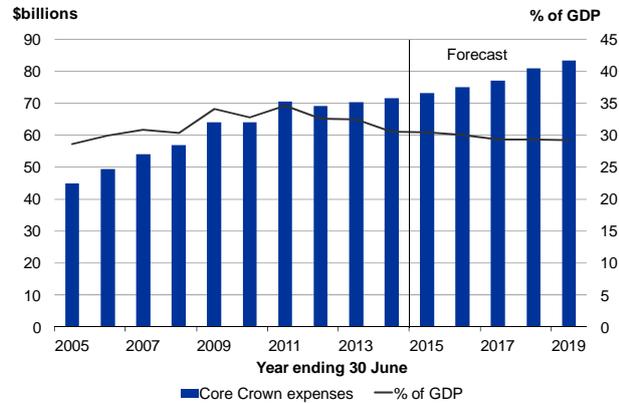
Nominal growth in core Crown expenses of \$11.9 billion over the forecast period from \$71.5 billion in 2013/14 to \$83.4 billion in 2018/19 is largely attributable to new spending in the Budget 2015 operating package, new operating allowances in future budgets and increased social assistance spending (as shown in Figure 2.4).

New operating allowances have been set at \$1.0 billion for Budget 2016, rising to \$2.5 billion in Budget 2017 before reducing to \$1.5 billion in Budget 2018.

The combined new spending totals \$6.4 billion by 2018/19 (Figure 2.5). For forecasting purposes, the allowances beyond Budget 2015 are assumed to be all expenditure. However, these allowances can be used for a combination of revenue and expense initiatives when allocated.

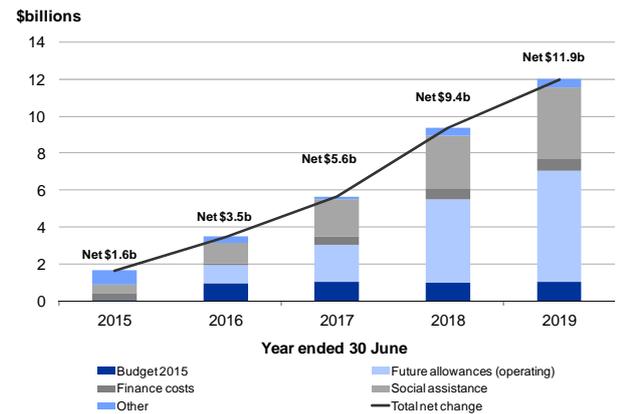
New operating spending will be allocated to department baselines as budget decisions are made. As a result, most functional expense areas (eg, health, education) in the Treasury tables remain flat beyond 2015/16 across the forecast period because specific decisions on where to allocate new spending have yet to be decided. Therefore comparisons are difficult at a functional level.

Figure 2.3 – Core Crown expenses



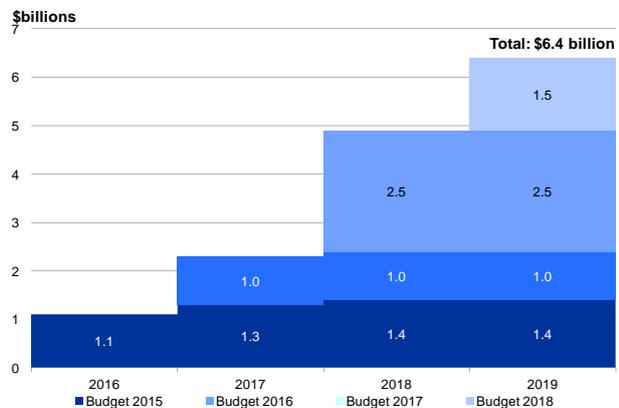
Source: The Treasury

Figure 2.4 – Increase in core Crown expenses



Source: The Treasury

Figure 2.5 – Budget 2015 and future Budget allowances impact on expenses



Source: The Treasury

The following table summarises the impact of the Budget 2015 package on core Crown expenses.

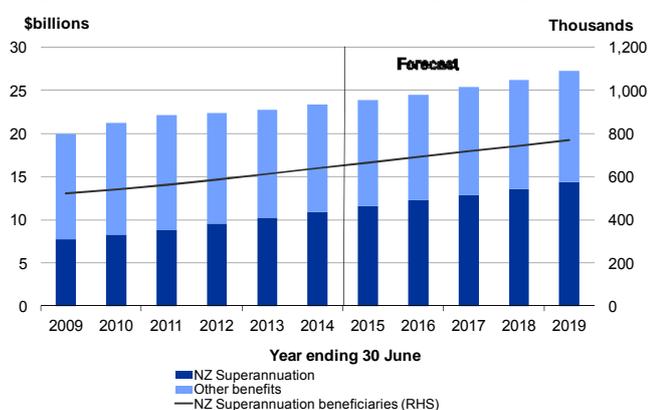
Table 2.5 – Summary of changes in revenue and expenses arising from Budget 2015 operating package

Year ending 30 June \$millions	2015 Forecast	2016 Forecast	2017 Forecast	2018 Forecast	2019 Forecast
Core Crown revenue	-	85	211	357	357
Core Crown expenses	42	1,038	1,251	1,355	1,388
OBEGAL impact	42	953	1,040	998	1,031
Composition of core Crown expense increase:					
Child hardship package	-	78	271	264	263
Health	-	406	435	417	402
Education	-	111	120	108	104
Other Social Sector	7	159	109	110	117
Business Growth Agenda	29	131	74	94	96
Canterbury Earthquake Recovery Authority	68	97	6	3	2
Defence	3	28	79	92	92
KiwiSaver kick-start	(17)	(175)	(126)	(106)	(107)
Other	-	117	100	82	92
Reprioritisation	(48)	(92)	(121)	(94)	(79)
Contingencies	-	178	304	385	406
Increase in core Crown expenses	42	1,038	1,251	1,355	1,388

Source: The Treasury

Apart from new budget spending, social assistance spending is expected to increase by \$3.9 billion across the forecast period. New Zealand superannuation payments grow by \$3.5 billion with costs linked to wage growth and increasing recipient numbers (Figure 2.6). As a percentage of total social assistance spending, New Zealand superannuation is expected to rise from about 39% in 2008/09 to around 53% a decade later.

Figure 2.6 – Social assistance spending



Source: The Treasury

Apart from superannuation, other welfare expenditure grows by \$0.4 billion over the five-year forecast horizon, including income-related rents subsidy, family tax credits and sole parent support. Overall working-age beneficiary numbers are expected to decline in every year, led by drops in Jobseeker Support and Sole Parent Support. In later years these reductions are largely offset by inflation-based rate indexation. The largest single year growth occurs between 2015/16 and 2016/17, with the introduction of the Child hardship package, particularly impacting Sole Parent Support.

Cost to the Crown of the Canterbury rebuild

Table 2.6 outlines the latest estimates of the net impact on the Crown of the earthquakes included in these forecasts. These estimates reflect the known costs under current policy settings. They do not include future decisions the Government may take regarding the rebuild.

The forecasts assume that any additional costs to the Crown will be met within budget allowances.

The total cost to the Crown is currently estimated to be \$16.5 billion, \$0.5 billion higher than the *Half Year Update*. \$393 million of the increase since the *Half Year Update* relates to operating expenses while capital costs (mostly Crown assets) are \$183 million higher. The largest increase in operating costs relate to Southern Response.

An updated valuation of Southern Response's insurance claim costs estimated an increase in claim numbers (particularly in relation to the number of properties that exceed the Earthquake Commission (EQC) cap) and out of scope claim size, along with increased repair costs. As a result, Southern Response's earthquake related expenses are expected to reach just over \$290 million in the current year, increasing the total cost to \$800 million.

The increase of \$134 million in Crown assets mostly reflects additional capital spending on schools in the Canterbury region.

Table 2.6 – Net earthquake expenses (operating and capital)

Year ended 30 June \$millions	2011-14 Actual	2015 Forecast	2016 Forecast	2017 Forecast	2018 Forecast	2019 Forecast	Outside forecast period	Total Budget Update	Total Half Year Update
Local infrastructure	1,473	110	173	50	-	-	-	1,806	1,806
Crown assets ¹	115	362	796	563	204	118	-	2,158	2,024
Land zoning	1,009	45	22	50	-	-	-	1,126	1,139
Christchurch central city rebuild ²	588	202	361	268	(4)	1	(175)	1,241	1,126
Welfare support	288	9	4	3	2	-	-	306	306
Southern Response support package	582	290	(30)	(30)	(15)	3	-	800	555
Other costs	628	219	123	76	69	82	-	1,197	1,094
Core Crown Canterbury earthquake recovery costs	4,683	1,237	1,449	980	256	204	(175)	8,634	8,050
EQC (net of reinsurance proceeds)	7,757	(201)	(164)	(124)	(1)	-	-	7,267	7,405
Other SOE and CEs	(86)	(26)	298	288	110	41	-	625	495
Total Crown	12,354	1,010	1,583	1,144	365	245	(175)	16,526	15,950
Operating and capital expenses									
Operating expenditure (OBEGAL)	11,552	327	385	188	133	135	-	12,720	12,327
Capital expenditure	802	683	1,198	956	232	110	(175)	3,806	3,623
Total Crown	12,354	1,010	1,583	1,144	365	245	(175)	16,526	15,950
Total cash payments³	8,002	2,740	3,007	1,690	535	245	(175)	16,044	15,477

Notes:

- 1 Crown assets includes capital expenditure on Canterbury hospitals, schools, Tertiary Education Institutions (TEIs), housing and the Justice and Emergency Services Precinct.
- 2 Central city rebuild costs include land acquisition and are net of expected recoveries and contributions from third parties.
- 3 Some expenses are non-cash (eg, asset write-offs and impairments) and therefore do not have a cash element to them.

Source: The Treasury

Key risks include the timing of expenditure and escalating costs as well as the independent review of infrastructure costs shared by the Christchurch City Council and the Crown (refer to the Specific Fiscal Risks chapter).

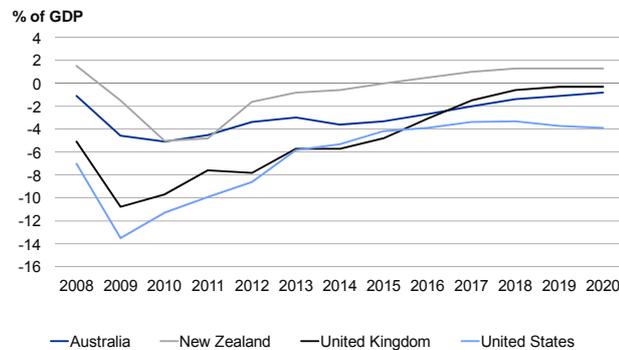
Operating Balance

Operating performance of the Crown continues to strengthen...

The OBEGAL deficit has reduced from \$18.4 billion in 2010/11, to \$2.9 billion in 2013/14 and is expected to be \$0.7 billion in 2014/15. A surplus of \$0.2 billion is now forecast in 2015/16 rising to \$3.6 billion by 2018/19.

It can be difficult to do international comparisons, as jurisdictions use different financial frameworks. However, looking at the fiscal balance⁶ the IMF produces, to enable cross-country comparisons, the New Zealand operating performance exceeds a number of other countries (Figure 2.7).

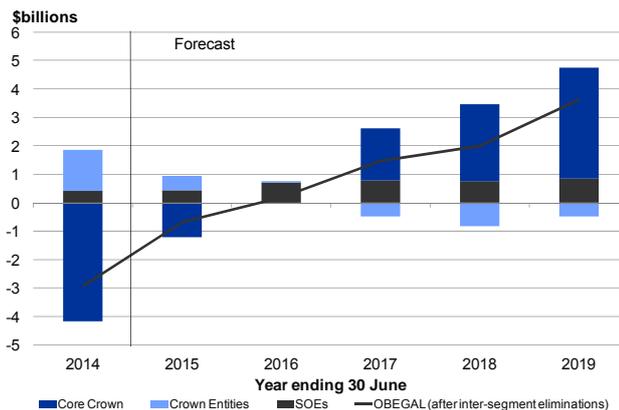
Figure 2.7 – International comparisons of fiscal balance



Source: IMF

Figure 2.8 shows the composition of OBEGAL from the different segments of the Government. The core Crown segment is forecast to have an OBEGAL deficit of \$1.2 billion in 2014/15, breakeven in 2015/16, then continues to rise over the forecast period, largely reflecting growth in tax revenue outpacing growth in nominal spending.

Figure 2.8 – Components of OBEGAL by segment



Source: The Treasury

State-owned Enterprises (SOEs) are expected to continue to record operating surpluses throughout the forecast period.

The impact of Crown entities' (CEs') performance on OBEGAL results varies across the forecast period, largely reflecting changes in ACC results. In addition, Southern Response insurance expenses are expected to be \$0.3 billion higher in 2014/15, adversely impacting that year.

⁶ Fiscal balance (sometimes referred to as net lending/borrowing) is defined as the net operating balance less the net acquisition of non financial assets such as property, plant and equipment. The inclusion of capital purchases and removal of impairments/write-offs are the major points of difference to OBEGAL.

As part of Budget 2015, the Government has signalled further reductions in the ACC levy rates of around \$1.5 billion across the forecast period (largely in the last three years of the forecast). When combined with the consequential impact on investment revenue and insurance expenses, the fiscal impact on OBEGAL is expected to be on average \$0.6 billion per year from 2016/17 (Table 2.7). An increase in expenses reflects the increased risk of meeting future claims with reduced revenue.

Table 2.7 – Impact of proposed ACC levy reduction

Year ending 30 June \$millions	2015 Forecast	2016 Forecast	2017 Forecast	2018 Forecast	2019 Forecast	Total
Decrease in levy revenue	-	(32)	(372)	(533)	(547)	(1,484)
Foregone investment revenue	-	-	(4)	(28)	(51)	(83)
Increase in insurance expenses	-	12	147	71	7	237
Impact on OBEGAL	-	(44)	(523)	(632)	(605)	(1,804)

Source: The Treasury

...while investment returns lift the operating balance

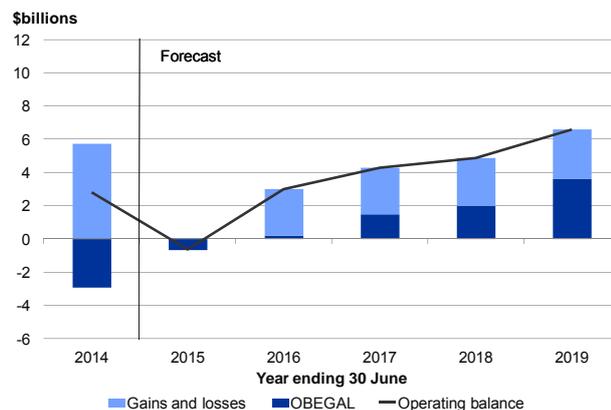
The total Crown operating balance, inclusive of gains and losses, is forecast to be a deficit in 2014/15 of \$0.6 billion before returning to growing surpluses in each year of the forecast period (Figure 2.9).

Investment returns in 2013/14 were higher than average, reflecting the strong performance of global equity markets. In 2014/15, the forecast gains on investments is \$6.0 billion, primarily ACC and NZS Fund. The forecast assumes investment income returns to a long-term rate of return, resulting in subdued growth going forward. These gains play a part in increasing the Government’s financial assets and the Crown’s net worth (discussed on page 43).

While financial gains on investments are positive, the 2014/15 year is adversely impacted by losses of \$6.6 billion, in relation to updated long-term liability valuations for ACC and the GSF, mainly owing to changes in economic factors (such as interest rates and inflation) impacting the valuations and reducing the operating balance surplus.

The operating balance is sensitive to balance sheet movements. Refer to the total Crown balance sheet section later in this chapter.

Figure 2.9 – Components of operating balance



Source: The Treasury

Structural fiscal balance indicators and the fiscal impulse

The Treasury calculates a range of fiscal indicators to help assess the relationship between fiscal policy and the economy. These indicators include measures of the structural budget balance and a fiscal impulse indicator. Further detail on these indicators can be found in the Additional Information section of the *Budget Update*, which is available on the Treasury website www.treasury.govt.nz/budget/forecasts/befu2015

Table 2.8 – Structural fiscal balance indicators

Year ended 30 June % of GDP	2014 Actual	2015 Forecast	2016 Forecast	2017 Forecast	2018 Forecast	2019 Forecast
OBEHAL	(1.3)	(0.3)	0.1	0.6	0.7	1.3
Cyclically-adjusted balance	(0.8)	(0.2)	-	0.4	0.5	1.2
Cyclically adjusted balance with terms-of-trade adjustment	(3.2)	(1.9)	(1.7)	(1.5)	(1.4)	(0.7)
Fiscal impulse⁷	(0.3)	(0.4)	0.6	(0.9)	(0.3)	(0.7)

Source: The Treasury

Structural budget balance

Indicators of the structural fiscal balance help to inform assessments of the sustainability of fiscal settings and identify shifts in discretionary fiscal policy. The Treasury's headline structural fiscal balance indicator (the cyclically-adjusted balance (CAB)) is an estimate of the OBEHAL adjusted for fluctuations of actual GDP around potential GDP. It provides an estimate of what the budget balance would be without the effect of the automatic stabilisers, which are the tax revenue and unemployment-related expenses that fluctuate with the business cycle. The economy is currently estimated to be operating close to its potential level, so there are only small differences between the OBEHAL and the CAB. Both the OBEHAL and the CAB increase by 1.0% of GDP between 2014/15 and 2018/19. Therefore the increase in the forecast OBEHAL is indicative of structural improvements in the fiscal position. This is largely owing to gradual reductions in the level of government expenses as a percentage of GDP over time.

A range of structural fiscal balance indicators can be calculated that are an extension of cyclically-adjusted balances, adjusting for a broader range of factors such as the effects of asset or commodity prices. An indicator of the structural budget balance relevant for New Zealand is one that incorporates a terms-of-trade adjustment. Such a measure gives an approximate indication of the OBEHAL if the terms of trade returned to its long-run average and the economy was operating at its potential level.

Although the terms of trade has recently fallen from a 40-year high, it remains above long-term historical averages. The medium and long-term outlook for New Zealand's terms of trade is underpinned by fast rising consumption in emerging market economies that is supporting demand for New Zealand's food exports. The Treasury's central forecast is for the terms of trade to remain elevated. Nevertheless, international and historical experience shows that terms-of-trade booms can reverse abruptly and so this is a risk to the outlook. The CAB with a terms-of-trade adjustment, using the 20-year average, suggests a weaker structural fiscal position than the CAB. Indeed, on this measure, a structural deficit persists across the forecast horizon. The trend is positive with a forecast improvement in this structural fiscal balance by 1.2% of GDP between 2014/15 and 2018/19.

⁷ The fiscal impulse measure shown is the core Crown fiscal impulse plus Crown entities excluding EQC and Southern Response payments.

Fiscal impulse

The fiscal impulse is a measure of discretionary changes in the fiscal position, which can be expected to have an impact on aggregate demand in the economy. The change in the structural budget balance is a rough indicator of the fiscal impulse. The indicators above show an improving structural fiscal balance, implying a contractionary fiscal impulse. However, these indicators are based on adjustments to the Crown's operating balance. These are only very approximate measures of the contribution of fiscal policy to aggregate demand since the operating balance excludes some spending that contributes to aggregate demand (eg, purchases of physical assets) while including some items that do not feed directly into aggregate demand, such as KiwiSaver subsidies and goods with high import content (eg, much defence equipment). For these reasons, the Treasury calculates a fiscal impulse indicator that is a more precise guide to the contribution of discretionary fiscal policy on aggregate demand. The fiscal impulse indicator is calculated as the change in the cyclically-adjusted cash balance and excludes net interest payments, and makes a number of other specific adjustments.

The fiscal impulse indicator shows that fiscal policy is expected to have a contractionary impact on demand in almost every year of the forecast horizon. Discretionary fiscal policy is expected to withdraw 0.3% of GDP from aggregate demand on average in each year over the five years to June 2019. However, the estimated fiscal impulse is positive in 2015/16. The positive fiscal impulse in 2015/16 is owing to:

- a fall in the tax receipts-to-GDP ratio in that year, partly as a result of the effect of lower inflation on tax receipts rather than any discretionary policy easing, and
- modest stimulus from higher capital spending, partly owing to Crown capital spending on the Canterbury rebuild that is expected to peak in 2015/16.

These factors offset the negative contribution to the fiscal impulse in 2015/16 from operating expenditure that continues to fall as a share of GDP.

The fiscal impulse is negative for the three years to 2018/19, which reflects ongoing operating spending restraint, some reduction in capital spending from its 2015/16 peak, and a small rise in the tax receipts-to-GDP ratio.

There is much uncertainty about the precise magnitude and timing of the fiscal impulse and revisions between forecast rounds can be material. Perhaps the main conclusion that can be drawn is that continued fiscal consolidation can be expected over the next four years according to a range of indicators, although the pace of fiscal tightening is relatively moderate at less than 1% of GDP per year and may in fact be positive in the coming fiscal year.

Fiscal tightening can be expected to provide some offset to other positive drivers of aggregate demand over the forecast period relating to private consumption, business and residential investment, and net exports. Fiscal consolidation is keeping interest and exchange rates lower than otherwise, which helps to facilitate this shift in the drivers of demand.

Residual Cash

Operating cash flows improve...

Similar to the trend in OBEGAL, operating cash flows are expected to strengthen across the forecast period. Net operating cash flows are forecast to be about \$1.0 billion in surplus for 2014/15, increasing across the remaining forecast period. The strength largely represents the growth in tax receipts outpacing operating payments.

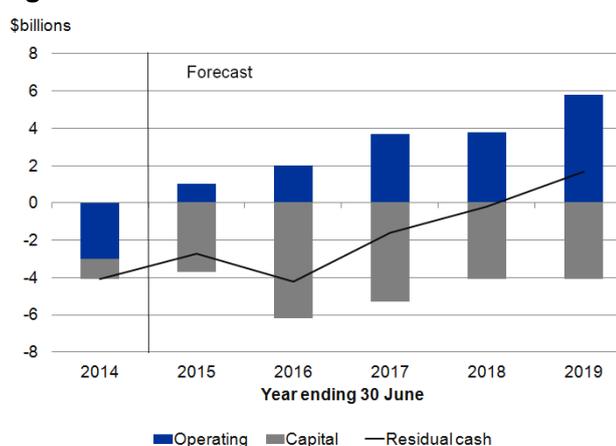
Over the forecast period, the Government is expected to generate cash flows from core Crown operations of \$16.5 billion.

...but capital spending exceeds operating cash flows in the short term

Net capital spending is forecast to exceed operating cash flows until 2018/19, while core Crown residual cash⁸ returns to surplus in the 2018/19 year (Figure 2.10).

The Government is forecast to spend \$24.0 billion (net of the Government Share Offer programme) on capital items, which include purchasing physical assets (eg, school buildings), advances (eg, student loans), providing capital to CEs and future new capital spending. The 2014/15 cash flows include capital receipts of \$0.6 billion from the deferred settlement for Meridian Energy shares.

Figure 2.10 – Core Crown residual cash



Source: The Treasury

Table 2.9 – Capital expenditure activity 2014/15 to 2018/19

Year ending 30 June \$billions	2015 Forecast	2016 Forecast	2017 Forecast	2018 Forecast	2019 Forecast	Cumulative Forecast
Purchase of physical assets	(2.7)	(3.0)	(2.6)	(1.9)	(1.7)	(11.9)
Sale of physical assets	0.2	0.1	0.1	0.1	0.1	0.6
Net purchase of physical assets	(2.5)	(2.9)	(2.5)	(1.8)	(1.6)	(11.3)
Advances made	(2.8)	(2.8)	(2.1)	(2.3)	(2.3)	(12.3)
Repayment of advances	2.1	1.6	1.6	2.2	2.1	9.6
Net advances	(0.7)	(1.2)	(0.5)	(0.1)	(0.2)	(2.7)
Purchase of investments	(1.8)	(2.1)	(2.0)	(1.6)	(1.5)	(9.0)
Sale of investments	0.3	-	-	-	-	0.3
Net investments	(1.5)	(2.1)	(2.0)	(1.6)	(1.5)	(8.7)
Government Share Offer proceeds	0.6	-	-	-	-	0.6
Top-down capital adjustment	0.4	0.3	0.1	0.1	0.1	1.0
Future new capital spending	-	(0.3)	(0.4)	(0.7)	(0.9)	(2.3)
Net capital spending	(3.7)	(6.2)	(5.3)	(4.1)	(4.1)	(23.4)

Source: The Treasury

⁸ Net core Crown 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.

Net purchases of physical assets represents forecast spending by core Crown agencies to maintain their existing asset base and includes spending on defence equipment and school property and also includes capital spending related to the Canterbury earthquakes (refer to the box on Canterbury earthquake costs on page 35).

Net investments largely represent capital injections to CEs, to expand their asset base, and are estimated to be \$1.5 billion to \$2.0 billion a year. The largest capital injections across the forecast period are to the New Zealand Transport Agency for state highways.

The unallocated new capital spending for Budget 2016 (totalling \$0.5 billion) is forecast to be funded by the proceeds from the Government Share Offer programme (the Future Investment Fund) (Table 2.10). In addition, \$190 million of KiwiRail funding is pre-committed against Budget 2016.

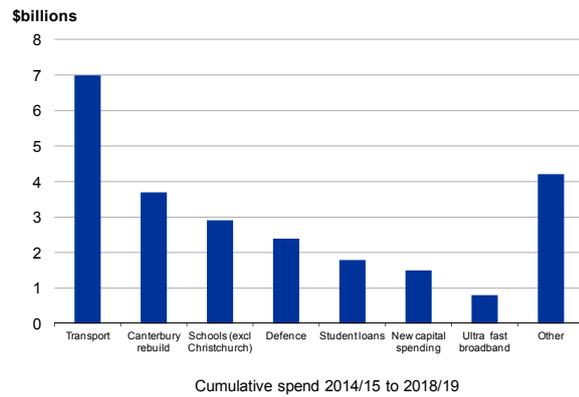
Capital allowances of \$0.9 billion are forecast in Budget 2017 before growing at a rate of 2.0% per year for subsequent budgets.

New capital spending is expected to be allocated in future Budgets. The new capital spending for each Budget is spread over four fiscal years reflecting the assumed profile of the spend. This profile is illustrated in Figure 2.12.

...leading to a forecast cash shortfall of \$6.9 billion

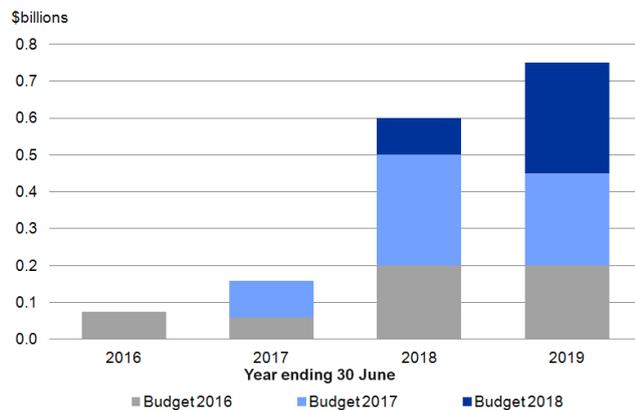
Over the entire forecast period a cash shortfall of \$6.9 billion is expected. The cash shortfall is funded through additional borrowing and reductions in financial assets.

Figure 2.11 – Forecast capital activity for 2014/15 to 2018/19 by significant spending



Source: The Treasury

Figure 2.12 – New capital spending (capital allowances)



Source: The Treasury

Table 2.10 – Future Investment Fund

\$billions	Total fund
Cash proceeds	4.669
Allocated in Budget 2012	(0.533)
Allocated in Budget 2013	(1.421)
Allocated in Budget 2014	(1.050)
Allocated in Budget 2015	(0.939)
Future new capital spending	0.726
Pre-committed Budget 2016	(0.190)
To be allocated	0.536

Source: The Treasury

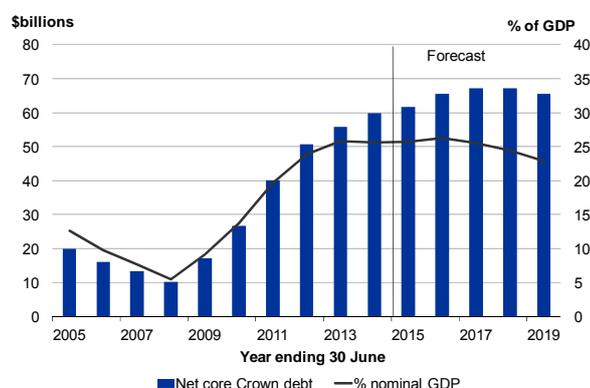
Net Core Crown Debt

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

Net core Crown debt as a share of nominal GDP is forecast to peak at 26.3% in 2015/16 (Figure 2.13) before reducing to 22.9% by 2018/19, consistent with the Government's long-term fiscal objectives of net core Crown debt at a level no higher than 20.0% of GDP by 2020.

As residual cash returns to surplus, nominal net core Crown debt begins to reduce in 2018/19, to stand at \$65.5 billion.

Figure 2.13 – Net core Crown debt



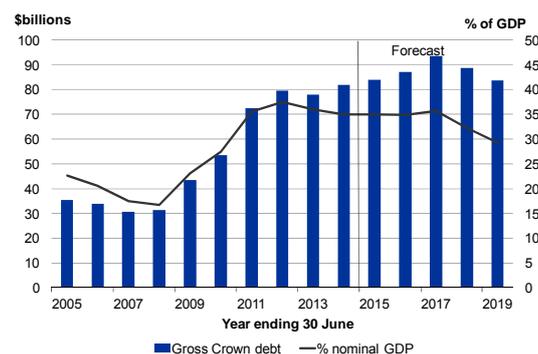
Source: The Treasury

...while gross debt begins to decline after 2016/17...

Gross debt is expected to peak at \$93.6 billion in 2016/17 after which forecast maturities are expected to exceed new debt being issued, so gross debt begins to decline. Gross debt is forecast to be \$83.7 billion in 2018/19 which is equivalent to 29.3% of nominal GDP.

The bond programme is expected to raise funds of \$36.5 billion over the forecast period, while \$34.8 billion of existing debt will be repaid, providing net cash proceeds of \$1.7 billion (Table 2.11). Any excess cash proceeds raised from the bond programme will be invested in financial assets and used to meet future debt maturities.

Figure 2.14 – Gross debt



Source: The Treasury

The total bond programme is broadly in line with total repayment of market bonds over the forecast period. The issuance profile is relatively flat in order to reduce year-to-year volatility of bond programmes and ensure consistency of supply over this time.

Table 2.11 – Net increase in government bonds

Year ending 30 June \$billions	2015 Forecast	2016 Forecast	2017 Forecast	2018 Forecast	2019 Forecast	5-year Total
Face value of government bonds issued (market)	8.0	8.0	7.0	7.0	7.0	37.0
Cash proceeds from government bond issue						
Cash proceeds from issue of market bonds	8.2	8.5	6.9	6.5	6.4	36.5
Repayment of market bonds	(8.7)	(1.8)	-	(11.3)	(11.5)	(33.3)
Net proceeds from market bonds	(0.5)	6.7	6.9	(4.8)	(5.1)	3.2
Repayment of non-market bonds	(1.2)	(0.3)	-	-	-	(1.5)
Net repayment of non-market bonds	(1.2)	(0.3)	-	-	-	(1.5)
Net cash proceeds from bond issuance	(1.7)	6.4	6.9	(4.8)	(5.1)	1.7

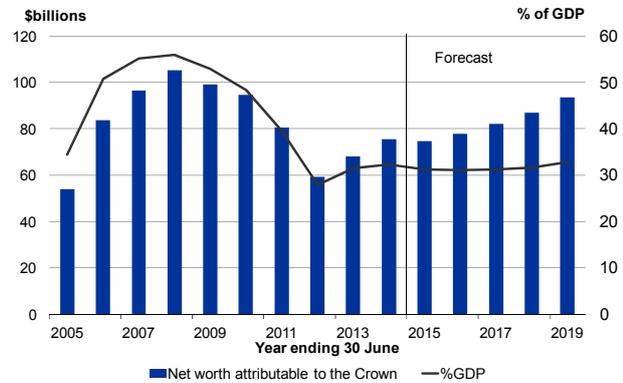
Source: The Treasury

Total Crown Balance Sheet

Operating balance surpluses result in a stronger balance sheet...

Net worth attributable to the Crown is forecast to grow steadily in nominal terms across the forecast period largely owing to forecast operating balance surpluses. Beyond 2015, net worth attributable to the Crown is expected to grow by \$18.1 billion to stand at \$93.6 billion by 2018/19, increasing as a share of nominal GDP to reach 32.8% by 2018/19 (Figure 2.15).

Figure 2.15 – Net worth attributable to the Crown



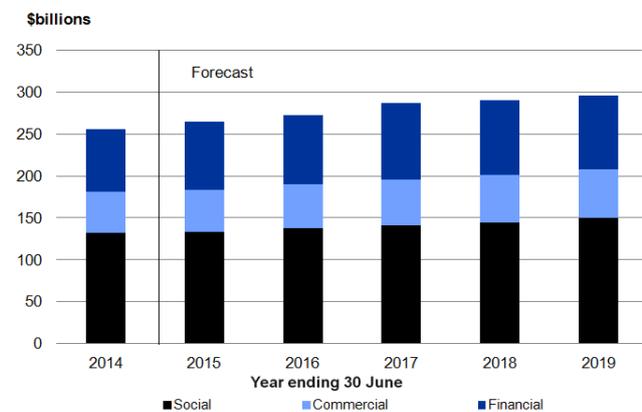
Source: The Treasury

...with assets increasing by \$40.2 billion over the forecast period...

Total assets are forecast to grow by \$40.2 billion over the forecast period to \$296.3 billion in 2018/19, made up of additional investments in assets (both physical and financial) of \$65.5 billion, partially offset by reductions (largely depreciation) of \$25.3 billion.

The largest asset growth over the forecast period is in the social assets portfolio which is expected to increase by \$17.8 billion to be \$149.4 billion in 2018/19 (Figure 2.16) over the forecast period. This growth reflects increases in student loans and property, plant and equipment, (including Canterbury rebuild assets, school property, hospitals and increases in the social housing portfolio value). See page 50 for social housing assumptions.

Figure 2.16 – Total Crown assets



Source: The Treasury

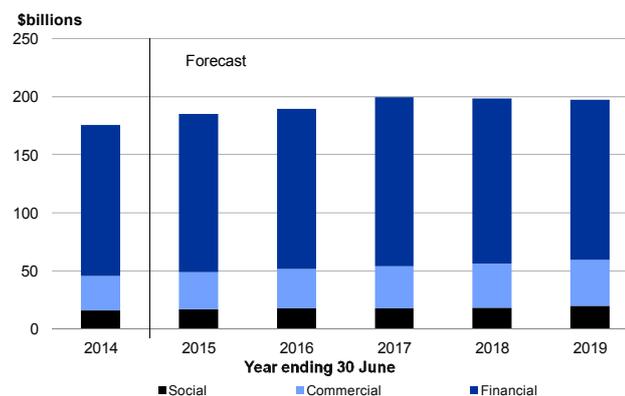
The financial asset portfolio is expected to increase by \$12.9 billion to be \$87.9 billion in 2018/19, reflecting the Treasury’s New Zealand Debt Management Office (NZDMO) and Reserve Bank activities, and investment growth in the investment portfolios such as those managed by NZS Fund and ACC.

The commercial asset portfolio is expected to increase by \$9.5 billion over the forecast period to be \$59.0 billion in 2018/19, with growth coming from SOEs’ investment in physical assets and growth in Kiwibank mortgages.

...while liabilities are expected to fall by the end of the forecast period

The Crown's liabilities begin to fall in 2017/18, from a peak of \$199.7 billion in 2016/17 (Figure 2.17). The increases in the first three years of the forecast are largely increased borrowing.

Borrowings are mostly conducted by NZDMO, which manages the Crown's bond programme, the Reserve Bank and Kiwibank, and are forecast to peak at \$121.7 billion in 2016/17 before decreasing slightly to stand at \$115.6 billion by 2018/19.

Figure 2.17 – Total Crown liabilities

Source: The Treasury

Insurance liabilities are mostly held by ACC, EQC and Southern Response and are expected to increase over the forecast period from \$38.5 billion in 2014/15 to reach \$42.1 billion in 2018/19. The increases primarily relate to the ACC claims liability, as EQC and Southern Response insurance liabilities are expected to fall as earthquake insurance settlements continue to progress.

Retirement plan liabilities, primarily the GSF, are \$12.6 billion in 2014/15 and fall to \$10.9 billion by 2018/19.

The Crown's balance sheet remains sensitive to market movements...

Many of the assets and liabilities on the Crown's balance sheet are measured at "fair value" in order to disclose current estimates of what the Crown owns and owes. While the measurement at fair value is seen as the most appropriate value of these items, it can be volatile, resulting in fluctuations in the value of the assets and liabilities reflecting changes in the market and underlying assumptions.

Refer to the Risks and Scenarios chapter page 65 for more details.

...and judgements and estimates will also impact on the balance sheet...

Apart from market factors, valuations are subject to a number of judgements and estimates. In general, as time goes on, better information becomes available and initial estimates are updated to reflect current information. Some examples of this include: ACC rehabilitation costs; earthquake-related liabilities; and future wage growth of students, which directly impacts the value of the student loan book.

...while other risks remain

In addition to those items on the balance sheet there are a number of liabilities (and assets) that may arise in the future but are not yet included in our forecasts, either because they are contingent on an uncertain future event occurring (eg, outcome of litigation) or the liability cannot be measured reliably. If these liabilities crystallise, there will be associated costs with a negative impact (or positive in the case of contingent assets) on the operating balance or net debt. Refer to page 82 for a list of the contingent liabilities at 31 March 2015.

Comparison to the *Half Year Update*

The *Half Year Update* was published on 16 December 2014. There have been a number of developments since then that have significantly impacted the fiscal outlook.

Table 2.12 – Key fiscal indicators compared to the *Half Year Update*

Year ending 30 June \$billions	2015 Forecast	2016 Forecast	2017 Forecast	2018 Forecast	2019 Forecast
Core Crown tax revenue					
Budget Update	66.1	68.9	72.5	76.8	80.5
Half Year Update	65.6	69.2	73.1	76.8	80.0
Change	0.5	(0.3)	(0.6)	-	0.5
Core Crown expenses					
Budget Update	73.1	74.9	77.1	80.8	83.4
Half Year Update	73.0	75.1	76.9	80.7	83.2
Change	0.1	(0.2)	0.2	0.1	0.2
OBEGAL					
Budget Update	(0.7)	0.2	1.5	2.0	3.6
Half Year Update	(0.6)	0.6	2.6	3.1	4.1
Change	(0.1)	(0.4)	(1.1)	(1.1)	(0.5)
Residual cash					
Budget Update	(2.7)	(4.2)	(1.6)	(0.2)	1.7
Half Year Update	(4.0)	(3.5)	(0.1)	0.6	1.8
Change	1.3	(0.7)	(1.5)	(0.8)	(0.1)
Net debt					
Budget Update	61.7	65.6	67.1	67.2	65.5
Half Year Update	63.5	67.0	67.0	66.4	64.5
Change	(1.8)	(1.4)	0.1	0.8	1.0

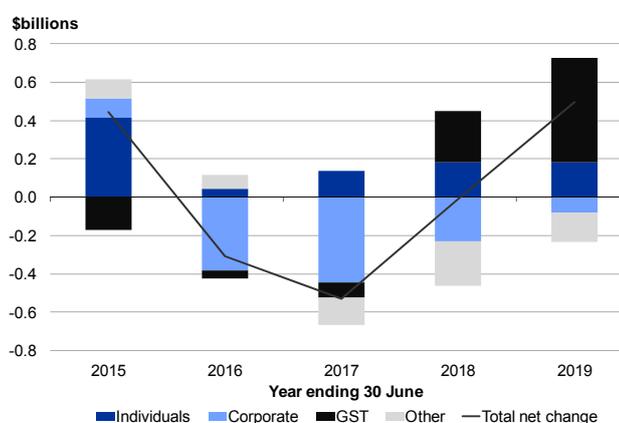
Source: The Treasury

Economic factors have adversely impacted OBEGAL...

The reduced outlook for economy-wide prices and domestic interest rates has adversely impacted OBEGAL, with tax revenue now expected to be lower across most of the forecast period.

Tax revenue in the year to 30 June 2015 has been revised up on the back of strong year-to-date results and a higher nominal GDP outlook overall for the 2014/15 year when compared with the *Half Year Update*. From then until 2017/18, tax revenue forecasts have been revised down largely owing to reductions in the forecast for nominal GDP growth and interest rates, which reflect the weaker inflation outlook. The tax revenue forecast for 2018/19 is higher than in the *Half Year Update*, mainly owing to increases to the forecasts of nominal private consumption and residential investment.

Figure 2.18 – Movement in core Crown tax revenue since the *Half Year Update*



Source: The Treasury

Table 2.13 – Reconciliation of the change in core Crown tax revenue

Year ending 30 June \$billions	2015 Forecast	2016 Forecast	2017 Forecast	2018 Forecast	2019 Forecast
Movement in core Crown tax owing to:					
Source deductions	0.1	-	-	(0.1)	(0.1)
Other persons tax	0.3	-	0.1	0.2	0.3
Corporate tax	0.1	(0.4)	(0.4)	(0.2)	(0.1)
RWT	-	-	(0.2)	(0.3)	(0.2)
GST	(0.2)	-	(0.1)	0.3	0.6
Other taxes	0.2	0.1	-	0.1	-
Total movement in core Crown tax revenue	0.5	(0.3)	(0.6)	-	0.5
Plus: Half Year Update's tax base	65.6	69.2	73.1	76.8	80.0
Core Crown tax revenue at Budget Update	66.1	68.9	72.5	76.8	80.5
As a % of GDP	26.3%	27.6%	27.6%	27.6%	27.9%
Core Crown tax movements consist of:					
Tax policy changes	-	0.1	0.2	0.3	0.3
Forecast changes	0.5	(0.4)	(0.8)	(0.3)	0.2

Source: The Treasury

The changes in tax forecasts owing to macroeconomic changes are not a fixed proportion of the nominal GDP forecast changes. This is owing to the components within the GDP forecasts changing by varying amounts, thereby affecting the forecasts of the various tax types differently. Specifically:

- Recent strength in employment and wages has seen source deductions above forecast for the current fiscal year to date. This is expected to persist through to the end of 2014/15, and the momentum in employment is expected to flow through to 2015/16, resulting in an increase in the source deductions forecast in that year. Thereafter, the lower wage growth track dominates, reducing the source deductions forecast below the *Half Year Update* level.
- A generally stronger forecast for entrepreneurial income than in the *Half Year Update* has caused an increase in the other persons' tax forecast, especially in 2017/18 and 2018/19. This is also responsible for some of the reduction in the corporate tax forecast, with unincorporated businesses now forecast to earn a higher proportion of total profits than in the *Half Year Update*.
- The GST forecast is initially lower than in the *Half Year Update* owing to weaker forecasts of nominal consumption and residential investment, and some earthquake-related refunds occurring earlier in the forecast period than previously assumed. However, by the end of the forecast period, the GST forecast is about 2% higher than the *Half Year Update* as a result of higher forecasts of private consumption and residential investment in 2017/18 and 2018/19.
- Finally, with interest rates lower than in the *Half Year Update*, the forecast for interest RWT has been reduced in most years of the forecast period.

Overall, OBEGAL is expected to be lower in each year of the forecast compared to the *Half Year Update* (Table 2.14).

Table 2.14 – Changes in OBEGAL since the *Half Year Update*

Year ending 30 June \$billions	2015 Forecast	2016 Forecast	2017 Forecast	2018 Forecast	2019 Forecast
OBEGAL – 2014 Half Year Update	(0.6)	0.6	2.6	3.1	4.1
<i>Changes in forecasts:</i>					
Economic factors					
Tax revenue (forecast changes)	0.5	(0.4)	(0.7)	(0.3)	0.2
Benefit expenses (forecast changes)	0.1	(0.1)	-	0.1	-
Petroleum royalties	(0.1)	(0.1)	(0.1)	-	-
Other factors					
Student loan impairment	(0.2)	-	-	-	-
Tax debt impairment	0.3	-	-	-	-
Net finance costs	(0.2)	0.2	0.1	-	-
ACC forecast changes	-	(0.1)	(0.5)	(0.9)	(0.6)
Southern Response	(0.3)	-	-	-	-
Other changes	-	0.1	0.1	-	(0.1)
<i>Total changes since the Budget Update</i>	(0.1)	(0.4)	(1.1)	(1.1)	(0.5)
OBEGAL – 2015 Budget Update	(0.7)	0.2	1.5	2.0	3.6

Source: The Treasury

Petroleum royalties have reduced as global oil prices have fallen considerably since the *Half Year Update* reflecting ongoing increases in supply even as demand has eased.

...while other factors also contribute to reducing OBEGAL...

Factors outside the macroeconomic environment can impact the operating result of the Government.

Since the *Half Year Update*, Southern Response insurance costs in 2014/15 are expected to increase by \$0.3 billion, reflecting an increase in the estimated number and cost of claims (particularly those claims over the EQC cap).

In addition, the Government's signalled reductions in the ACC levy rates (discussed on page 37) also reduce OBEGAL, particularly in the last three years of the forecast.

The student loan impairment forecasts increase in the current year due to assumptions around forecast income levels of students.

The forecast impairment of IRD's debt portfolio in the current year is expected to be lower than previously forecast as growth in the debt book has slowed considerably.

...leading to an increase in net core Crown debt by the end of the forecast period

Similar to the changes to OBEGAL, residual cash deficits increase by \$1.8 billion across the forecast period, resulting in net core Crown debt being higher by 2018/19 when compared to the *Half Year Update*.

Tax receipts and petroleum royalties are reduced, partially offset by lower benefit payments.

On the capital side, some spending is now expected to occur sooner than previously forecast. This coupled with additional capital spending (including Southern Response), sees the overall capital spend across the forecast period increase.

The increased cash deficits are the primary reason for net core Crown debt being \$1.0 billion higher by 2018/19.

Fiscal Forecast Assumptions

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 2.15 below (on a June-year-end basis to align with the Government's balance date).

Table 2.15 – Summary of key economic forecasts used in fiscal forecasts

Year ended 30 June	2014 Actual	2015 Forecast	2016 Forecast	2017 Forecast	2018 Forecast	2019 Forecast
Real GDP ¹ (ann avg % chg)	2.9	3.3	3.0	2.8	2.8	2.1
Nominal GDP ² (\$m)	234,184	239,771	249,890	262,825	275,207	285,765
CPI (ann avg % chg)	1.5	0.5	1.0	2.1	2.1	2.1
Govt 10-year bonds (ann avg, %)	4.5	3.7	3.5	4.1	4.8	5.1
5-year bonds (ann avg, %)	4.1	3.6	3.5	4.0	4.6	5.0
90-day bill rate (ann avg, %)	2.9	3.7	3.6	3.7	4.2	4.8
Unemployment rate (ann avg, %)	6.0	5.6	5.2	4.8	4.5	4.5
Employment (ann avg % chg)	3.2	3.2	1.9	1.5	1.3	1.1

Notes: 1 Production measure.
2 Expenditure measure.

Source: The Treasury

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

Government decisions	The forecasts incorporate government decisions and other circumstances known to the Government and advised to the Treasury up to 1 May 2015.																		
Tax revenue	Tax policy changes enacted and announced by the Government will take place as planned and will affect tax revenue and receipts.																		
Earthquake costs	Expenditure (accrual measure) is forecast based on estimates of 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 35 for further discussion.																		
Operating allowance	Operating allowances are a net \$1.0 billion for Budget 2016, increasing to \$2.5 billion in Budget 2017 and reducing to \$1.5 billion in Budget 2018. For further details, see note 9 of the Forecast Financial Statements.																		
Provision for new capital spending	Capital allowances are \$0.7 billion in Budget 2016 and \$0.9 billion in Budget 2017 then growing at a rate of 2.0% per year for subsequent Budgets. For further details, see note 9 of the Forecast Financial Statements.																		
Social housing	The Government has announced social housing reforms as a key priority for this term. Cabinet has agreed the general direction of the Social Housing Reform programme. This includes transferring Housing New Zealand Corporation stock to non-government providers to create a competitive market for social housing. The level of uncertainty, particularly around the structure of the transactions, makes it difficult to quantify the fiscal impacts, and therefore are not included in the forecasts, with the exception of funding to the Tāmaki Redevelopment Company, which is included in these forecasts.																		
Finance cost on new bond issuances	Based on the five-year rate from the main economic forecasts and adjusted for differing maturities.																		
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 adjustments to operating and capital expenses are as follows:</p> <table border="1"> <thead> <tr> <th>Year ending 30 June \$billions</th> <th>2015 Forecast</th> <th>2016 Forecast</th> <th>2017 Forecast</th> <th>2018 Forecast</th> <th>2019 Forecast</th> </tr> </thead> <tbody> <tr> <td>Operating</td> <td>0.6</td> <td>1.0</td> <td>0.5</td> <td>0.4</td> <td>0.4</td> </tr> <tr> <td>Capital</td> <td>0.4</td> <td>0.3</td> <td>0.1</td> <td>0.1</td> <td>0.1</td> </tr> </tbody> </table> <p>The adjustment will be higher at the front end of the forecast period as departments' appropriations (and therefore expenses) tend to be higher in these years, reflecting the flexibility departments have around transferring underspends to later years.</p>	Year ending 30 June \$billions	2015 Forecast	2016 Forecast	2017 Forecast	2018 Forecast	2019 Forecast	Operating	0.6	1.0	0.5	0.4	0.4	Capital	0.4	0.3	0.1	0.1	0.1
Year ending 30 June \$billions	2015 Forecast	2016 Forecast	2017 Forecast	2018 Forecast	2019 Forecast														
Operating	0.6	1.0	0.5	0.4	0.4														
Capital	0.4	0.3	0.1	0.1	0.1														
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 2014 annual financial statements and any additional valuations that have occurred up to 31 March 2015 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 forecasts.</p>															
Investment rate of returns	<p>The forecasts incorporate the actual results to 31 March 2015. 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 31 January 2015 and 31 December 2014 respectively. The ACC liability has also been adjusted for the 31 March 2015 discount rate. Both liabilities are valued by projecting future cash payments, and discounting them to the present. These valuations rely on historical data to predict future trends and use assumptions such as inflation and discount rates. Any changes 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 in line with the Government's stated intentions to commence contributions once net core Crown debt has fallen to 20.0% of GDP as set out in the <i>Fiscal Strategy Report (FSR)</i>.</p> <table border="1" data-bbox="440 1205 1225 1339"> <thead> <tr> <th data-bbox="440 1205 730 1261">Year ending 30 June \$billions</th> <th data-bbox="738 1205 842 1261">2016 Forecast</th> <th data-bbox="850 1205 962 1261">2017 Forecast</th> <th data-bbox="970 1205 1082 1261">2018 Forecast</th> <th data-bbox="1090 1205 1225 1261">2019 Forecast</th> </tr> </thead> <tbody> <tr> <td data-bbox="440 1272 730 1305">Annual contribution¹</td> <td data-bbox="738 1272 842 1305">2.2</td> <td data-bbox="850 1272 962 1305">2.4</td> <td data-bbox="970 1272 1082 1305">2.5</td> <td data-bbox="1090 1272 1225 1305">2.4</td> </tr> <tr> <td data-bbox="440 1317 730 1350">Actual contribution</td> <td data-bbox="738 1317 842 1350">-</td> <td data-bbox="850 1317 962 1350">-</td> <td data-bbox="970 1317 1082 1350">-</td> <td data-bbox="1090 1317 1225 1350">-</td> </tr> </tbody> </table> <p data-bbox="440 1373 1182 1406">Note 1 Calculations of annual contributions if they were to resume in 2015/16</p> <p data-bbox="440 1440 1394 1697">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 40 years of nominal GDP, net (after-tax) New Zealand superannuation expenses and the government five-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 data-bbox="440 1720 1118 1756">Refer to the Treasury's website for the NZS Fund model.</p>	Year ending 30 June \$billions	2016 Forecast	2017 Forecast	2018 Forecast	2019 Forecast	Annual contribution ¹	2.2	2.4	2.5	2.4	Actual contribution	-	-	-	-
Year ending 30 June \$billions	2016 Forecast	2017 Forecast	2018 Forecast	2019 Forecast												
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