2016
BUDGET

Budget Policy Statement

Hon Bill English, Minister of Finance

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New Zealand Government

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Budget Policy Statement

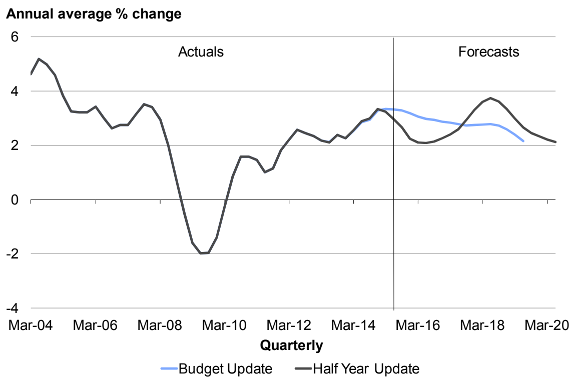
Economic and Fiscal Outlook

The New Zealand economy continues to expand. Forecasts in the accompanying *Half Year Economic and Fiscal Update* show economic growth averaging around 2.7 per cent a year over the next five years (Table 1).

The economy hit an unexpected soft patch, however, in the first half of 2015, when global concerns and falling dairy prices knocked business and consumer confidence. Looking ahead, real Gross Domestic Product (GDP) growth is expected to be weaker over the next two years than was forecast in the *Budget Update*, although stronger in 2018 and 2019 (Figure 1).

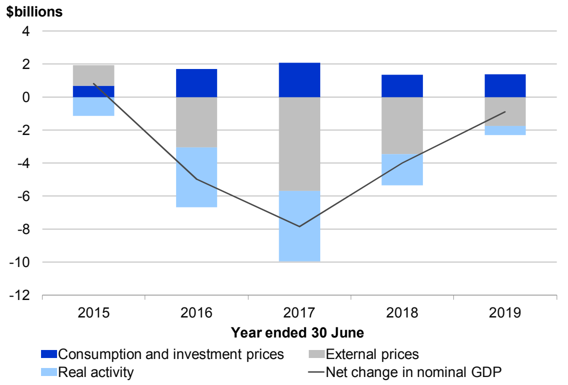
This lower-than-expected near-term growth, together with weaker export prices, means the nominal economy (the dollar value of what New Zealand produces) is forecast to be around $17 billion lower over the five years to June 2019 than was expected in the *Budget Update* (Figure 2). In turn, this flows through to slightly less tax revenue and therefore slightly lower operating balances, compared to forecasts in the *Budget Update*.

Figure 1 – Real GDP growth



Sources: The Treasury, Statistics New Zealand

Figure 2 – Changes in nominal GDP since *Budget Update*



Sources: The Treasury, Statistics New Zealand

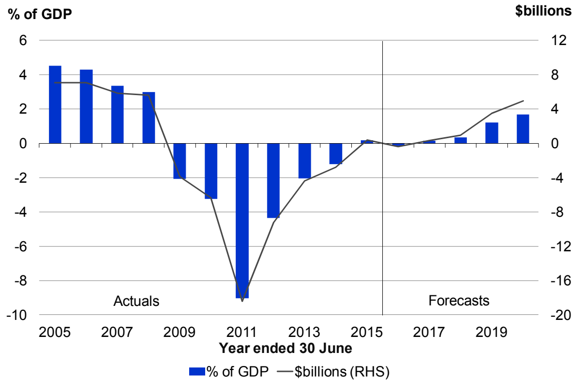
Table 1 – Summary of the Treasury's economic forecasts

March years	2015 Actual	2016 Forecast	2017 Forecast	2018 Forecast	2019 Forecast	2020 Forecast
Real GDP (annual average % change)	3.2	2.1	2.4	3.6	3.0	2.2
Consumers Price Index (annual % change)	0.3	1.4	2.1	1.9	2.1	2.2
Employment growth (annual % change)	3.2	0.3	1.7	2.2	2.2	1.2
Unemployment rate (%, March quarter)	5.8	6.5	6.1	5.3	4.7	4.5
Wage growth (annual % change)	2.1	2.6	1.8	2.2	2.8	3.3
Current account (% of GDP)	-3.5	-4.8	-6.0	-4.5	-3.9	-4.3

Source: The Treasury, Statistics New Zealand

The Crown's operating balance (before gains and losses) has recovered from a deficit of $18.4 billion in 2010/11 to a surplus of $414 million in 2014/15. Forecasts show the operating balance broadly in balance over the next few years, before rising rapidly in 2018/19 (Figure 3).

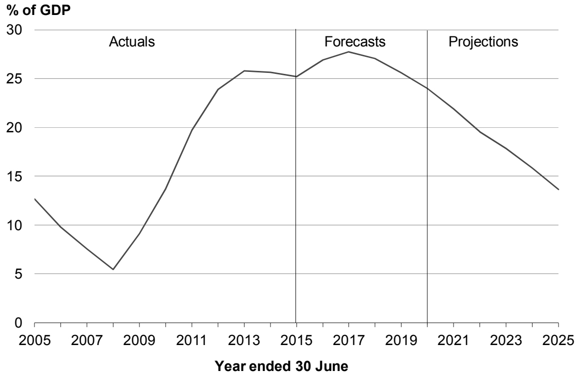
Figure 3 – Operating balance (before gains and losses)



Source: The Treasury

Net core Crown debt is forecast to peak at 27.7 per cent of GDP in 2016/17 and falls below 20 per cent of GDP in 2021/22 – one year later than expected in the *Budget Update* (Figure 4). Core Crown expenses are forecast to remain around 30 per cent of GDP over the next two years before falling below 30 per cent from 2017/18. Contributions to the New Zealand Superannuation Fund (NZS Fund) are projected to resume in 2022/23.

Figure 4 – Net core Crown debt



Source: The Treasury

Inflationary pressures remain weak, and interest rates and exchange rates are expected to be lower than forecast in the *Budget Update*. At the *Budget Update*, fiscal policy was considered to be slightly contractionary on average over the forecast period, but is now expected to be a little more supportive of economic activity.

Fiscal Strategy

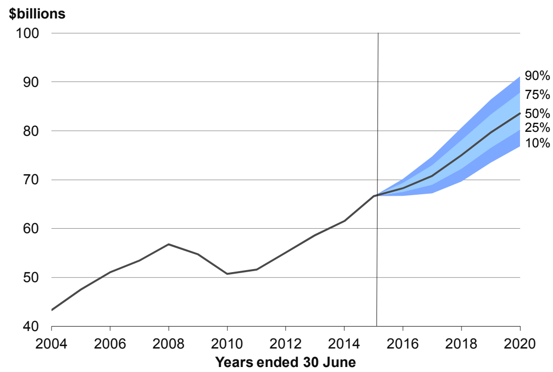
The marked fiscal turnaround over the past five years reflects both the recovering economy and ongoing, considered restraint in government spending.

The Government's focus has been on improving public sector productivity, achieving results and getting on top of the longer-term drivers of spending. It has managed to drive substantial improvements to public services in part because of, rather than in spite of, tight financial constraints.

None of the forecast revisions in the *Half Year Update* change the Government's overall fiscal strategy – keeping a tight rein on spending, focusing on results from public services, starting to pay down debt and looking to return any excess revenue on top of this to taxpayers.

It is also important to recognise the uncertainty around economic and fiscal forecasts, which will continue to move around (Figure 5). It is the overall path of the Crown's finances that is important. This means taking a medium-term approach to economic and fiscal management, looking through temporary ups and downs, and providing some certainty and predictability to taxpayers, businesses and recipients of public services.

Figure 5 – Core Crown tax revenue uncertainty[1]



Source: The Treasury

With the operating balance (before gains and losses) now broadly in balance, in the immediate future the Government will not distinguish between forecasts of small negative and small positive balances. In particular, the Government will not sharply reduce operating allowances in response to a forecast weakening in the tax take, as this would risk exacerbating the expected weakness in the economy in the near term.

While the fiscal strategy remains unchanged, the Government has updated some of its short-term intentions and long-term objectives, including those required by the Public Finance Act 1989, given that some are now out of date and others need adjusting to reflect the near-term changes in the economic outlook.

The Government's fiscal priorities have therefore been amended since the *Fiscal Strategy Report 2015*. Overall, the focus on the medium term remains the same, but the changes provide scope for the fiscal position to fluctuate in response to changing economic circumstances. Within the current economic and fiscal outlook, the fiscal priorities are:

1 maintaining rising operating surpluses (before gains and losses) over the forecast period so that cash surpluses are generated and net government debt begins to reduce in dollar terms

[1] Figure 5 plots the *Half Year Update* tax revenue forecast, along with confidence intervals around these forecasts based on the Treasury's historical tax forecast variances and the assumption of an even balance of risks around the central forecast. The outermost shaded area captures the range ±$7.2 billion in the June 2020 year, within which actual tax outturns are expected to fall 80 per cent of the time.

2 reducing net government debt to around 20 per cent of GDP in 2020 and, in the medium term, reducing net debt to within a range of 0 per cent to 20 per cent of GDP

3 implementing a new funding policy for the Accident Compensation Corporation (ACC), following previous levy reductions

4 if economic and fiscal conditions allow, beginning to reduce income taxes from Budget 2017, and

5 using any further fiscal headroom – including from positive revenue surprises – to reduce net debt faster.

A formal statement of the Government's short-term intentions and long-term objectives can be found in the Annex.

Budget Priorities

Decisions in Budget 2016 will be consistent with these fiscal priorities. The Budget will continue to progress the Government's programme and priorities, which are:

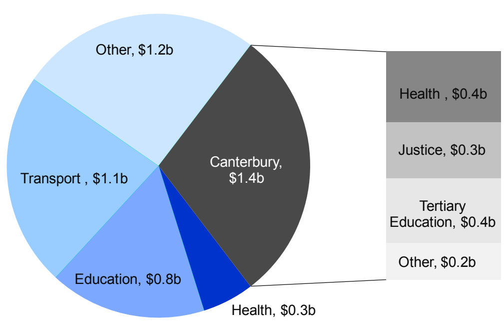
- Responsibly managing the Government's finances
- Building a more productive and competitive economy
- Delivering better public services within tight financial constraints, and
- Rebuilding Christchurch.

Responsibly managing the Government's finances

The strongest fiscal management tool the Government has in the Budget is the setting of new spending limits through the operating and capital allowances.

The operating allowance remains at $1 billion for Budget 2016, $2.5 billion for Budget 2017 and $1.5 billion for both Budget 2018 and Budget 2019. Some rephasing of these allowances between Budgets is possible, however, to meet particular spending priorities.

Figure 6 – Future Investment Fund allocations ($4.7 billion)[2]



Source: The Treasury

Over the past few years, the Future Investment Fund has funded $4.7 billion of new capital spending but has now been fully allocated (Figure 6). The capital allowance for Budget 2016 has therefore been increased by $1 billion. The Government is looking at ways to reprioritise existing capital to cover at least some of this increased investment. The fiscal forecasts in the *Half Year Update* include this $1 billion increase.

2 Figures may not sum due to rounding.

The Government remains committed to effectively and efficiently managing its large balance sheet, including using private sector capital and disciplines where appropriate, getting better performance from Crown-owned entities and reprioritising capital spending to higher-value uses.

Building a more productive and competitive economy

The Business Growth Agenda is the Government's programme of work to build a more productive, confident and competitive economy that will deliver higher incomes and higher living standards for New Zealand. It is focused on six key inputs for businesses: skilled and safe workplaces; export markets; infrastructure; innovation; natural resources; and investment.

Budget 2016 will continue to support and add to this programme of work to ensure there is a supportive business environment for firms to invest, grow and create jobs. Infrastructure will be one priority in the Budget, including the Government's continuing work on housing supply.

Delivering better public services

The Government has ensured departments and other agencies are focused squarely on getting better results for New Zealanders. As part of this, the Prime Minister has set 10 challenging results for the public service to achieve, including reducing crime, long-term welfare dependency and educational underachievement.

Budget 2016 will continue to support this focus on results as well as its programme of social investment, which applies rigorous and evidence-based investment practices to social services. The Government is looking to invest early to assist vulnerable people to change their lives and become more independent.

A priority in the Budget will therefore be spending to achieve better outcomes for New Zealanders, and to meet demand and other pressures on social spending, most of which is made up of spending on health, education and income support transfers. There will also be a strong focus on driving the best value from existing spending.

Rebuilding Christchurch

Budget 2016 will commit the last major tranche of funding to support the rebuilding of Christchurch after the destructive earthquakes in 2010 and 2011 as we move from recovery to regeneration.

The Government's contribution to the rebuild is very significant, totalling around $17.0 billion, including payments made by the Earthquake Commission (EQC), net of reinsurance proceeds. This is an increase over the $16.5 billion estimate in the *Budget Update* (Table 2).

Table 2 – Net earthquake expenses

Year ending 30 June $millions	2011-15 Actual	2016 Forecast	2017 Forecast	2018 Forecast	2019 Forecast	2020 Forecast	Outside forecast period	Total *Half Year* *Update*	Total *Budget* *Update*
Local infrastructure	1,582	107	107	57	-	-	-	1,853	1,806
Crown assets	471	666	603	269	128	116	150	2,403	2,158
Land zoning	999	101	57	-	-	-	-	1,157	1,126
Christchurch central city rebuild	767	199	441	178	56	6	-175	1,472	1,241
Welfare support	297	4	3	2	-	-	-	306	306
Southern Response support package	907	-14	-29	-14	-4	1	-	847	800
Other costs	726	134	92	93	97	101	-	1,243	1,197
Core Crown Canterbury earthquake recovery costs	**5,749**	**1,197**	**1,274**	**585**	**277**	**224**	**-25**	**9,281**	**8,634**
EQC (net of reinsurance proceeds)	7,313	-146	-192	-29	3	-	-	6,949	7,267
Other SOE and CEs	-119	226	336	226	91	50	-	810	625
Total Crown	12,943	1,277	1,418	782	371	274	-25	17,040	16,526

Source: The Treasury

Hon Bill English
Minister of Finance

15 December 2015

Annex

Long-term Fiscal Objectives and Short-term Fiscal Intentions

The Government's long term objectives relate to the next 10 years. The Government's long-term objective for debt has been amended since the *Fiscal Strategy Report 2015* (FSR) to provide additional scope for debt to fluctuate in response to changing economic circumstances. The rest of the long-term objectives are unchanged from the FSR 2015.

Table A1 – Long-term fiscal objectives

Budget Policy Statement 2016
Debt Manage total debt at prudent levels. Reduce net debt to within a range of 0 per cent to 20 per cent of GDP.
Operating balance Return to an operating surplus sufficient to meet the Government's net capital requirements, including contributions to the NZS Fund, and ensure consistency with the debt objective.
Operating expenses To meet the operating balance objective, the Government will control the growth in government spending so that, over time, core Crown expenses are reduced to below 30 per cent of GDP.
Operating revenues Ensure sufficient operating revenue to meet the operating balance objective.
Net worth Ensure net worth remains at a level sufficient to act as a buffer to economic shocks. Consistent with the debt and operating balance objectives, we will start building up net worth ahead of the full fiscal impact of the demographic change expected in the mid-2020s.

The Government's short-term fiscal intentions include changes since the FSR 2015 reflecting revisions to the fiscal forecasts including an increase in the capital allowance for Budget 2016 (see Table A2). The short-term intentions have also been made more explicit about the government's priorities over the next five years.

The short-term intentions and long-term objectives are consistent with each other and with the principles of responsible fiscal management as set out in the Public Finance Act 1989. That is, they aim to:

- reduce total debt to prudent levels and achieve and maintain levels of total net worth so as to provide a buffer against adverse economic shocks
- ensure that on average total operating expenses do not exceed total operating revenues
- take into account the impact on monetary policy
- prudently manage the fiscal risks facing government
- have regard for present and future generations, and
- ensure the Crown's resources are managed effectively and efficiently.

Table A2 – Short-term fiscal intentions

Budget Policy Statement 2016	***Fiscal Strategy Report 2015***
Debt Our intention is to reduce net debt to around 20 per cent of GDP in 2020. Gross sovereign-issued debt (including Reserve Bank settlement cash and Reserve Bank bills) is forecast to be 33.5 per cent of GDP in 2019/20. Net core Crown debt (excluding NZS Fund and advances) is forecast to be 25.6 per cent of GDP in 2018/19, 24.0 per cent of GDP in 2019/20 and 21.9 per cent in 2020/21.	***Debt*** Gross sovereign-issued debt (including Reserve Bank settlement cash and Reserve Bank bills) is forecast to be 31.4 per cent of GDP in 2018/19. Net core Crown debt (excluding NZS Fund and advances) is forecast to be 22.9 per cent in 2018/19, 20.9 per cent of GDP in 2019/20 and 19.7 per cent of GDP in 2020/21.
Operating balance Our intention is to maintain rising operating surpluses (before gains and losses) so that net core Crown debt begins to reduce in dollar terms (subject to any significant shocks to the economy). The operating balance (before gains and losses) is forecast to be -0.2 per cent of GDP in 2015/16, rising to 0.1 per cent of GDP in 2016/17 and 1.7 per cent of GDP in 2019/20. This is consistent with the long-term objective for the operating balance. The operating balance is forecast to be 2.6 per cent of GDP in 2019/20.	***Operating balance*** Our intention is to return the operating balance (before gains and losses) to surplus as soon as practical and no later than 2014/15, subject to any significant shocks. The operating balance (before gains and losses) is forecast to be -0.3 per cent of GDP in 2014/15. The operating balance (before gains and losses) is then forecast to be 0.1 per cent of GDP in 2015/16 and 1.3 per cent of GDP in 2018/19. This is consistent with the long-term objective for the operating balance. The operating balance is forecast to be 2.3 per cent of GDP in 2018/19.
Expenses Our intention is to support fiscal surpluses by restraining the growth in core Crown expenses and reducing these to below 30 per cent of GDP. Core Crown expenses are forecast to fall from 30.6 per cent of GDP in 2015/16 to 29.1 per cent of GDP in 2019/20. Total Crown expenses are forecast to be 37.3 per cent of GDP in 2019/20. This assumes a new operating allowance of $1 billion in Budget 2016, $2.5 billion in Budget 2017 and $1.5 billion from Budget 2018.	***Expenses*** Our intention is to support a return to fiscal surplus by restraining the growth in core Crown expenses – so that they are reduced to around 30 per cent of GDP by 2015/16. Core Crown expenses are forecast to be 29.2 per cent of GDP in 2018/19. Total Crown expenses are forecast to be 37.7 per cent of GDP in 2018/19. This assumes a new operating allowance of $1 billion in Budget 2016, $2.5 billion in Budget 2017 and $1.5 billion from Budget 2018.
Revenues Our intention is to support fiscal surpluses by growing revenue in dollar terms, although maintaining it at broadly the same proportion of GDP. Total Crown revenues are forecast to be 39.2 per cent of GDP in 2019/20. Core Crown revenues are forecast to be 30.7 per cent of GDP in 2019/20. Core Crown tax revenues are forecast to be 28.4 per cent of GDP in 2019/20.	***Revenues*** Total Crown revenues are forecast to be 39.2 per cent of GDP in 2018/19. Core Crown revenues are forecast to be 30.6 per cent of GDP in 2018/19. Core Crown tax revenues are forecast to be 28.2 per cent of GDP in 2018/19.
Net worth Our intention is to strengthen the Crown's balance sheet as a buffer against future adverse shocks. Total net worth attributable to the Crown is forecast to be 36.2 per cent of GDP in 2019/20. Total Crown net worth is forecast to be 38.2 per cent of GDP in 2019/20.	***Net worth*** Total Crown net worth is forecast to be 34.6 per cent of GDP in 2018/19. Total net worth attributable to the Crown is forecast to be 32.8 per cent of GDP in 2018/19.