
Pre-Election Economic and Fiscal Update 2017 Additional Information

The following information forms part of the Pre-election *Economic and Fiscal Update 2017 (Pre-election Update)* released by the Treasury on 23 August 2017. This information provides further details on the *Pre-election Update* and should be read in conjunction with the published document. The additional information includes:

- **Detailed economic forecast information** – breakdowns of the economic forecasts.
- **Treasury and Inland Revenue tax forecasts** – detailed tax revenue and receipts tables comparing Treasury’s forecasts with IRD’s forecasts.
- **Tax Policy changes** – details of material changes to tax revenue since the *Budget Update* as a result of policy initiatives.
- **Additional fiscal indicators** – estimates of the cyclically-adjusted balance and fiscal impulse.
- **Accounting policies** – outline of the specific Crown accounting policies.

Detailed Economic Forecast Information

This section includes tables with additional detail on the economic forecasts in the *Pre - Election Economic Fiscal Update*.

The economic numbers and forecasts in this section were finalised on 20 July 2017.

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|----------------|---|
| Table 1 | Real Gross Domestic Product |
| Table 2 | Consumers Price Index and exchange rates |
| Table 3 | Expenditure on gross domestic product and gross domestic product (income) in current prices |
| Table 4 | Labour market indicators |
| Table 5 | Exports – SNA basis |
| Table 6 | Imports – SNA basis |
| Table 7 | Balance of payments – Current account |

Table 1 – Real Gross Domestic Product

Production based chain volume series expressed in 2009/10 prices

Seasonally adjusted

| | \$ million | Quarterly % change | Annual % change | Annual average % change |
|--------|------------|-----------------------|--------------------|-------------------------------|
| 2014Q1 | 53,440 | 1.4 | 3.0 | 2.5 |
| 2014Q2 | 53,849 | 0.8 | 2.7 | 2.5 |
| 2014Q3 | 54,457 | 1.1 | 3.4 | 2.6 |
| 2014Q4 | 55,033 | 1.1 | 4.5 | 3.4 |
| 2015Q1 | 55,082 | 0.1 | 3.1 | 3.4 |
| 2015Q2 | 55,131 | 0.1 | 2.4 | 3.3 |
| 2015Q3 | 55,653 | 0.9 | 2.2 | 3.0 |
| 2015Q4 | 56,263 | 1.1 | 2.2 | 2.5 |
| 2016Q1 | 56,659 | 0.7 | 2.9 | 2.4 |
| 2016Q2 | 57,102 | 0.8 | 3.6 | 2.7 |
| 2016Q3 | 57,544 | 0.8 | 3.4 | 3.0 |
| 2016Q4 | 57,767 | 0.4 | 2.7 | 3.1 |
| 2017Q1 | 58,073 | 0.5 | 2.5 | 3.0 |
| 2017Q2 | 58,596 | 0.9 | 2.6 | 2.8 |
| 2017Q3 | 59,123 | 0.9 | 2.7 | 2.6 |
| 2017Q4 | 59,655 | 0.9 | 3.3 | 2.8 |
| 2018Q1 | 60,056 | 0.7 | 3.4 | 3.0 |
| 2018Q2 | 60,637 | 1.0 | 3.5 | 3.2 |
| 2018Q3 | 61,268 | 1.0 | 3.6 | 3.4 |
| 2018Q4 | 61,854 | 1.0 | 3.7 | 3.6 |
| 2019Q1 | 62,366 | 0.8 | 3.8 | 3.7 |
| 2019Q2 | 62,785 | 0.7 | 3.5 | 3.7 |
| 2019Q3 | 63,196 | 0.7 | 3.1 | 3.6 |
| 2019Q4 | 63,598 | 0.6 | 2.8 | 3.3 |
| 2020Q1 | 63,980 | 0.6 | 2.6 | 3.0 |
| 2020Q2 | 64,341 | 0.6 | 2.5 | 2.8 |
| 2020Q3 | 64,697 | 0.6 | 2.4 | 2.6 |
| 2020Q4 | 65,044 | 0.5 | 2.3 | 2.4 |
| 2021Q1 | 65,380 | 0.5 | 2.2 | 2.3 |
| 2021Q2 | 65,735 | 0.5 | 2.2 | 2.3 |

Source: Statistics New Zealand, the Treasury

Table 2 – Consumers Price Index and Exchange Rates

| | Consumers Price Index | | | Exchange rates | |
|--------|-----------------------|--------------------|-----------------|----------------|------|
| | Index | Quarterly % change | Annual % change | TWI | USD |
| 2014Q1 | 1192 | 0.3 | 1.5 | 80.0 | 0.84 |
| 2014Q2 | 1195 | 0.3 | 1.6 | 81.5 | 0.86 |
| 2014Q3 | 1199 | 0.3 | 1.0 | 80.1 | 0.84 |
| 2014Q4 | 1197 | -0.2 | 0.8 | 77.5 | 0.78 |
| 2015Q1 | 1195 | -0.2 | 0.3 | 77.9 | 0.75 |
| 2015Q2 | 1200 | 0.4 | 0.4 | 76.2 | 0.73 |
| 2015Q3 | 1204 | 0.3 | 0.4 | 69.8 | 0.65 |
| 2015Q4 | 1198 | -0.5 | 0.1 | 72.1 | 0.67 |
| 2016Q1 | 1200 | 0.2 | 0.4 | 72.2 | 0.66 |
| 2016Q2 | 1205 | 0.4 | 0.4 | 73.6 | 0.69 |
| 2016Q3 | 1209 | 0.3 | 0.4 | 77.0 | 0.72 |
| 2016Q4 | 1214 | 0.4 | 1.3 | 77.6 | 0.71 |
| 2017Q1 | 1226 | 1.0 | 2.2 | 78.0 | 0.71 |
| 2017Q2 | 1226 | 0.0 | 1.7 | 76.5 | 0.70 |
| 2017Q3 | 1230 | 0.3 | 1.7 | 78.1 | 0.70 |
| 2017Q4 | 1232 | 0.2 | 1.5 | 78.1 | 0.70 |
| 2018Q1 | 1236 | 0.3 | 0.8 | 78.1 | 0.70 |
| 2018Q2 | 1242 | 0.5 | 1.3 | 78.1 | 0.70 |
| 2018Q3 | 1250 | 0.6 | 1.6 | 78.1 | 0.70 |
| 2018Q4 | 1251 | 0.1 | 1.5 | 78.2 | 0.70 |
| 2019Q1 | 1257 | 0.5 | 1.7 | 78.3 | 0.70 |
| 2019Q2 | 1266 | 0.7 | 1.9 | 78.5 | 0.71 |
| 2019Q3 | 1275 | 0.7 | 2.0 | 78.6 | 0.71 |
| 2019Q4 | 1277 | 0.2 | 2.1 | 78.6 | 0.71 |
| 2020Q1 | 1284 | 0.5 | 2.1 | 78.7 | 0.71 |
| 2020Q2 | 1292 | 0.7 | 2.1 | 78.7 | 0.71 |
| 2020Q3 | 1302 | 0.7 | 2.1 | 78.7 | 0.71 |
| 2020Q4 | 1304 | 0.2 | 2.1 | 78.7 | 0.71 |
| 2021Q1 | 1310 | 0.5 | 2.1 | 78.5 | 0.71 |
| 2021Q2 | 1319 | 0.6 | 2.1 | 78.0 | 0.70 |

Source: RBNZ, Statistics New Zealand, the Treasury

Table 3 – Expenditure on Gross Domestic Product and Gross Domestic Product (income) in current prices

| Year ended June | 2016 | | | 2017 | | | 2018 | | | 2019 | | | 2020 | | | 2021 | | | |
|--------------------------------|-----------|---------|--------|-----------|---------|--------|-----------|---------|--------|-----------|---------|--------|-----------|---------|--------|-----------|---------|--------|--|
| | Actual | %volume | %price | Forecast | %volume | %price | Forecast | %volume | %price | Forecast | %volume | %price | Forecast | %volume | %price | Forecast | %volume | %price | |
| | \$million | | | \$million | | | \$million | | | \$million | | | \$million | | | \$million | | | |
| Consumption: | | | | | | | | | | | | | | | | | | | |
| - Private | 146,137 | 4.6 | 1.0 | 154,266 | 3.8 | 1.6 | 162,705 | 3.7 | 1.3 | 170,968 | 2.5 | 1.6 | 178,180 | 2.0 | 1.6 | 184,646 | 2.0 | 1.6 | |
| - Public | 47,201 | 3.2 | 1.9 | 49,638 | 1.8 | 2.2 | 51,657 | 1.4 | 2.1 | 53,467 | 1.4 | 2.2 | 55,379 | 1.1 | 2.2 | 57,250 | 1.1 | 2.2 | |
| Gross Fixed Capital Formation: | | | | | | | | | | | | | | | | | | | |
| - Residential | 17,692 | 6.1 | 6.2 | 19,925 | -0.1 | 3.8 | 20,671 | 4.5 | 2.6 | 22,149 | 3.0 | 3.0 | 23,507 | 3.9 | 3.3 | 25,222 | 3.9 | 3.3 | |
| - Business * | 40,490 | 5.3 | 0.1 | 42,688 | 7.6 | -1.0 | 45,487 | 5.3 | 0.1 | 47,931 | 6.2 | 0.8 | 51,284 | 5.2 | 1.0 | 54,486 | 5.2 | 1.0 | |
| - Total all sectors | 58,182 | 5.5 | 2.0 | 62,613 | 5.6 | 0.1 | 66,158 | 5.1 | 0.8 | 70,080 | 5.4 | 1.3 | 74,790 | 4.9 | 1.6 | 79,709 | 4.9 | 1.6 | |
| Change in Stocks | -409 | | | 1,440 | | | -1,047 | | | 481 | | | 1,768 | | | 2,243 | | | |
| Gross National Expenditure | 251,161 | 4.8 | 1.7 | 267,842 | 4.0 | 0.4 | 279,473 | 4.1 | 1.4 | 294,997 | 3.4 | 1.7 | 310,117 | 2.7 | 1.7 | 323,847 | 2.7 | 1.7 | |
| Exports | 70,780 | -0.6 | 2.3 | 71,976 | 4.0 | 2.1 | 76,441 | 2.5 | -0.7 | 77,793 | 2.3 | 0.9 | 80,278 | 2.2 | 1.4 | 83,193 | 2.2 | 1.4 | |
| Imports | 68,721 | 6.7 | -3.5 | 70,795 | 4.1 | -1.1 | 72,882 | 3.8 | 0.5 | 76,051 | 4.4 | 0.4 | 79,750 | 3.6 | 1.4 | 83,747 | 3.6 | 1.4 | |
| Expenditure on GDP | 253,086 | 2.7 | 3.4 | 268,821 | 3.4 | 1.7 | 282,626 | 3.7 | 1.2 | 296,548 | 2.7 | 1.9 | 310,543 | 2.2 | 1.8 | 323,240 | 2.2 | 1.8 | |
| Statistical Discrepancy | 1,201 | | | 1,190 | | | 1,178 | | | 1,167 | | | 1,156 | | | 1,145 | | | |
| Gross Domestic Product | 254,287 | | | 270,011 | | | 283,804 | | | 297,715 | | | 311,699 | | | 324,386 | | | |
| Compensation of employees | 110,570 | | | 117,014 | | | 122,233 | | | 128,259 | | | 133,699 | | | 138,607 | | | |
| Operating Surplus, net: | | | | | | | | | | | | | | | | | | | |
| - Agriculture | 3,139 | | | 4,257 | | | 4,678 | | | 4,687 | | | 4,799 | | | 5,022 | | | |
| - Other | 70,685 | | | 74,943 | | | 79,363 | | | 83,352 | | | 87,975 | | | 91,685 | | | |
| - Total all sectors | 73,825 | | | 79,200 | | | 84,040 | | | 88,040 | | | 92,774 | | | 96,707 | | | |
| Consumption of fixed capital | 36,226 | | | 38,038 | | | 39,939 | | | 41,936 | | | 44,033 | | | 46,235 | | | |
| Indirect Taxes | 34,503 | | | 36,596 | | | 38,428 | | | 40,317 | | | 42,030 | | | 43,674 | | | |
| Less subsidies | 837 | | | 837 | | | 837 | | | 837 | | | 837 | | | 837 | | | |
| Gross Domestic Product | 254,287 | | | 270,011 | | | 283,804 | | | 297,715 | | | 311,699 | | | 324,386 | | | |

* Central government investment data is currently suppressed in the national accounts. Therefore the usual distinction between market and non-market investment cannot be made.
 Note: GDP Income measure has been converted from March years to June years by Treasury
 Source: Statistics New Zealand, the Treasury

Table 4 – Labour Market Indicators

| Annual Average Percentage Change | | | | | | |
|---|-------------|-------------|-------------|-------------|-------------|-------------|
| Year ended June | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
| | Actual | Forecast | Forecast | Forecast | Forecast | Forecast |
| Real GDP (production basis) | 2.7 | 2.8 | 3.2 | 3.7 | 2.8 | 2.3 |
| Working Age Population | 2.4 | 2.6 | 2.4 | 2.1 | 1.7 | 1.4 |
| Labour Force | 2.1 | 5.2 | 2.6 | 1.8 | 1.3 | 1.0 |
| Employment | 2.3 | 5.4 | 2.7 | 2.1 | 1.5 | 1.1 |
| Labour Productivity* | -0.3 | -2.4 | 0.3 | 1.7 | 1.3 | 1.3 |
| CPI (annual percentage change) | 0.4 | 1.7 | 1.3 | 1.9 | 2.1 | 2.1 |
| Average Ordinary Time Hourly Wages | 2.2 | 1.5 | 2.3 | 2.9 | 2.7 | 2.7 |
| Average Weekly Earnings | 2.6 | 1.9 | 2.2 | 2.8 | 2.7 | 2.6 |
| Real Wages | 1.9 | 0.1 | 1.0 | 1.2 | 0.6 | 0.6 |
| Compensation of Employees | 4.6 | 5.8 | 4.5 | 4.9 | 4.2 | 3.7 |
| Unit Labour Costs (Hours worked basis) | 2.5 | 4.0 | 2.0 | 1.2 | 1.4 | 1.4 |
| Real Unit Labour Costs | 2.2 | 2.5 | 0.6 | -0.5 | -0.6 | -0.7 |

* Hours worked basis

| Number (000's) | | | | | | |
|--------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|
| As at June Quarter | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
| | Actual | Forecast | Forecast | Forecast | Forecast | Forecast |
| Total Population | 4,693 | 4,801 | 4,900 | 4,985 | 5,055 | 5,109 |
| Natural Increase | 28 | 36 | 32 | 33 | 33 | 34 |
| Net Migration | 69 | 72 | 67 | 52 | 36 | 20 |
| Annual Change | 98 | 108 | 99 | 85 | 70 | 54 |
| Working Age Population | 3,714 | 3,805 | 3,895 | 3,971 | 4,033 | 4,082 |
| Annual Change | 99 | 91 | 90 | 76 | 62 | 49 |
| Not in the labour force (s.a.) | 1,125 | 1,119 | 1,148 | 1,181 | 1,209 | 1,233 |
| Annual Change | 1 | -6 | 30 | 32 | 28 | 23 |
| Labour Force (s.a.) | 2,589 | 2,686 | 2,747 | 2,790 | 2,824 | 2,850 |
| Annual Change | 98 | 97 | 60 | 43 | 34 | 26 |
| Total Employment (s.a.) | 2,458 | 2,554 | 2,617 | 2,666 | 2,701 | 2,726 |
| Annual Change | 104 | 96 | 63 | 49 | 35 | 25 |
| Unemployment (s.a.) | 131 | 132 | 130 | 124 | 123 | 123 |
| Annual Change | -6 | 1 | -3 | -6 | -1 | 0 |
| Participation Rate (% , s.a.) | 69.7 | 70.6 | 70.5 | 70.3 | 70.0 | 69.8 |
| Unemployment Rate (% , s.a.) | 5.0 | 4.9 | 4.7 | 4.4 | 4.3 | 4.3 |

Source: Statistics New Zealand, the Treasury
s.a. - seasonally adjusted

Table 5 – Exports – SNA basis

| Year ended June | Dairy Products | | | Meat and Meat Products | | | Non-Commodity* | | |
|--------------------|----------------|--------|-----------|------------------------|--------|-----------|----------------|--------|-----------|
| | %volume | %price | \$million | %volume | %price | \$million | %volume | %price | \$million |
| 2013 | 14.6 | -13.1 | 12,477 | 14.4 | -9.8 | 5,720 | -1.3 | -6.4 | 12,839 |
| 2014 | -2.9 | 37.5 | 16,764 | 1.7 | 3.7 | 6,031 | 1.4 | 1.3 | 13,181 |
| 2015 | 4.3 | -23.3 | 13,389 | 1.2 | 10.9 | 6,771 | 4.9 | -4.1 | 13,266 |
| 2016 | 4.7 | -11.9 | 12,354 | 6.9 | -0.1 | 7,239 | -1.5 | 3.0 | 13,461 |
| 2017 | -0.4 | 9.1 | 13,366 | -8.2 | -1.8 | 6,528 | -0.3 | 1.4 | 13,615 |
| 2018 | 6.3 | 4.6 | 14,923 | 1.6 | 2.2 | 6,767 | 4.3 | -0.4 | 14,132 |
| 2019 | 4.1 | -2.3 | 15,171 | 0.3 | -3.2 | 6,566 | 2.7 | -2.3 | 14,173 |
| 2020 | 4.1 | -0.1 | 15,777 | 0.4 | -1.2 | 6,513 | 1.9 | 1.1 | 14,596 |
| 2021 | 4.1 | 0.3 | 16,475 | 0.4 | 0.4 | 6,568 | 1.5 | 2.1 | 15,123 |

| Year ended June | Total Goods** | | | Services | | | Total Exports | | |
|--------------------|---------------|--------|-----------|----------|--------|-----------|---------------|--------|-----------|
| | %volume | %price | \$million | %volume | %price | \$million | %volume | %price | \$million |
| 2013 | 5.3 | -7.4 | 46,081 | -3.5 | 0.5 | 16,306 | 3.0 | -5.5 | 62,388 |
| 2014 | -0.2 | 12.0 | 51,536 | 0.6 | 1.5 | 16,654 | 0.1 | 9.1 | 68,189 |
| 2015 | 3.4 | -8.7 | 48,652 | 13.2 | 1.1 | 19,077 | 5.7 | -6.0 | 67,729 |
| 2016 | 3.0 | -1.7 | 49,266 | 10.2 | 2.4 | 21,514 | 5.1 | -0.6 | 70,780 |
| 2017 | -1.2 | 2.9 | 50,049 | 0.3 | 1.6 | 21,926 | -0.6 | 2.3 | 71,976 |
| 2018 | 3.8 | 1.8 | 52,902 | 5.5 | 1.8 | 23,538 | 4.0 | 2.1 | 76,441 |
| 2019 | 2.6 | -1.7 | 53,352 | 2.4 | 1.4 | 24,445 | 2.5 | -0.7 | 77,793 |
| 2020 | 2.4 | 0.3 | 54,788 | 2.0 | 2.2 | 25,494 | 2.3 | 0.9 | 80,278 |
| 2021 | 2.4 | 1.1 | 56,691 | 1.8 | 2.1 | 26,506 | 2.2 | 1.4 | 83,193 |

* Consists of 'Metal Products and Machinery Equipment', 'Chemicals, Rubber and Other Non-Metallic Goods' and 'Textile, Apparel and Leather'

** Note that Statistics NZ withholds data for some components of exports for confidentiality reasons. As a result we have not published the 'Wood and Wood Products' and 'Other Goods' components of exports.

Source: Statistics New Zealand, the Treasury

Table 6 – Imports – SNA basis

| Year ended June | Capital Goods (Value for Duty) | | | Mineral Fuel* (VFD) | | | Intermediate Goods** (VFD) | | | Consumption Goods (VFD) | | |
|--------------------|--------------------------------|--------|-----------|---------------------|--------|-----------|----------------------------|--------|-----------|-------------------------|--------|-----------|
| | %volume | %price | \$million | %volume | %price | \$million | %volume | %price | \$million | %volume | %price | \$million |
| 2013 | 2.8 | -6.9 | 7,996 | 4.8 | -5.3 | 8,439 | 2.9 | -3.3 | 17,636 | 3.3 | -2.1 | 11,781 |
| 2014 | 26.4 | -6.0 | 9,493 | -0.9 | -2.8 | 8,128 | 8.1 | -2.9 | 18,502 | 7.3 | -2.9 | 12,265 |
| 2015 | 15.8 | -3.8 | 10,592 | 5.0 | -20.7 | 6,702 | 5.5 | 0.4 | 19,603 | 7.5 | 0.1 | 13,195 |
| 2016 | -4.4 | 8.3 | 10,955 | -2.0 | -29.5 | 4,585 | 3.4 | 3.8 | 21,021 | 6.3 | 6.4 | 14,913 |
| 2017 | 7.3 | -5.7 | 11,087 | 7.6 | 4.0 | 5,222 | 8.5 | -4.9 | 21,709 | 4.7 | -4.5 | 14,911 |
| 2018 | 5.3 | -3.6 | 11,258 | -5.2 | 0.4 | 4,971 | 3.0 | 0.0 | 22,349 | 7.6 | -0.5 | 15,960 |
| 2019 | 2.6 | -2.5 | 11,265 | 3.7 | 3.8 | 5,350 | 2.8 | 1.1 | 23,237 | 7.5 | 0.2 | 17,183 |
| 2020 | 7.5 | -2.4 | 11,811 | 1.6 | 4.4 | 5,670 | 3.9 | 1.2 | 24,434 | 5.1 | 0.0 | 18,060 |
| 2021 | 7.7 | -1.8 | 12,487 | 0.0 | 7.6 | 6,103 | 2.7 | 2.1 | 25,621 | 4.2 | 0.9 | 18,999 |

| Year ended June | Total Goods (VFD) | | | Services | | | Total Imports | | |
|--------------------|-------------------|--------|-----------|----------|--------|-----------|---------------|--------|-----------|
| | %volume | %price | \$million | %volume | %price | \$million | %volume | %price | \$million |
| 2013 | 3.1 | -3.7 | 45,920 | 1.2 | -1.5 | 15,266 | 2.6 | -3.1 | 61,185 |
| 2014 | 9.6 | -3.7 | 48,458 | 7.1 | -4.0 | 15,684 | 9.0 | -3.8 | 64,141 |
| 2015 | 7.9 | -4.1 | 50,116 | 2.7 | 1.5 | 16,357 | 6.6 | -2.8 | 66,472 |
| 2016 | 1.8 | 1.1 | 51,550 | -1.2 | 6.3 | 17,170 | 1.0 | 2.3 | 68,721 |
| 2017 | 6.8 | -3.6 | 53,110 | 5.8 | -2.7 | 17,683 | 6.7 | -3.5 | 70,795 |
| 2018 | 4.3 | -1.4 | 54,591 | 3.7 | -0.1 | 18,300 | 4.1 | -1.1 | 72,882 |
| 2019 | 4.3 | 0.2 | 57,087 | 2.3 | 1.4 | 18,981 | 3.8 | 0.5 | 76,051 |
| 2020 | 4.9 | 0.2 | 60,028 | 2.7 | 1.3 | 19,761 | 4.4 | 0.4 | 79,750 |
| 2021 | 4.1 | 1.2 | 63,262 | 1.8 | 2.1 | 20,531 | 3.6 | 1.4 | 83,747 |

* Consists of 'Fuels and Lubricants' and 'Petrol and Aviation Gas'

** Consists of 'Intermediate Goods' excluding 'Fuels and Lubricants' and 'Passenger Cars'

Source: Statistics New Zealand, the Treasury

Table 7 – Balance of Payments – Current Account

| \$ millions Year ended June | 2016 Actual | 2017 Forecast | 2018 Forecast | 2019 Forecast | 2020 Forecast | 2021 Forecast |
|---|----------------|------------------|------------------|------------------|------------------|------------------|
| Exports Goods | 49,266 | 50,049 | 52,902 | 53,352 | 54,788 | 56,691 |
| <i>annual % change</i> | 1.3 | 1.6 | 5.7 | 0.8 | 2.7 | 3.5 |
| Imports Goods | 51,550 | 53,110 | 54,591 | 57,087 | 60,028 | 63,262 |
| <i>annual % change</i> | 2.9 | 3.0 | 2.8 | 4.6 | 5.2 | 5.4 |
| Balance on Goods | -2,284 | -3,061 | -1,689 | -3,735 | -5,240 | -6,571 |
| <i>% of nominal GDP</i> | -0.9 | -1.1 | -0.6 | -1.3 | -1.7 | -2.0 |
| Exports Services | 21,514 | 21,926 | 23,538 | 24,445 | 25,494 | 26,506 |
| <i>annual % change</i> | 12.8 | 1.9 | 7.4 | 3.9 | 4.3 | 4.0 |
| Imports Services | 17,170 | 17,683 | 18,300 | 18,981 | 19,761 | 20,531 |
| <i>annual % change</i> | 5.0 | 3.0 | 3.5 | 3.7 | 4.1 | 3.9 |
| Balance on services | 4,344 | 4,243 | 5,239 | 5,465 | 5,733 | 5,975 |
| <i>% of nominal GDP</i> | 1.7 | 1.6 | 1.9 | 1.8 | 1.8 | 1.8 |
| Balance on goods & services | 2,060 | 1,181 | 3,550 | 1,729 | 493 | -596 |
| <i>% of nominal GDP</i> | 0.8 | 0.4 | 1.3 | 0.6 | 0.2 | -0.2 |
| Primary and secondary income balance | -9,370 | -9,494 | -9,825 | -9,964 | -10,871 | -11,987 |
| <i>% of nominal GDP</i> | -3.7 | -3.5 | -3.5 | -3.4 | -3.5 | -3.7 |
| Current account balance | -7,316 | -8,311 | -6,275 | -8,235 | -10,378 | -12,582 |
| <i>% of nominal GDP</i> | -2.9 | -3.1 | -2.2 | -2.8 | -3.3 | -3.9 |

Source: Statistics New Zealand, the Treasury

Treasury and Inland Revenue Tax Forecasts

In line with established practice, Inland Revenue has also prepared a set of tax forecasts, which, like the Treasury's tax forecasts, were based on the Treasury's macroeconomic forecasts. The two sets of forecasts differ from each other because of the different modelling approaches used by the two agencies and the various assumptions and judgements made by the forecasting teams in producing their forecasts.

Overall, the Treasury's tax forecasts are higher than Inland Revenue's, but the differences are relatively small; Treasury's total tax revenue forecasts are less than 1% higher than Inland Revenue's forecasts in each forecast year and just 0.6% higher on average over the 2018 to 2021 June years. Both agencies have based their 2016/17 forecast on the preliminary 2017 June-year result.

The largest differences between the two agencies' tax forecasts were:

- The Treasury's forecasts of RWT on interest are \$1 billion higher than Inland Revenue's forecasts, in total across the forecast period. The differences arise from differing assumptions made around interest rates and funding rates between the two agencies, and judgements around exactly when the turning point in RWT will occur. RWT has been in decline for some years now, but is expected to start increasing again in line with increasing interest rates.
- The Treasury's source deductions forecast is similar to Inland Revenue's through 2018 and 2019, but is higher through 2020 and 2021 owing to judgements made around the degree to which fiscal drag will affect source deduction revenue.
- The Treasury's forecasts of RWT on dividends are around \$0.1 billion higher than Inland Revenue's forecasts from 2018 onwards, reflecting the different assumptions made on the level of dividend distribution.

The following two tables detail the respective forecasts by the Treasury and Inland Revenue for tax revenue and receipts across each of the various sources:

Table 8 Treasury and Inland Revenue forecasts of tax revenue (accrual)

Table 9 Treasury and Inland Revenue forecasts of tax receipts (cash)

Table 8 – Treasury and Inland Revenue forecasts of tax revenue (accrual)

| | 2016/17 | | 2017/18 | | 2018/19 | | 2019/20 | | 2020/21 | |
|--|---------------|----------------|---------------|----------------|---------------|----------------|---------------|----------------|---------------|----------------|
| | Treasury | IRD Difference | Treasury | IRD Difference | Treasury | IRD Difference | Treasury | IRD Difference | Treasury | IRD Difference |
| Direct tax | | | | | | | | | | |
| Individuals | | | | | | | | | | |
| Source deductions | 27,499 | 29,128 | 30,118 | 30,107 | 30,606 | 30,593 | 32,235 | 31,974 | 33,763 | 33,383 |
| Other persons tax | 5,786 | 6,291 | 6,521 | 6,555 | 6,685 | 6,626 | 6,871 | 6,744 | 7,171 | 7,017 |
| Refunds | (1,739) | (1,737) | (1,738) | (1,732) | (1,719) | (1,669) | (1,634) | (1,590) | (1,670) | (1,588) |
| Fringe benefit tax | 502 | 540 | 549 | 550 | 577 | 565 | 602 | 580 | 624 | 590 |
| Subtotal: Individuals | 32,048 | 34,222 | 35,450 | 35,480 | 36,149 | 36,115 | 38,074 | 37,708 | 39,888 | 39,402 |
| Company tax (net) | 11,532 | 13,757 | 13,756 | 13,684 | 14,587 | 14,585 | 15,489 | 15,552 | 16,248 | 16,233 |
| Withholding taxes on: | | | | | | | | | | |
| Resident interest income | 1,667 | 1,465 | 1,604 | 1,295 | 1,772 | 1,425 | 2,231 | 1,960 | 2,561 | 2,475 |
| Non-resident income | 734 | 599 | 606 | 610 | 659 | 649 | 743 | 710 | 808 | 757 |
| Foreign-source dividends | (8) | (10) | .. | 1 | (1) | 1 | (1) | 1 | (1) | 1 |
| Resident dividend income | 626 | 743 | 756 | 682 | 74 | 707 | 85 | 732 | 103 | 757 |
| Subtotal: Withholding tax | 3,019 | 2,797 | 2,966 | 2,588 | 3,223 | 2,782 | 3,809 | 3,403 | 4,06 | 3,990 |
| Total direct tax | 46,599 | 50,776 | 52,172 | 51,752 | 53,959 | 53,482 | 57,372 | 56,663 | 60,394 | 59,625 |
| Indirect tax | | | | | | | | | | |
| GST (net) | 24,902 | 26,583 | 27,739 | 27,855 | 29,046 | 29,148 | 30,305 | 30,200 | 31,385 | 31,325 |
| Excise duties on: | | | | | | | | | | |
| Alcoholic drinks | 671 | 681 | 712 | 704 | 728 | 720 | 751 | 750 | 774 | 770 |
| Tobacco products | 362 | 344 | 356 | 360 | 369 | 370 | 382 | 385 | 396 | 398 |
| Petroleum fuels | 1,185 | 1,142 | 1,242 | 1,240 | 1,259 | 1,253 | 1,277 | 1,265 | 1,291 | 1,280 |
| Subtotal: Excise duties | 2,218 | 2,167 | 2,310 | 2,304 | 2,356 | 2,343 | 2,410 | 2,400 | 2,461 | 2,448 |
| Other indirect tax | | | | | | | | | | |
| Customs duty | 2,442 | 2,547 | 2,510 | 2,490 | 2,578 | 2,540 | 2,650 | 2,610 | 2,723 | 2,680 |
| Road user charges | 1,381 | 1,458 | 1,464 | 1,546 | 1,497 | 1,622 | 1,534 | 1,699 | 1,574 | 1,773 |
| Gaming duties | 275 | 298 | 301 | 299 | 308 | 300 | 313 | 301 | 320 | 303 |
| Motor vehicle fees | 214 | 231 | 232 | 231 | 236 | 239 | 238 | 246 | 241 | 252 |
| Exhaustible resource levy | 28 | 31 | 30 | 24 | 30 | 24 | 30 | 24 | 30 | 24 |
| Approved issuer levy, cheque duty & other | 87 | 85 | 82 | 100 | 90 | 105 | 99 | 110 | 100 | 115 |
| Subtotal: Other indirect tax | 4,427 | 4,650 | 4,619 | 4,690 | 4,739 | 4,830 | 4,864 | 4,990 | 4,988 | 5,147 |
| Total indirect tax | 31,547 | 33,400 | 34,668 | 34,849 | 36,141 | 36,321 | 37,579 | 37,590 | 38,834 | 38,920 |
| Total tax | 78,146 | 84,174 | 86,840 | 86,601 | 90,100 | 89,803 | 94,951 | 94,253 | 99,228 | 98,545 |
| Total tax (% of GDP) | 30.9% | 31.3% | 30.7% | 30.6% | 30.4% | 30.3% | 30.6% | 30.4% | 30.7% | 30.5% |
| less Core Crown tax eliminations | | | | | | | | | | |
| Core Crown income tax | 512 | 1,134 | 716 | 716 | 769 | 769 | 824 | 824 | 883 | 883 |
| GST on Crown expenses and departmental outputs | 6,694 | 6,920 | 7,334 | 7,334 | 7,515 | 7,515 | 7,823 | 7,823 | 8,006 | 8,006 |
| Crown ESCR | 450 | 443 | 457 | 457 | 460 | 460 | 465 | 465 | 466 | 466 |
| Crown All | 45 | 54 | 55 | 55 | 55 | 55 | 54 | 54 | 56 | 56 |
| Core Crown taxation | 70,445 | 75,625 | 78,278 | 78,039 | 81,301 | 81,004 | 85,785 | 85,087 | 89,817 | 89,134 |
| Core Crown tax (% of GDP) | 27.8% | 28.1% | 27.7% | 27.6% | 27.4% | 27.3% | 27.6% | 27.4% | 27.8% | 27.6% |
| less Total Crown tax eliminations | | | | | | | | | | |
| Income tax from SOEs and CEs | 691 | 524 | 601 | 601 | 551 | 551 | 629 | 629 | 659 | 659 |
| Other Crown GST | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. |
| ESCT from SOEs and CEs | 30 | 36 | 37 | 37 | 38 | 38 | 37 | 37 | 37 | 37 |
| Lottery duty | 55 | 53 | 54 | 54 | 55 | 55 | 56 | 56 | 57 | 57 |
| Total Crown taxation | 69,669 | 75,012 | 77,586 | 77,347 | 80,657 | 80,360 | 85,063 | 84,365 | 89,064 | 88,381 |
| Total Crown tax (% of GDP) | 27.5% | 27.9% | 27.5% | 27.4% | 27.2% | 27.1% | 27.4% | 27.2% | 27.6% | 27.3% |
| Nominal expenditure GDP | 253,086 | 268,821 | 282,626 | 282,626 | 296,548 | 296,548 | 310,543 | 310,543 | 323,240 | 323,240 |

Table 9 – Treasury and Inland Revenue forecasts of tax receipts (cash)

| | 2015/16 Actual | | 2016/17 Estimated Actual | | 2017/18 Forecast | | 2018/19 Forecast | | 2019/20 Forecast | | 2020/21 Forecast | |
|--|----------------|----------------|--------------------------|----------------|------------------|----------------|------------------|----------------|------------------|----------------|------------------|----------------|
| | Treasury | IRD Difference | Treasury | IRD Difference | Treasury | IRD Difference | Treasury | IRD Difference | Treasury | IRD Difference | Treasury | IRD Difference |
| Direct tax | | | | | | | | | | | | |
| Individuals | | | | | | | | | | | | |
| Source deductions | 27,320 | 28,910 | 28,910 | 28,910 | 30,083 | 30,035 | 30,431 | 30,261 | 32,051 | 31,773 | 33,570 | 33,183 |
| Other persons tax | 6,170 | 6,683 | 6,683 | 6,683 | 6,872 | 6,962 | 7,116 | 7,046 | 7,317 | 7,201 | 7,548 | 7,502 |
| Refunds | (2,540) | (2,540) | (2,540) | (2,540) | (2,527) | (2,507) | (2,585) | (2,484) | (1,011) | (2,533) | (2,535) | (2,453) |
| Fringe benefit tax | 506 | 526 | 526 | 526 | 549 | 550 | 577 | 565 | 602 | 580 | 624 | 590 |
| Subtotal: Individuals | 31,456 | 33,579 | 33,579 | 33,579 | 34,977 | 35,040 | 35,539 | 35,388 | 37,437 | 37,124 | 39,207 | 38,822 |
| Company tax (net) | 10,974 | 13,038 | 13,038 | 13,038 | 13,490 | 13,447 | 14,462 | 14,385 | 15,375 | 15,355 | 16,109 | 16,035 |
| Withholding taxes on: | | | | | | | | | | | | |
| Resident interest income | 1,727 | 1,446 | 1,446 | 1,446 | 1,604 | 1,295 | 1,772 | 1,425 | 2,231 | 1,960 | 2,561 | 2,475 |
| Non-resident income | 636 | 583 | 583 | 583 | 606 | 610 | 659 | 649 | 743 | 710 | 808 | 757 |
| Foreign-source dividends | (5) | 3 | 3 | 3 | .. | 1 | .. | 1 | (1) | 1 | .. | 1 |
| Resident dividend income | 620 | 729 | 729 | 729 | 756 | 682 | 792 | 707 | 835 | 732 | 869 | 757 |
| Subtotal: Withholding tax | 2,978 | 2,761 | 2,761 | 2,761 | 2,966 | 2,588 | 3,223 | 2,782 | 3,809 | 3,403 | 4,258 | 3,990 |
| Total direct tax | 45,408 | 49,378 | 49,378 | 49,378 | 51,433 | 51,075 | 53,224 | 52,555 | 56,621 | 55,882 | 59,574 | 58,847 |
| Indirect tax | | | | | | | | | | | | |
| GST (net) | 24,736 | 25,975 | 25,975 | 25,975 | 27,448 | 27,534 | 28,696 | 28,817 | 29,964 | 29,877 | 31,051 | 30,938 |
| Excise duties on: | | | | | | | | | | | | |
| Alcoholic drinks | 667 | 678 | 678 | 678 | 712 | 704 | 728 | 720 | 751 | 750 | 774 | 770 |
| Tobacco products | 370 | 330 | 330 | 330 | 356 | 360 | 369 | 370 | 382 | 385 | 396 | 398 |
| Petroleum fuels | 1,187 | 1,135 | 1,135 | 1,135 | 1,242 | 1,240 | 1,259 | 1,253 | 1,277 | 1,265 | 1,291 | 1,280 |
| Subtotal: Excise duties | 2,224 | 2,143 | 2,143 | 2,143 | 2,310 | 2,304 | 2,356 | 2,343 | 2,410 | 2,400 | 2,461 | 2,448 |
| Other indirect tax | | | | | | | | | | | | |
| Customs duty | 2,553 | 2,525 | 2,525 | 2,525 | 2,516 | 2,490 | 2,572 | 2,540 | 2,644 | 2,610 | 2,718 | 2,680 |
| Road user charges | 1,382 | 1,458 | 1,469 | 1,469 | 1,464 | 1,546 | 1,497 | 1,622 | 1,534 | 1,699 | 1,574 | 1,773 |
| Gaming duties | 276 | 297 | 297 | 297 | 301 | 299 | 308 | 300 | 313 | 301 | 320 | 303 |
| Motor vehicle fees | 240 | 231 | 217 | 217 | 232 | 231 | 236 | 239 | 238 | 246 | 241 | 252 |
| Exhaustible resource levy | 28 | 31 | 24 | 24 | 30 | 24 | 30 | 24 | 30 | 24 | 30 | 24 |
| Approved issuer levy, cheque duty & other | 91 | 88 | 88 | 88 | 82 | 100 | 90 | 105 | 99 | 110 | 100 | 115 |
| Subtotal: Other indirect tax | 4,570 | 4,630 | 4,620 | 4,620 | 4,625 | 4,690 | 4,733 | 4,830 | 4,858 | 4,990 | 4,983 | 5,147 |
| Total indirect tax | 31,530 | 32,748 | 32,738 | 32,738 | 34,383 | 34,528 | 35,785 | 35,990 | 37,232 | 37,267 | 38,495 | 38,533 |
| Total tax | 76,938 | 82,126 | 82,116 | 82,116 | 85,816 | 85,603 | 89,009 | 88,545 | 93,853 | 93,149 | 98,069 | 97,380 |
| Total tax (% of GDP) | 30.4% | 30.6% | 30.5% | 30.5% | 30.4% | 30.3% | 30.0% | 29.9% | 30.2% | 30.0% | 30.3% | 30.1% |
| less Core Crown tax eliminations | | | | | | | | | | | | |
| Core Crown income tax | (36) | 944 | 944 | 944 | 932 | 932 | 758 | 758 | 813 | 813 | 871 | 871 |
| GST on Crown expenses and departmental outputs | 6,698 | 6,882 | 6,882 | 6,882 | 7,374 | 7,374 | 7,482 | 7,482 | 7,791 | 7,791 | 7,973 | 7,973 |
| Crown/ESCT | 446 | 439 | 439 | 439 | 452 | 452 | 456 | 456 | 460 | 460 | 462 | 462 |
| Crown/ALL | 45 | 54 | 54 | 54 | 55 | 55 | 55 | 55 | 55 | 55 | 56 | 56 |
| Core Crown taxation | 69,785 | 73,807 | 73,797 | 73,797 | 77,003 | 76,790 | 80,258 | 79,794 | 84,734 | 84,030 | 88,707 | 88,018 |
| Core Crown tax (% of GDP) | 27.6% | 27.5% | 27.5% | 27.5% | 27.2% | 27.2% | 27.1% | 26.9% | 27.3% | 27.1% | 27.4% | 27.2% |
| less Total Crown tax eliminations | | | | | | | | | | | | |
| Income tax from SOEs and CEs | 629 | 546 | 546 | 546 | 543 | 543 | 622 | 622 | 629 | 629 | 696 | 696 |
| Other Crown GST | 50 | (2) | (2) | (2) | 7 | 7 | (10) | (10) | (5) | (5) | 15 | 15 |
| ESCT from SOEs and CEs | 23 | 33 | 33 | 33 | 35 | 35 | 35 | 35 | 35 | 35 | 35 | 35 |
| Lottery duty | 56 | 52 | 52 | 52 | 54 | 54 | 55 | 55 | 56 | 56 | 57 | 57 |
| Total Crown taxation | 69,027 | 73,178 | 73,168 | 73,168 | 76,364 | 76,151 | 79,556 | 79,092 | 84,019 | 83,315 | 87,904 | 87,215 |
| Total Crown tax (% of GDP) | 27.3% | 27.2% | 27.2% | 27.2% | 27.0% | 26.9% | 26.8% | 26.7% | 27.1% | 26.8% | 27.2% | 27.0% |

Tax Policy Changes

This section details the material changes to forecast tax revenue since the *Budget Economic and Fiscal Update* as a result of revenue and spending initiatives. Table 10 shows a breakdown of the changes and the supplementary text describes each initiative.

Table 10 – Tax forecasting effects of initiatives announced since the *Budget Update*

| Year ending 30 June \$ millions | 2017 Forecast | 2018 Forecast | 2019 Forecast | 2020 Forecast | 2021 Forecast | Total 5 years |
|---|------------------|------------------|------------------|------------------|------------------|------------------|
| Base Erosion and Profit Shifting (BEPS) | | | | | | |
| Pre-Election Update | .. | .. | 114 | 209 | 209 | 532 |
| less Budget Update | .. | .. | (50) | (100) | (100) | (250) |
| Net change | .. | .. | 64 | 109 | 109 | 282 |

Source: The Treasury

Recent Initiatives

Base Erosion and Profit Shifting (BEPS)

A number of measures relating to the taxation of multi-national companies operating in New Zealand. Initial revenue estimates for these measures were included in the Budget Update forecast. These estimates have been updated to include the estimated effect of the measures, as announced on 3 August.

Additional Fiscal Indicators

The Treasury calculates two summary fiscal indicators: the cyclically-adjusted balance (CAB) and the fiscal impulse indicator.

- The CAB adjusts the operating balance before gains and losses (OBEGAL) for the cyclical position of the economy. The CAB is subject to uncertainty because it uses estimated variables and is sensitive to new information, particularly regarding the output gap.
- The fiscal impulse indicator uses the change in a cash-based version of the fiscal balance to estimate the marginal contribution of discretionary fiscal policy to aggregate demand.

Further information on the methodology, interpretation and limitations behind the indicators can be found in Treasury Working Papers 02/30 and 10/08.¹

This section discusses the Treasury’s central estimates of the CAB and fiscal impulse. The next section discusses sensitivity analysis. Detailed tables of data can be found at the end of the Additional Fiscal Indicators section.

Central Estimates

Cyclically-adjusted balance

The CAB is essentially an estimate of what the operating balance would be without the effect of cyclical fluctuations in revenues and expenses. When the economy is operating above its potential level (a positive output gap) tax receipts are higher and unemployment expenses are lower than they would be relative to an economy operating at potential. When the economy is operating below its potential level, the opposite is true. Adjusting the headline OBEGAL for the economic cycle therefore shows the underlying, structural fiscal position.

Significant “one-off” impacts on expenses from the Canterbury and Kaikoura earthquakes are removed from the central estimates of the CAB to give a better indication of underlying fiscal performance.

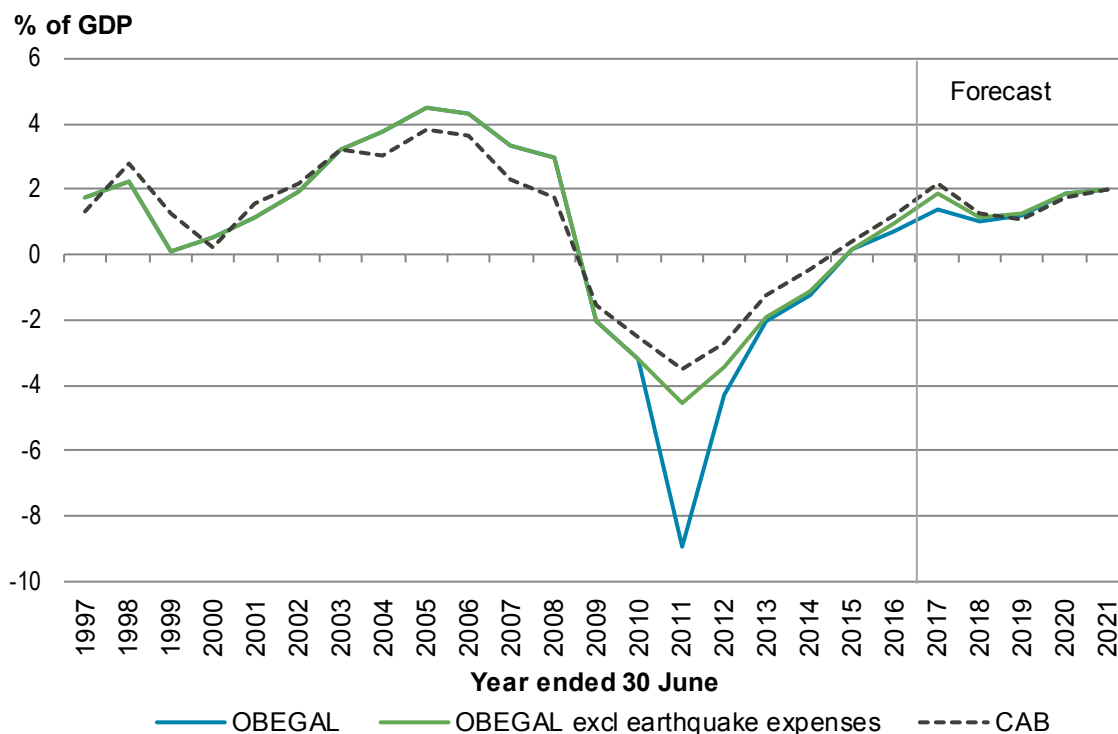
Figure 1 shows the OBEGAL and the CAB. The CAB is in surplus across the entire forecast period, suggesting forecast OBEGAL surpluses are structural – that is, they are not due to cyclical economic conditions. In 2016/17 and 2017/18 the economy is estimated to be operating below its potential level (a negative output gap). From 2018/19 the economy is forecast to be operating above its potential (a positive output gap). As a result the CAB is higher than the headline OBEGAL in 2016/17 and 2017/18 and lower than the headline OBEGAL from 2018/19 onwards.

¹ Renee Philip and John Janssen (2002) "Indicators of Fiscal Impulse for New Zealand" New Zealand Treasury Working Paper 02/30, December 2002 <http://www.treasury.govt.nz/publications/research-policy/wp/2002/02-30/>

Oscar Parkyn (2010) "Estimating New Zealand’s Structural Budget Balance" New Zealand Treasury Working Paper 10/08, December 2010 <http://www.treasury.govt.nz/publications/research-policy/wp/2010/10-08/>

The CAB in 2016/17 is estimated to be around 0.8 percentage points of GDP higher relative to the *Budget Update*. This is partly driven by improved Crown entity and state-owned enterprise performance, higher than forecast company profits and employment growth that have resulted in higher estimated revenue from corporate tax and source deductions, respectively. Expenses are also lower in 2016/17 relative to the *Budget Update* driven by timing effects. For the remainder of the forecast period the CAB is broadly similar to estimates at the *Budget Update*, with the Family Incomes Package seeing the CAB decline across 2017/18 and 2018/19. Cyclically-adjusted surpluses are then forecast to increase from 1.1% of GDP in 2018/19 to 2.0% of GDP in 2020/21.

Figure 1 – Cyclically-adjusted balance



Source: The Treasury

Fiscal impulse

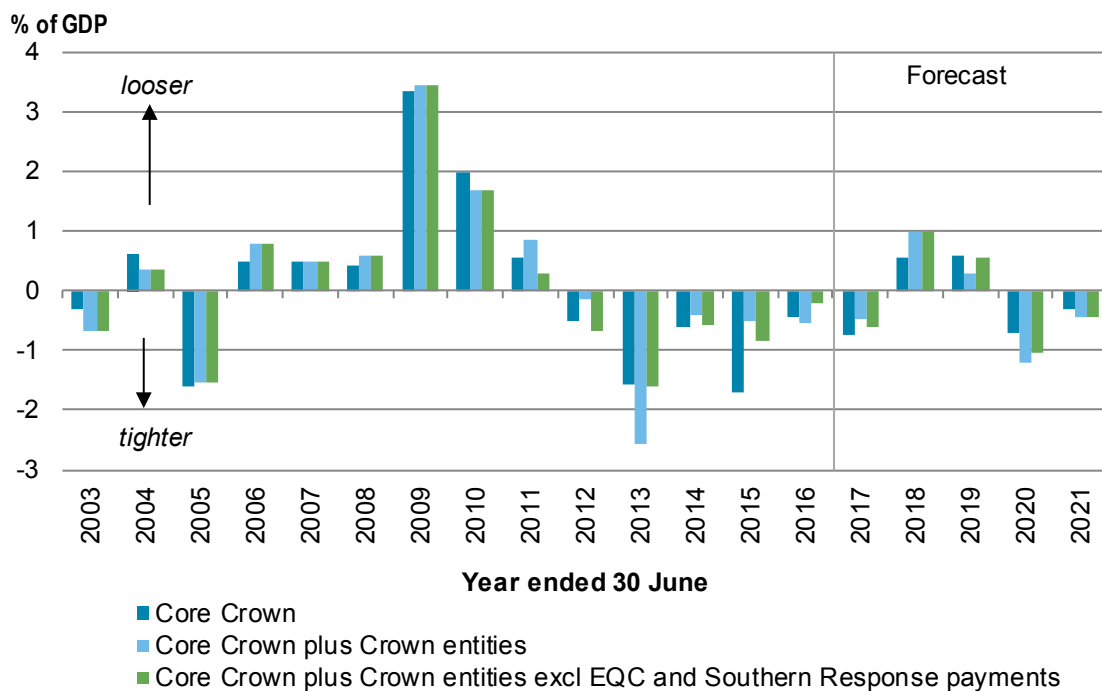
The fiscal impulse is an estimate of discretionary changes in the fiscal position that have an impact on aggregate demand pressures in the economy. It is calculated as the change in a cash-based version of the fiscal balance (a cyclically-adjusted primary balance supplemented by capital expenditure). Capital expenditure on defence, KiwiSaver subsidies and Deposit Guarantee Scheme payments are excluded from the measure since these are expected to have a limited direct impact on aggregate demand pressures. Purchases and sales of investments are also excluded as they represent a transfer of resources.

The fiscal impulse is shown for both the core Crown and combined core Crown and Crown entities segments (ie, total Crown excluding State-owned enterprises). The core Crown indicator mostly reflects changes in receipts and expenditure impacted by Budget decisions, whereas the core Crown plus Crown entities indicator provides a better indication of the total impact of central government activities on aggregate demand pressures. A measure of the fiscal impulse that excludes earthquake-related (Canterbury and Kaikōura) financial transactions is also shown, which adjusts for EQC and Southern Response payments and receipts. These excluded items are expected to finance private

demand (eg, residential construction). The core Crown plus Crown entities (excluding EQC and Southern Response payments) indicator is used by the Treasury as the headline estimate of the fiscal impulse.

It is worth noting that summary indicators such as the fiscal impulse do not take account of the composition of fiscal policy changes or how a change in fiscal policy will be transmitted through the economy. Research by the Treasury using time series statistical analysis indicates that spending and taxes have different effects on New Zealand GDP.² Therefore the fiscal impulse indicator is only an imprecise guide to the impact of fiscal policy on the economy.

Figure 2 – Estimates of the fiscal impulse



Source: The Treasury

Across the forecast period the ongoing decline in operating expenditure as a percentage of GDP has a negative contribution to the headline fiscal impulse in each year except 2017/18 where timing effects of operating expenditure result in a small positive contribution.

The headline estimate of the fiscal impulse (Figure 2) shows that in 2016/17 fiscal policy is expected to have a contractionary impact on aggregate demand, reflecting declining operating expenditure as a percentage of GDP. The fiscal stance turns expansionary in 2017/18 and 2018/19, driven by the Family Incomes package and elevated capital spending. For the remainder of the forecast period, fiscal policy is forecast to have a contractionary impact on aggregate demand. This is largely driven by declining operating expenditure as per cent of GDP. The year-on-year decline in capital expenditure as a percentage of GDP from 2018/19 to 2019/20 also contributes to the negative impulse in 2019/20.

² Parkyn and Vehbi (2013) "The Effects of Fiscal Policy in New Zealand: Evidence from a VAR Model with Debt Constraints" New Zealand Treasury Working Paper 13/02, January 2013 <http://www.treasury.govt.nz/publications/research-policy/wp/2013/13-02>

Compared with the *Budget Update*, the direction of the headline fiscal impulse in each year is unchanged however there have been some changes in magnitude. The negative impulse in 2016/17 has increased from -0.0% of GDP at the *Budget Update* to -0.6% of GDP at the *Pre-Election Update*. This is driven by timing shifts in operating and capital expenditure. A large portion of this expenditure is now forecast to occur in the 2017/18 fiscal year, resulting in a positive impulse of 1.0% of GDP relative to the 0.5% of GDP forecast at the *Budget Update*.

Sensitivity Analysis

There is uncertainty around the estimates of the summary indicators. The two broad sources of uncertainty are:

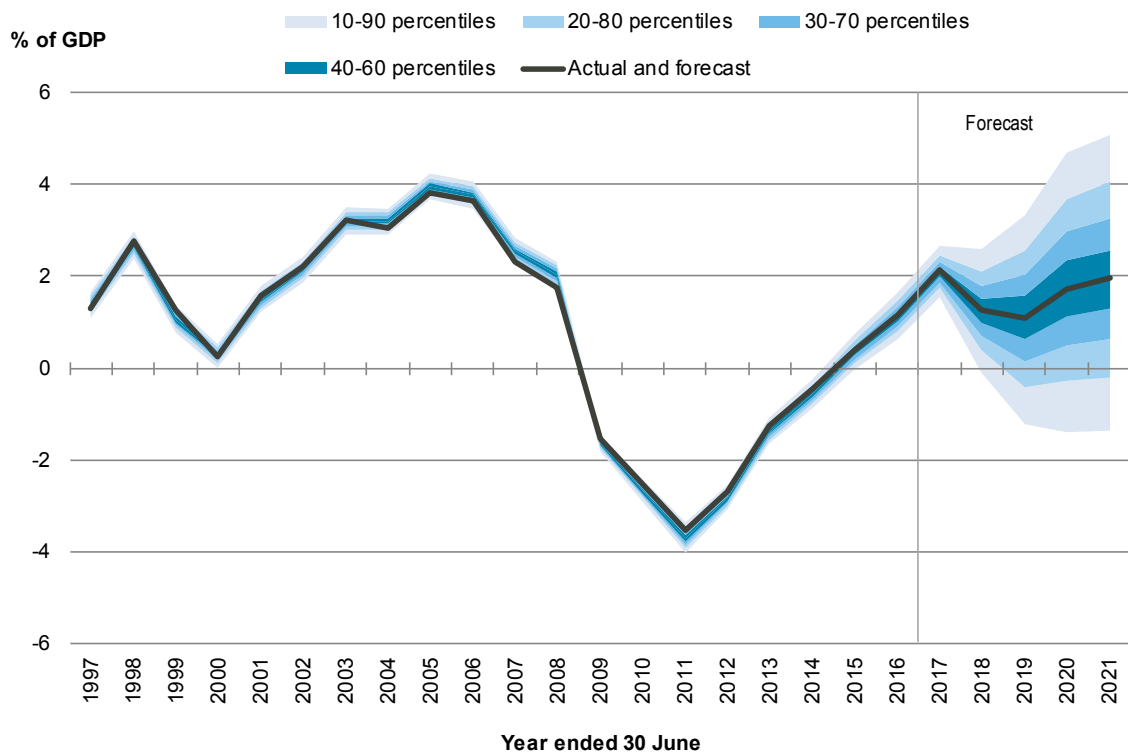
- estimation uncertainty of the key model parameters (ie, the output gap and the elasticity of different tax revenues with respect to the output gap), and
- forecast uncertainty relating to future fiscal and economic developments.

To illustrate this uncertainty, sensitivity analysis is performed on estimates of the CAB and core Crown fiscal impulse by using alternative output gap estimates from the RBNZ, IMF and OECD. Alternative values for the elasticity of different tax revenues with respect to the output gap that are half and twice the magnitude of the baseline estimates are also used. The range of alternative estimates is plotted in Figures 4-6, with data reported in Tables 14-16. These estimates of the fiscal impulse and CAB show little difference to the Treasury's central estimate across the forecast period.

An alternative means of illustrating uncertainty is to show a probability distribution around the central forecast. A probability distribution requires making some assumptions about future forecast errors based on historical forecast errors of observable economic and fiscal variables and historical revisions to the Treasury's output gap estimates. Figure 3 presents a fan chart of the CAB indicator. The probability intervals calculated are conditional on current policy and reflect historical revisions to the Treasury's official output gap estimate, rather than the full uncertainty implied by different estimation techniques. Details of the methodology and parameter values for the confidence intervals are reported in Treasury Working Paper 10/08.³ This analysis shows that, although the central estimate of the CAB indicates the Government is running a structural surplus each year of the forecast period, there is uncertainty around these estimates.

³ Oscar Parkyn (2010) "Estimating New Zealand's Structural Budget Balance". New Zealand Treasury Working Paper 10/08 <http://www.treasury.govt.nz/publications/research-policy/wp/2010/10-08/>

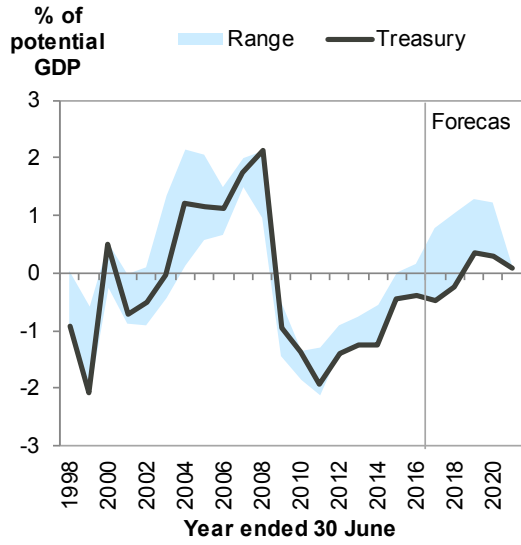
Figure 3 – Fan chart for the cyclically-adjusted balance



Source: The Treasury

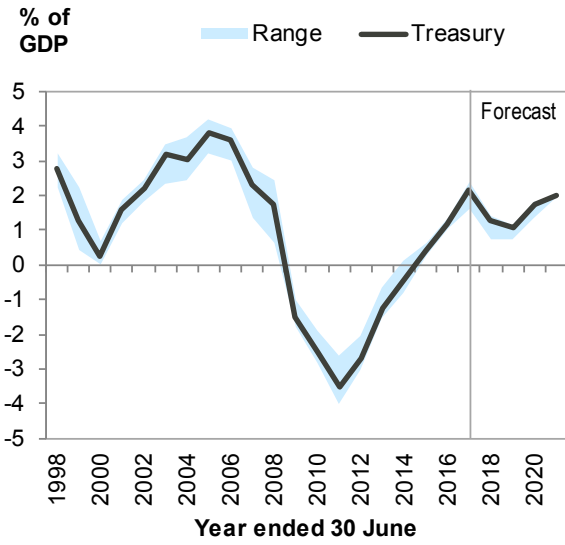
Note: the bands represent sequential deciles such that the difference between the 10th and 90th percentiles represents an 80% confidence interval.

Figure 4 – Output gap range



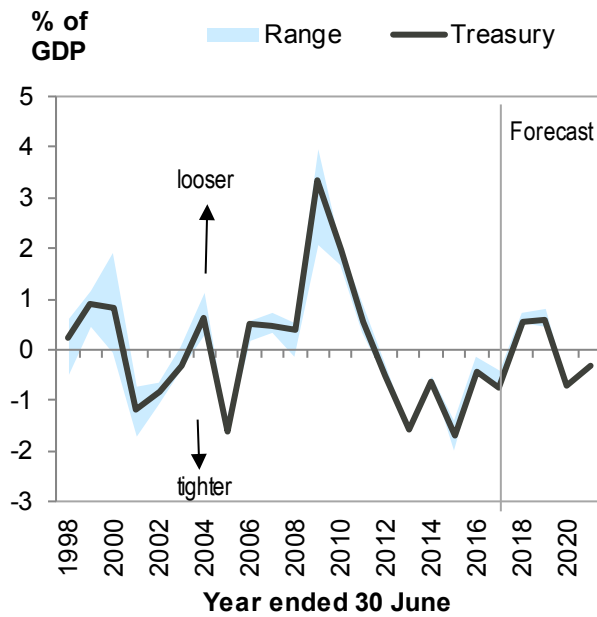
Source: The Treasury

Figure 5 – Cyclically-adjusted balance range



Source: The Treasury

Figure 6 – Core Crown fiscal impulse range



Source: The Treasury

Terms of Trade Adjustment

The Treasury produces regular estimates of the terms of trade effect on the budget balance following the methodology outlined in Treasury Working Paper 10/08.⁴

Estimating the terms of trade effect requires calculating the approximate amount of tax revenue that is attributable to deviations in the terms of trade from its specified structural, or long-run, level.

The terms of trade are expected to remain broadly flat across the forecast period at a relatively high level compared to historical averages, with modest increases in both world export and import prices forecast. The terms of trade for the September 2017 quarter is estimated to be approximately 21% higher than the 30-year average and is forecast to be 19% higher at the end of the forecast period. Adjusting the CAB for historical averages of the terms of trade shows how the underlying fiscal position may vary under different assumptions (ie, scenarios) from the central forecast estimates. The terms of trade sensitivity analysis is used to help make judgements about the fiscal position from a medium-term perspective, without compromising the forecasts' role of presenting the most likely near-term outcome.

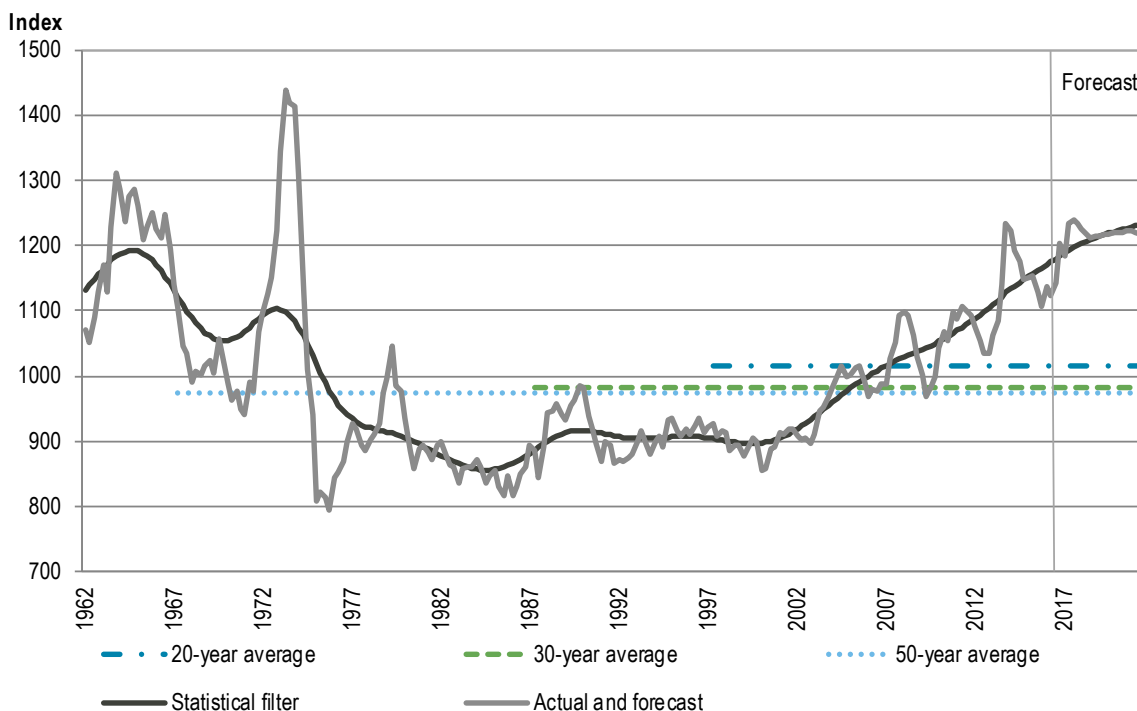
Figure 7 shows New Zealand's terms of trade with historical average levels (50-, 30- and 20-year averages) and a time-varying trend using a statistical filter.⁵ The historical average and trend estimates are used as estimates of the structural level of the terms of trade. Using the statistical filter runs the risk of interpreting long cycles as structural shifts in real time, whereas using an historical average suffers from the opposite risk.

A terms of trade adjustment for each alternative assumption is reported in Table 17. The CAB with a terms of trade adjustment using the 30-year average is plotted in Figure 8. Using the 30-year average suggests a structural budget deficit of 0.7% of GDP for the 2016/17 fiscal year, relative to the 2.2% of GDP structural surplus estimated using the central terms of trade estimates. Alternatively, a terms of trade adjustment using a statistical filter, which smoothes out fluctuations around a time-varying trend, suggests a structural surplus of 2.1% of GDP in 2016/17.

⁴ Oscar Parkyn (2010) "Estimating New Zealand's Structural Budget Balance." New Zealand Treasury Working Paper 10/08 <http://www.treasury.govt.nz/publications/research-policy/wp/2010/10-08/>

⁵ A Hodrick-Prescott filter is used on quarterly data with a smoothing parameter of 1600.

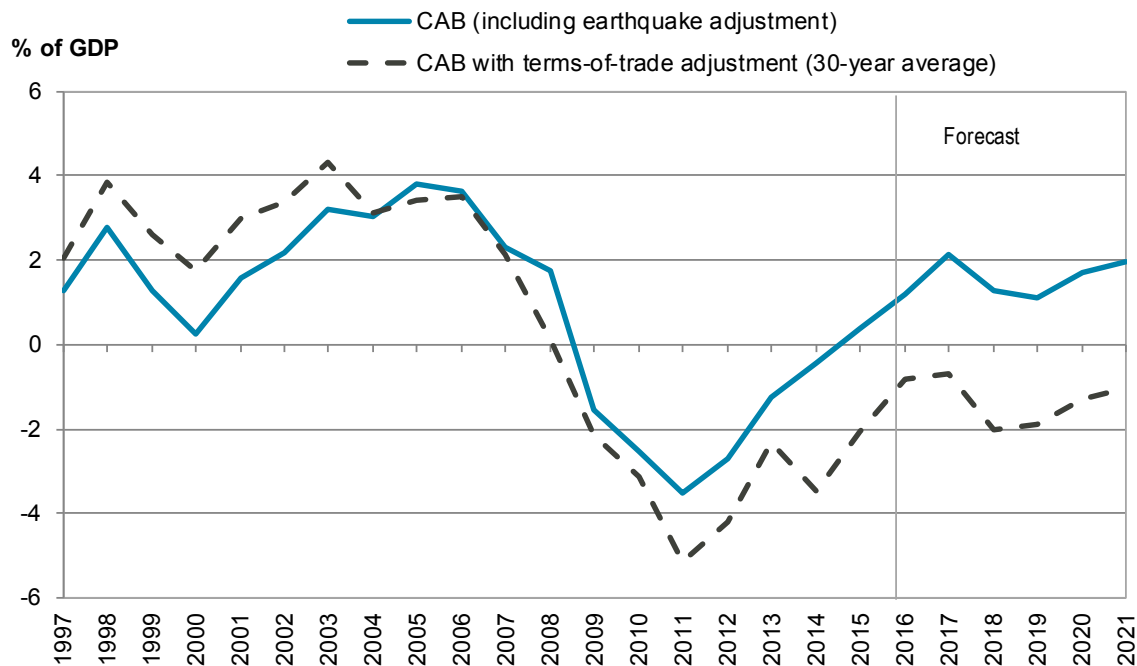
Figure 7 – Terms of trade with historical average and time-varying trend



Sources: Stats NZ, the Treasury

Note: Due to data availability, this uses the goods and services terms of trade spliced with the goods terms of trade for the period prior to 1987.

Figure 8 – Cyclically-adjusted balance with terms of trade adjustment



Source: The Treasury

Data Tables for Summary Fiscal Indicators

Table 11 – Central estimates of output gap, cyclically-adjusted balance and fiscal impulse (% of GDP)

| June year | Output gap | OBEGAL | OBEGAL excl earthquake expenses | CAB | Fiscal impulse (core Crown) | Fiscal impulse (core Crown plus Crown entity) | Fiscal impulse (core Crown plus CE) excluding EQC & Southern Response payouts |
|-----------|------------|--------|---------------------------------|------|-----------------------------|---|---|
| 1997 | 0.8 | 1.8 | - | 1.3 | 2.3 | - | - |
| 1998 | -0.9 | 2.2 | - | 2.8 | 0.2 | - | - |
| 1999 | -2.1 | 0.1 | - | 1.3 | 0.9 | - | - |
| 2000 | 0.5 | 0.5 | - | 0.2 | 0.8 | - | - |
| 2001 | -0.7 | 1.2 | - | 1.6 | -1.2 | - | - |
| 2002 | -0.5 | 1.9 | - | 2.2 | -0.8 | - | - |
| 2003 | 0.0 | 3.2 | - | 3.2 | -0.3 | -0.7 | -0.7 |
| 2004 | 1.2 | 3.8 | - | 3.1 | 0.6 | 0.3 | 0.3 |
| 2005 | 1.2 | 4.5 | - | 3.8 | -1.6 | -1.5 | -1.5 |
| 2006 | 1.1 | 4.3 | - | 3.6 | 0.5 | 0.8 | 0.8 |
| 2007 | 1.7 | 3.3 | - | 2.3 | 0.5 | 0.5 | 0.5 |
| 2008 | 2.1 | 3.0 | - | 1.8 | 0.4 | 0.6 | 0.6 |
| 2009 | -1.0 | -2.1 | - | -1.5 | 3.3 | 3.4 | 3.4 |
| 2010 | -1.4 | -3.2 | - | -2.5 | 2.0 | 1.7 | 1.7 |
| 2011 | -1.9 | -8.9 | -4.5 | -3.5 | 0.5 | 0.8 | 0.3 |
| 2012 | -1.4 | -4.3 | -3.4 | -2.7 | -0.5 | -0.1 | -0.7 |
| 2013 | -1.2 | -2.0 | -1.9 | -1.3 | -1.6 | -2.6 | -1.6 |
| 2014 | -1.2 | -1.2 | -1.1 | -0.4 | -0.6 | -0.4 | -0.6 |
| 2015 | -0.5 | 0.2 | 0.1 | 0.4 | -1.7 | -0.5 | -0.9 |
| 2016 | -0.4 | 0.7 | 1.0 | 1.2 | -0.4 | -0.5 | -0.2 |
| 2017 | -0.5 | 1.4 | 1.9 | 2.2 | -0.7 | -0.5 | -0.6 |
| 2018 | -0.2 | 1.0 | 1.1 | 1.3 | 0.6 | 1.0 | 1.0 |
| 2019 | 0.3 | 1.2 | 1.3 | 1.1 | 0.6 | 0.3 | 0.6 |
| 2020 | 0.3 | 1.9 | 1.9 | 1.7 | -0.7 | -1.2 | -1.1 |
| 2021 | 0.1 | 2.0 | 2.0 | 2.0 | -0.3 | -0.4 | -0.4 |

Source: The Treasury

Table 12 – Sources for alternative output gaps

| Institution | Source | Publication date |
|--------------|---|------------------|
| The Treasury | Pre-Election Economic and Fiscal Update | August 2017 |
| RBNZ | Monetary Policy Statement | August 2017 |
| IMF | World Economic Outlook | April 2017 |
| OECD | Economic Outlook | June 2017 |

Table 13 – Elasticity values used in sensitivity analysis

| Elasticities | Base case | Low | High |
|---------------------------------|-----------|-----|------|
| Individual income tax | 1.2 | 0.6 | 2.5 |
| Company tax | 2.4 | 1.2 | 4.8 |
| GST | 1.0 | 0.5 | 2.0 |
| Excise duties | 1.3 | 0.7 | 2.6 |
| Other indirect tax | 1.0 | 0.5 | 2.0 |
| Interest, profits and dividends | 0.0 | 0.0 | 0.0 |
| Other receipts | 1.0 | 0.5 | 2.0 |

Source: The Treasury

Table 14 – Output gap estimates used in sensitivity analysis (% of potential GDP)

| June year | The Treasury | RBNZ | IMF | OECD |
|-----------|--------------|------|------|------|
| 1997 | 0.8 | - | 1.6 | 1.4 |
| 1998 | -0.9 | - | -0.3 | 0.0 |
| 1999 | -2.1 | - | -1.2 | -0.6 |
| 2000 | 0.5 | 0.5 | -0.3 | 0.3 |
| 2001 | -0.7 | -0.9 | -0.6 | 0.0 |
| 2002 | -0.5 | -0.3 | -0.9 | 0.1 |
| 2003 | 0.0 | 0.4 | -0.4 | 1.3 |
| 2004 | 1.2 | 1.9 | 0.1 | 2.2 |
| 2005 | 1.2 | 1.7 | 0.6 | 2.0 |
| 2006 | 1.1 | 1.5 | 0.7 | 1.4 |
| 2007 | 1.7 | 2.0 | 1.5 | 1.8 |
| 2008 | 2.1 | 1.9 | 1.5 | 1.0 |
| 2009 | -1.0 | -1.4 | -0.5 | -1.1 |
| 2010 | -1.4 | -1.9 | -1.6 | -1.5 |
| 2011 | -1.9 | -2.1 | -1.3 | -1.3 |
| 2012 | -1.4 | -1.2 | -0.9 | -1.0 |
| 2013 | -1.2 | -0.9 | -0.8 | -0.8 |
| 2014 | -1.2 | -0.7 | -0.5 | -0.8 |
| 2015 | -0.5 | 0.0 | -0.4 | -0.5 |
| 2016 | -0.4 | 0.1 | -0.3 | 0.2 |
| 2017 | -0.5 | 0.1 | 0.1 | 0.8 |
| 2018 | -0.2 | 0.6 | 0.6 | 1.0 |
| 2019 | 0.3 | 1.3 | - | - |
| 2020 | 0.3 | 1.2 | - | - |
| 2021 | 0.1 | - | - | - |

Sources: The Treasury, RBNZ, IMF, OECD

Table 15 – Cyclically-adjusted balance with alternative output gap and elasticity values (% of GDP)

| June year | OBEGAL | Baseline CAB | CAB using alternative output gaps | | | CAB using alternative elasticities | |
|-----------|--------|--------------|-----------------------------------|------|------|------------------------------------|------|
| | | | RBNZ | IMF | OECD | Low | High |
| 1997 | 1.8 | 1.3 | - | 0.8 | 1.0 | 1.5 | 0.9 |
| 1998 | 2.2 | 2.8 | - | 2.4 | 2.2 | 2.5 | 3.2 |
| 1999 | 0.1 | 1.3 | - | 0.8 | 0.4 | 0.8 | 2.2 |
| 2000 | 0.5 | 0.2 | 0.2 | 0.7 | 0.4 | 0.4 | 0.0 |
| 2001 | 1.2 | 1.6 | 1.7 | 1.5 | 1.2 | 1.4 | 1.9 |
| 2002 | 1.9 | 2.2 | 2.1 | 2.4 | 1.8 | 2.1 | 2.4 |
| 2003 | 3.2 | 3.2 | 2.9 | 3.5 | 2.4 | 3.2 | 3.2 |
| 2004 | 3.8 | 3.1 | 2.7 | 3.7 | 2.5 | 3.4 | 2.4 |
| 2005 | 4.5 | 3.8 | 3.5 | 4.2 | 3.3 | 4.1 | 3.2 |
| 2006 | 4.3 | 3.6 | 3.4 | 3.9 | 3.5 | 3.9 | 3.0 |
| 2007 | 3.3 | 2.3 | 2.2 | 2.5 | 2.3 | 2.8 | 1.4 |
| 2008 | 3.0 | 1.8 | 1.9 | 2.1 | 2.4 | 2.3 | 0.6 |
| 2009 | -2.1 | -1.5 | -1.3 | -1.8 | -1.5 | -1.8 | -1.0 |
| 2010 | -3.2 | -2.5 | -2.3 | -2.4 | -2.5 | -2.8 | -1.9 |
| 2011 | -8.9 | -3.5 | -3.4 | -3.9 | -3.9 | -4.0 | -2.6 |
| 2012 | -4.3 | -2.7 | -2.8 | -2.9 | -2.9 | -3.0 | -2.0 |
| 2013 | -2.0 | -1.3 | -1.4 | -1.5 | -1.5 | -1.6 | -0.6 |
| 2014 | -1.2 | -0.4 | -0.7 | -0.8 | -0.7 | -0.7 | 0.1 |
| 2015 | 0.2 | 0.4 | 0.3 | 0.5 | 0.6 | 0.3 | 0.6 |
| 2016 | 0.7 | 1.2 | 1.1 | 1.3 | 1.0 | 1.1 | 1.4 |
| 2017 | 1.4 | 2.2 | 2.0 | 2.0 | 1.6 | 2.0 | 2.4 |
| 2018 | 1.0 | 1.3 | 0.9 | 1.0 | 0.7 | 1.2 | 1.4 |
| 2019 | 1.2 | 1.1 | 0.7 | - | - | 1.2 | 0.9 |
| 2020 | 1.9 | 1.7 | 1.4 | - | - | 1.8 | 1.6 |
| 2021 | 2.0 | 2.0 | - | - | - | 2.0 | 1.9 |

Source: The Treasury

Table 16 – Core Crown fiscal impulse with alternative output gap and elasticity values (% of GDP)

| June year | Fiscal impulse | Fiscal impulse using alternative output gaps | | | Fiscal impulse using alternative elasticities | |
|-----------|----------------|--|------|------|---|------|
| | | RBNZ | IMF | OECD | Low | High |
| 1997 | 2.3 | - | 1.9 | 2.8 | 2.2 | 2.4 |
| 1998 | 0.2 | - | 0.2 | 0.4 | 0.6 | -0.5 |
| 1999 | 0.9 | - | 1.0 | 1.2 | 1.1 | 0.4 |
| 2000 | 0.8 | - | -0.1 | -0.1 | 0.3 | 1.9 |
| 2001 | -1.2 | - | -0.7 | -0.7 | -0.9 | -1.7 |
| 2002 | -0.8 | -0.7 | -1.1 | -0.9 | -0.9 | -0.8 |
| 2003 | -0.3 | -0.2 | -0.3 | 0.1 | -0.4 | -0.1 |
| 2004 | 0.6 | 0.7 | 0.3 | 0.4 | 0.4 | 1.1 |
| 2005 | -1.6 | -1.7 | -1.4 | -1.6 | -1.6 | -1.6 |
| 2006 | 0.5 | 0.4 | 0.6 | 0.2 | 0.5 | 0.5 |
| 2007 | 0.5 | 0.4 | 0.6 | 0.4 | 0.3 | 0.7 |
| 2008 | 0.4 | 0.2 | 0.2 | -0.2 | 0.3 | 0.5 |
| 2009 | 3.3 | 3.2 | 3.8 | 3.8 | 4.0 | 2.1 |
| 2010 | 2.0 | 2.0 | 1.7 | 2.0 | 2.0 | 1.8 |
| 2011 | 0.5 | 0.7 | 0.9 | 0.9 | 0.6 | 0.4 |
| 2012 | -0.5 | -0.3 | -0.6 | -0.6 | -0.6 | -0.3 |
| 2013 | -1.6 | -1.5 | -1.6 | -1.6 | -1.6 | -1.5 |
| 2014 | -0.6 | -0.5 | -0.5 | -0.6 | -0.6 | -0.6 |
| 2015 | -1.7 | -1.7 | -2.0 | -1.9 | -1.8 | -1.4 |
| 2016 | -0.4 | -0.4 | -0.4 | -0.1 | -0.4 | -0.4 |
| 2017 | -0.7 | -0.7 | -0.5 | -0.4 | -0.7 | -0.8 |
| 2018 | 0.6 | 0.7 | 0.7 | 0.6 | 0.5 | 0.7 |
| 2019 | 0.6 | 0.6 | - | - | 0.5 | 0.8 |
| 2020 | -0.7 | -0.7 | - | - | -0.7 | -0.7 |
| 2021 | -0.3 | - | - | - | -0.3 | -0.4 |

Source: The Treasury

Table 17 – Terms of trade adjustment to the cyclically-adjusted balance (% of GDP)

| June year | Baseline CAB | Terms-of-trade adjustment (impact on CAB) | | | | CAB with terms-of-trade adjustment | | | |
|-----------|--------------|---|-----------------|-----------------|--------------------|------------------------------------|-----------------|-----------------|--------------------|
| | | 50-year average | 30-year average | 20-year average | Statistical filter | 50-year average | 30-year average | 20-year average | Statistical filter |
| 1997 | 1.3 | 0.7 | 0.8 | 1.2 | -0.3 | 2.0 | 2.1 | 2.5 | 1.0 |
| 1998 | 2.8 | 1.0 | 1.1 | 1.5 | -0.1 | 3.7 | 3.8 | 4.3 | 2.7 |
| 1999 | 1.3 | 1.2 | 1.3 | 1.8 | 0.1 | 2.5 | 2.6 | 3.0 | 1.4 |
| 2000 | 0.2 | 1.4 | 1.5 | 2.0 | 0.3 | 1.7 | 1.8 | 2.2 | 0.5 |
| 2001 | 1.6 | 1.3 | 1.4 | 2.0 | 0.1 | 2.9 | 3.0 | 3.5 | 1.6 |
| 2002 | 2.2 | 1.1 | 1.2 | 1.7 | 0.1 | 3.3 | 3.4 | 3.9 | 2.3 |
| 2003 | 3.2 | 1.0 | 1.1 | 1.6 | 0.4 | 4.2 | 4.3 | 4.8 | 3.6 |
| 2004 | 3.1 | -0.1 | 0.1 | 0.6 | -0.3 | 3.0 | 3.1 | 3.6 | 2.8 |
| 2005 | 3.8 | -0.5 | -0.4 | 0.1 | -0.4 | 3.3 | 3.4 | 3.9 | 3.4 |
| 2006 | 3.6 | -0.2 | -0.1 | 0.4 | 0.1 | 3.4 | 3.5 | 4.0 | 3.8 |
| 2007 | 2.3 | -0.3 | -0.2 | 0.3 | 0.3 | 2.0 | 2.1 | 2.6 | 2.6 |
| 2008 | 1.8 | -1.8 | -1.6 | -1.1 | -0.9 | 0.0 | 0.1 | 0.7 | 0.9 |
| 2009 | -1.5 | -0.8 | -0.6 | 0.0 | 0.4 | -2.3 | -2.1 | -1.5 | -1.2 |
| 2010 | -2.5 | -0.7 | -0.6 | -0.1 | 0.4 | -3.2 | -3.1 | -2.6 | -2.2 |
| 2011 | -3.5 | -1.7 | -1.6 | -1.1 | -0.3 | -5.3 | -5.1 | -4.6 | -3.8 |
| 2012 | -2.7 | -1.6 | -1.5 | -0.9 | 0.1 | -4.3 | -4.2 | -3.6 | -2.6 |
| 2013 | -1.3 | -1.2 | -1.1 | -0.5 | 0.7 | -2.4 | -2.3 | -1.8 | -0.6 |
| 2014 | -0.4 | -3.2 | -3.0 | -2.5 | -0.8 | -3.6 | -3.5 | -2.9 | -1.3 |
| 2015 | 0.4 | -2.6 | -2.4 | -1.9 | -0.1 | -2.2 | -2.0 | -1.5 | 0.3 |
| 2016 | 1.2 | -2.1 | -2.0 | -1.5 | 0.5 | -0.9 | -0.8 | -0.3 | 1.7 |
| 2017 | 2.2 | -3.0 | -2.8 | -2.3 | -0.1 | -0.8 | -0.7 | -0.1 | 2.1 |
| 2018 | 1.3 | -3.4 | -3.3 | -2.8 | -0.3 | -2.2 | -2.0 | -1.5 | 1.0 |
| 2019 | 1.1 | -3.1 | -3.0 | -2.5 | 0.0 | -2.0 | -1.9 | -1.4 | 1.1 |
| 2020 | 1.7 | -3.1 | -3.0 | -2.5 | 0.0 | -1.4 | -1.3 | -0.8 | 1.8 |
| 2021 | 2.0 | -3.2 | -3.0 | -2.5 | 0.1 | -1.2 | -1.1 | -0.5 | 2.1 |

Source: The Treasury

Accounting Policies

The forecast financial statements contained in the published *Pre-Election Economic and Fiscal Update 2017 (Pre-election Update)* are based on the following accounting policies:

Statement of Compliance

These forecast financial statements have been prepared in accordance with the Public Finance Act 1989 and with New Zealand Generally Accepted Accounting Practice (NZ GAAP) as defined in the Financial Reporting Act 2013.

These forecasts have been prepared in accordance with Public Sector PBE Accounting Standards (PBE Standards) – Tier 1. These standards are based on International Public Sector Accounting Standards (IPSAS). The forecast financial statements comply with PBE FRS-42: Prospective Financial Statements and NZ GAAP as it relates to prospective financial statements.

For the purposes of these financial statements, the Government reporting entity has been designated as a public benefit entity (PBE). Public benefit entities (PBEs) are reporting entities whose primary objective is to provide goods or services for community or social benefit and where any equity has been provided with a view to supporting that primary objective rather than for a financial return to equity holders.

The use of public resources by the Government is primarily governed by the Public Finance Act 1989, the State Sector Act 1988, the Crown Entities Act 2004 and the State-owned Enterprises Act 1986.

Reporting and Forecast Period

The reporting periods for these forecast financial statements are the years ended 30 June 2017 to 30 June 2021.

The “2016 Actual” figures reported in the statements are the audited results reported in the Financial Statements of Government for the year ended 30 June 2016. The “2017 Previous Budget” figures are the original forecasts to 30 June 2017 as presented in the 2016 Budget.

Where necessary, the financial information for State-owned Enterprises and Crown entities that have a balance date other than 30 June has been adjusted for any transactions or events that have occurred since their most recent balance date and that are significant for the Financial Statements of the Government. Such entities are primarily in the education sector.

Basis of Preparation

These forecast financial statements have been prepared on the basis of historic cost modified by the revaluation of certain assets and liabilities, and prepared on an accrual basis, unless otherwise specified (for example, the Statement of Cash Flows).

The forecast financial statements are presented in New Zealand dollars rounded to the nearest million, unless separately identified.

Judgements and Estimations

The preparation of these financial statements requires judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, revenue and expenses. For example, the present value of large cash flows that are predicted to occur a long time into the future, as with the settlement of ACC outstanding claim obligations and Government superannuation retirement benefits, depends critically on judgements regarding future cash flows, including inflation assumptions and the risk-free discount rate used to calculate present values.

These forecasts include budget adjustments for new unallocated spending during the year (both operating and capital) and top-down adjustments which reduce the bias for forecast expenditure by departments to reflect maximum spending limits instead of mid-point estimates. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised, if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Where these judgements significantly affect the amounts recognised in the forecast financial statements they are described below.

Reporting Entity

The Government reporting entity as defined in section 2(1) of the Public Finance Act 1989 means:

- the Sovereign in right of New Zealand, and
- the legislative, executive, and judicial branches of the Government of New Zealand.

The description “Consolidated Financial Statements of the Government reporting entity” and the description “Financial Statements of the Government” have the same meaning and can be used interchangeably.

Basis of Combination

These forecast financial statements combine the following entities using the acquisition method of combination:

Core Crown entities

- Ministers of the Crown
- Government departments
- Offices of Parliament
- the Reserve Bank of New Zealand
- New Zealand Superannuation Fund

Other entities

- State-owned Enterprises
- Crown entities (excluding tertiary education institutions)
- Air New Zealand Limited
- Regenerate Christchurch
- Education Council of Aotearoa New Zealand
- Organisations listed in Schedule 4 and 4A (Non-listed companies in which the Crown is majority or sole shareholder) of the Public Finance Act 1989
- Organisations listed in Schedule 5 (Mixed ownership model companies) of the Public Finance Act 1989
- Legal entities listed in Schedule 6 (Legal entities created by Treaty of Waitangi settlement Acts) of the Public Finance Act 1989

The Crown has a full residual interest in all the above entities with the exception of Air New Zealand Limited, Tāmaki Redevelopment Company Limited (listed in Schedule 4A of the Public Finance Act 1989), Regenerate Christchurch and the entities listed in Schedule 5 of the Public Finance Act 1989 (Mixed Ownership Model Companies).

Corresponding assets, liabilities, revenue and expenses, are added together line by line. Transactions and balances between these sub-entities are eliminated on combination. Where necessary, adjustments are made to the financial statements of controlled entities to bring the accounting policies into line with those used by the Government reporting entity.

Tertiary education institutions are equity-accounted for the reasons explained in the note to the Government's financial statements for the period ended 30 June 2016. This treatment recognises these entities' net assets, including asset revaluation movements, surpluses and deficits.

The basis of combination for a joint venture depends on the form of the joint venture.

Significant Accounting Policies

The accounting policies set out below have been applied consistently to all periods in the *Pre-election Update*.

Revenue

Taxation revenue levied through the Crown's sovereign power

The Government provides many services and benefits that do not give rise to revenue. Further, payment of tax does not of itself entitle a taxpayer to an equivalent value of services or benefits, since there is no relationship between paying tax and receiving Crown services and transfers. Such revenue is received through the exercise of the sovereign power of the Crown in Parliament.

Tax revenue is recognised when a taxable event has occurred and the tax revenue can be reliably measured. The taxable event is defined as follows:

| Revenue type | Revenue recognition point |
|--|---|
| Source deductions | When an individual earns income that is subject to PAYE |
| Resident withholding tax (RWT) | When an individual is paid interest or dividends subject to deduction at source |
| Fringe benefit tax (FBT) | When benefits are provided that give rise to FBT |
| Income tax | The earning of assessable income during the taxation period by the taxpayer |
| Goods and services tax (GST) | When the purchase or sale of taxable goods and services occurs during the taxation period |
| Customs and excise duty | When goods become subject to duty |
| Road user charges and motor vehicle fees | When payment of the fee or charge is made |
| Other indirect taxes | When the debt to the Crown arises |
| ACC levies | The levy revenue is earned evenly over the levy period |
| Other levies | When the obligation to pay the levy is incurred |

The New Zealand tax system is predicated on self-assessment where taxpayers are expected to understand the tax laws and comply with them. Inland Revenue has implemented systems and controls (eg, performing audits of taxpayer records) in order to detect and correct situations where taxpayers are not complying with the various acts it administers.

Revenue earned through operations

Revenue from the supply of goods and services to third parties is measured at the fair value of consideration received. Revenue from the supply of goods is recognised when the significant risks and rewards of ownership have been transferred to the buyer. Revenue from the supply of services is recognised on a straight-line basis over the specified period for the services unless an alternative method better represents the stage of completion of the transaction.

Interest revenue

Interest revenue is accrued using the effective interest method.

The effective interest rate exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount. The method applies this rate to the principal outstanding to determine interest revenue each period.

Dividend revenue

Dividend revenue from investments is recognised when the Government's rights as a shareholder to receive payment have been established.

Rental revenue

Rental revenue is recognised in the statement of financial performance on a straight-line basis over the term of the lease. Lease incentives granted are recognised evenly over the term of the lease as a reduction in total rental revenue.

Donated or subsidised assets

Where an asset is acquired for nil or nominal consideration, the fair value of the asset received is recognised as revenue in the statement of financial performance.

If control of the donated assets is conditional on the satisfaction of performance obligations, the revenue is deferred and recognised when the conditions are satisfied.

Gains

Gains may be reported in the Statement of Financial Performance when assets are revalued or liabilities are devalued in certain circumstances as described in the accounting policies for those assets and liabilities. For the purposes of reporting the operating balance before gains and losses (OBEGAL) these gains are excluded from total revenue and presented elsewhere in the Statement of Financial Performance.

Expenses

General

Expenses are recognised in the period to which they relate.

Welfare benefits and entitlements

Welfare benefits and entitlements, including New Zealand Superannuation, are recognised in the period when an application for a benefit has been received and the eligibility criteria have been met.

Grants and subsidies

Where grants and subsidies are at the government's discretion until payment, the expense is recognised when the payment is made. Otherwise, the expense is recognised when the specified criteria for the grant or subsidy have been fulfilled and notice has been given to the government.

Interest expense

Interest expense is accrued using the effective interest method.

The effective interest rate exactly discounts estimated future cash payments through the expected life of the financial liability to that liability's net carrying amount. The method applies this rate to the principal outstanding to determine interest expense each period.

Losses

Losses may be reported in the Statement of Financial Performance when assets are devalued or liabilities are revalued in certain circumstances as described in the accounting policies for those assets and liabilities. For the purposes of reporting the operating balance before gains and losses (OBEGAL) these losses are excluded from total expenses and presented elsewhere in the Statement of Financial Performance.

Foreign currency

Transactions in foreign currencies are initially translated at the foreign exchange rate at the date of the transaction. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the statement of financial performance, except when recognised in the statement of comprehensive revenue and expense when hedge accounting is applied.

Non-monetary assets and liabilities measured at historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies and measured at fair value are translated into New Zealand dollars at the exchange rate applicable at the fair value date. The associated foreign exchange gains or losses follow the fair value gains or losses to either the statement of financial performance or the statement of comprehensive revenue and expense.

Foreign exchange gains and losses arising from translating monetary items that form part of the net investment in a foreign operation are reported in a translation reserve in net worth and recognised in the statement of comprehensive revenue and expense.

Sovereign receivables and taxes repayable

Receivables from taxes, levies and fines (and any penalties associated with these activities) as well as social benefit receivables which do not arise out of a contract are collectively referred to as sovereign receivables.

Receivables arising from sovereign revenue will be initially recognised at fair value. These receivables are subsequently adjusted for penalties and interest as they are charged, and tested for impairment. Interest and penalties charged on tax receivables are presented as tax revenue in the statement of financial performance.

Taxes repayable represent refunds due to taxpayers and are recognised at their nominal value. They are subsequently adjusted for interest once account and refund reviews are complete.

Financial Instruments – forecasting policies

For forecast purposes sales and purchases of bonds and other liquid instruments are assumed to be issued at par value, with no discounts or premiums forecasted. Generally, financial assets and financial liabilities held at the forecast reference date are assumed to be held until they mature.

Forecasts of instruments that have non-market elements (eg, low or no interest rates with long maturities such as student loans or social benefit receivables) include the write-down to fair value when the loan or receivable is forecast to be issued and the revenue from the effective interest unwind.

Interest income and interest expense are recognised using the effective interest rate method (which in most instances will equal the coupon rate for future instruments).

Forecasts use the exchange rates, interest rate curves and electricity pricing curves prevailing at the forecast reference date. As a consequence, no additional realised or unrealised foreign exchange gains or losses are forecast.

Gains and losses reflect long run rate of return assumptions appropriate to the forecast portfolio mix, after adjusting for interest income and interest expense (recognised separately using the effective interest rate method).

Derivatives

Only the value of derivatives as at the forecast reference date are forecast to be realised. No additional realised or unrealised derivative gains or losses are recognised over the forecast period. Forward margins on forward foreign exchange contracts existing at the start of the forecast period are amortised over the period of the contract on a straight line basis.

Forecasts for derivatives only include those that exist at the forecast reference date, and then only to their maturity. That is, by the end of the forecast period only those derivatives existing at the forecast reference date with a maturity beyond the end of the period should be recognised in the financial statements.

Except in limited circumstances, future derivative activity is not included in forecasts. This is because fair value forecasts of future derivatives are assumed to be zero due to forecast exchange rates being fixed at the rate at the forecast reference date, as are interest rate curves and other assumptions (eg, electricity pricing curves) affecting the value of derivatives.

Financial instruments – accounting policies

Non-derivative financial assets

Financial assets are designated into the following categories: loans and receivables at amortised cost, financial assets available-for-sale, financial assets held-for-trading and financial assets designated as fair value through the operating balance. This designation is made by reference to the purpose of the financial instruments, policies and practices for their management, their relationship with other instruments and the reporting costs and benefits associated with each designation.

The maximum loss due to default on any financial asset is the carrying value reported in the statement of financial position.

| Major financial asset type | Designation |
|-----------------------------------|--|
| Trade and other receivables | All designated as loans and receivables at amortised cost |
| Student loans | All designated as loans and receivables at amortised cost |
| Kiwibank mortgages | All designated as loans and receivables at amortised cost |
| Other advances | Generally designated as loans and receivables at amortised cost |
| IMF financial assets | All designated as loans and receivables at amortised cost |
| Share investments | Generally designated as fair value through the operating balance |
| Marketable securities | Generally designated as fair value through the operating balance |
| Long-term deposits | Generally designated as loans and receivables at amortised cost |

Loans and receivables are recognised initially at fair value plus transaction costs and subsequently measured at amortised cost using the effective interest method (refer interest revenue policy). Loans and receivables issued with durations of less than 12 months are recognised at their nominal value, unless the effect of discounting is material. Allowances for estimated irrecoverable amounts are recognised when there is objective evidence that the asset is impaired. Interest, impairment losses and foreign exchange gains and losses are recognised in the statement of financial performance.

Financial assets held-for-trading and financial assets designated at fair value through the operating balance are recorded at fair value with any realised and unrealised gains or losses recognised in the statement of financial performance.

A financial asset is designated at fair value through the operating balance if acquired principally for the purpose of trading in the short term. It may also be designated into this category if the accounting treatment results in more relevant information because it either significantly reduces an accounting mismatch with related liabilities or is part of a group of financial assets that is managed and evaluated on a fair value basis, such as with the NZ Superannuation Fund. Gains or losses from interest, foreign exchange and other fair value movements are separately reported in the statement of financial performance. Transaction costs are expensed as they are incurred.

Available-for-sale financial assets are initially recorded at fair value plus transaction costs. They are subsequently recorded at fair value with any resultant fair value gains or losses recognised in the statement of comprehensive revenue and expense, with some exceptions. Those exceptions are for impairment losses, any interest calculated using the effective interest method and, in the case of monetary items (such as debt securities), foreign exchange gains and losses resulting from translation differences due to changes in amortised cost of the asset. These latter items are recognised in the statement of financial performance. For non-monetary available-for-sale financial assets (eg, some unlisted equity instruments) the fair value movements recognised in the statement of comprehensive revenue and expense include any related foreign exchange component. At derecognition, the cumulative fair value gain or loss previously recognised in the statement of comprehensive revenue and expense, is recognised in the statement of financial performance.

Cash and cash equivalents include cash on hand, cash in transit, bank accounts and deposits with an original maturity of no more than three months.

Fair values of quoted investments are based on market prices. Regular way purchases and sales of all financial assets are accounted for at trade date. If the market for a financial asset is not active, fair values for initial recognition and, where appropriate, subsequent measurement are established by using valuation techniques, as set out in the notes to the financial statements. At each balance date an assessment is made whether there is objective evidence that a financial asset or group of financial assets is impaired.

Non-derivative financial liabilities

Financial liabilities are designated into the following categories: amortised cost, financial liabilities held-for-trading and financial liabilities designated as fair value through the operating balance. This designation is made by reference to the purpose of the financial instruments, policies and practices for their management, their relationship with other instruments and the reporting costs and benefits associated with each designation.

| Major financial liability type | Designation |
|---------------------------------------|--|
| Accounts payable | All designated at amortised cost |
| Government stock | Generally designated at amortised cost |
| Treasury bills | Generally designated at amortised cost |
| Government retail stock | All designated at amortised cost |
| Settlement deposits with Reserve Bank | All designated at amortised cost |
| Issued currency | Not designated: Recognised at face value |

Financial liabilities held-for-trading and financial liabilities designated at fair value through the operating balance are recorded at fair value with any realised and unrealised gains or losses recognised in the statement of financial performance. A financial liability is designated at fair value through the operating balance if acquired principally for the purpose of trading in the short term. It may also be designated into this category if the accounting treatment results in more relevant information because it either eliminates or significantly reduces an accounting mismatch with related assets or is part of a group of financial liabilities that is managed and evaluated on a fair value basis. Gains or losses from interest, foreign exchange and other fair value movements are separately reported in the statement of financial performance. Transaction costs are expensed as they are incurred.

Other financial liabilities are recognised initially at fair value less transaction costs and are subsequently measured at amortised cost using the effective interest method. Financial liabilities entered into with durations of less than 12 months are recognised at their nominal value. Amortisation and, in the case of monetary items, foreign exchange gains and losses, are recognised in the statement of financial performance as is any gain or loss when the liability is derecognised.

Currency issued for circulation, including demonetised currency after 1 July 2004, is recognised at face value. Currency issued represents a liability in favour of the holder.

Derivative financial instruments

Derivative financial instruments are recognised both initially and subsequently at fair value. They are reported as either assets or liabilities depending on whether the derivative is in a net gain or net loss position respectively. Recognition of the movements in the value of derivatives depends on whether the derivative is designated as a hedging instrument and, if so, the nature of the item being hedged (see Hedging section below).

Derivatives that are not designated for hedge accounting are classified as held-for-trading financial instruments with fair value gains or losses recognised in the statement of financial performance. Such derivatives may be entered into for risk management purposes, although not formally designated for hedge accounting, or for tactical trading.

Hedging

Individual entities consolidated within the Government reporting entity apply hedge accounting after considering the costs and benefits of adopting hedge accounting, including:

- whether an economic hedge exists and the effectiveness of that hedge
- whether the hedge accounting qualifications could be met, and
- the extent to which it would improve the relevance of reported results.

(a) Cash flow hedge

Where a derivative qualifies as a hedge of variability in asset or liability cash flows (cash flow hedge), the effective portion of any gain or loss on the derivative is recognised in the statement of comprehensive revenue and expense and the ineffective portion is recognised in the statement of financial performance. Where the hedge of a forecast transaction subsequently results in the recognition of a non-financial asset or non-financial liability (eg, where the hedge relates to the purchase of an asset in a foreign currency), the amount recognised in the statement of comprehensive revenue and expense is included in the initial cost of the asset or liability. Otherwise, gains or losses recognised in the statement of comprehensive revenue and expense transfer to the statement of financial performance in the same period as when the hedged item affects the statement of financial performance (eg, when the forecast sale occurs). Effective portions of the hedge are recognised in the same area of the statement of financial performance as the hedged item.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in net worth at that time remains in net worth and is recognised when the forecast transaction is ultimately recognised in the statement of financial performance. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in the statement of comprehensive revenue and expense is transferred to the statement of financial performance.

(b) Fair value hedge

Where a derivative qualifies as a hedge of the exposure to changes in fair value of an asset or liability (fair value hedge) any gain or loss on the derivative is recognised in the statement of financial performance together with any changes in the fair value of the hedged asset or liability. The carrying amount of the hedged item is adjusted by the fair value gain or loss on the hedged item in respect of the risk being hedged.

Inventories

Inventories are recorded at the lower of cost (calculated using a weighted average method) and net realisable value. Inventories held for distribution for public benefit purposes are recorded at cost adjusted where applicable for any loss of service potential. Where inventories are acquired at no cost, or for nominal consideration, their cost is deemed to be fair value, usually determined through an assessment of current replacement cost at the date of acquisition.

Inventories include unissued currency and harvested agricultural produce (eg, logs, wool). The cost of harvested agricultural produce is measured at fair value less estimated costs to sell at the point of harvest.

Property, plant and equipment – forecasting policy

Forecasts of the value of property, plant and equipment (PPE) (including state highways and rail infrastructure) use the valuations recorded in the Financial Statements of the Government for the prior year and any additional valuations that have occurred up to the forecast preparation date. As a consequence, no further realised or unrealised gains or losses are forecast for the entire forecast period.

Property, plant and equipment – accounting policies

Measurement on initial recognition

Items of PPE are initially recorded at cost. Cost may include transfers from net worth of any gains or losses on qualifying cash flow hedges of foreign currency purchases of PPE. Where an asset is acquired for nil or nominal consideration the asset is recognised initially at fair value, where fair value can be reliably determined, as revenue in the statement of financial performance.

Capitalisation of borrowing costs

Generally, Government borrowings are not directly attributable to individual assets. Therefore, borrowing costs incurred during the period, including any that could be allocated as a cost of completing and preparing assets for their intended use are expensed rather than capitalised.

Subsequent measurement

Subsequent to initial recognition, classes of PPE are accounted for as set out below.

Revaluations are carried out for a number of classes of PPE to reflect the service potential or economic benefit obtained through control of the asset. Revaluation is based on the fair value of the asset, with changes reported by class of asset.

| Class of PPE | Accounting policy |
|--|--|
| Land and buildings | <p>Land and buildings are recorded at fair value and, for buildings, less depreciation accumulated since the assets were last revalued.</p> <p>Land associated with the rail network and state highways is valued using an estimate based on adjacent use, as an approximation to fair value.</p> <p>Valuations undertaken in accordance with standards issued by the New Zealand Property Institute are used where applicable.</p> <p>Otherwise, valuations conducted in accordance with the Rating Valuation Act 1998, may be used if they have been confirmed as appropriate by an independent valuer.</p> <p>When revaluing buildings, there must be componentisation to the level required to ensure adequate representation of the material components of the buildings. At a minimum, this requires componentisation to three levels: structure, building services and fit-out.</p> |
| Specialist military equipment | <p>Specialist military equipment is recorded on a depreciated replacement cost basis less depreciation accumulated since the assets were last revalued.</p> <p>Valuations are obtained through specialist assessment by New Zealand Defence Force advisers, and the basis for the valuation is confirmed as appropriate by an independent valuer.</p> |
| State highways | <p>State highways are recorded on a depreciated replacement cost basis less depreciation accumulated since the assets were last revalued.</p> |
| Rail network | <p>Rail infrastructure used for freight services (freight only and dual use lines required for freight operations) are recorded at fair value less depreciation accumulated since the assets were last revalued. Rail infrastructure not required for freight operations and used for metro services is recorded on a depreciated replacement cost basis less depreciation accumulated since the assets were last revalued.</p> |
| Aircraft | <p>Aircraft (excluding specialised military equipment) are recorded at fair value less depreciation accumulated since the assets were last revalued.</p> |
| Electricity distribution | <p>Electricity distribution network assets are recorded at cost, less depreciation and impairment losses accumulated since the assets were purchased.</p> |
| Electricity generation | <p>Electricity generation assets are recorded at fair value less depreciation accumulated since the assets were last revalued.</p> |
| Specified cultural and heritage assets | <p>Specified cultural and heritage assets comprise national parks, conservation areas and related recreational facilities, as well as National Archives holdings and the collections of the National Library, Parliamentary Library and Te Papa. Of these, non-land assets are recorded at fair value less subsequent impairment losses. Assets are not reported with a financial value in cases where they are not realistically able to be reproduced or replaced, and where no market exists to provide a valuation. For example, Crown research institutes own various collections, library resources and databases that are an integral part of the research work they undertake. These collections are highly specialised and there is no reliable basis for establishing a valuation. They have therefore not been valued for financial reporting purposes.</p> |
| Other plant and equipment | <p>Other plant and equipment, which includes motor vehicles and office equipment, are recorded at cost less depreciation and impairment losses accumulated since the assets were purchased.</p> |

Revaluation

Classes of PPE that are revalued are revalued at least every five years or whenever the carrying amount differs materially to fair value.

Items of PPE are revalued to fair value for the highest and best use of the item on the basis of the market value of the item, or on the basis of market evidence, such as discounted cash flow calculations. If no market evidence of fair value exists, an optimised depreciated replacement cost approach is used as the best proxy for fair value. Where an item of PPE is recorded at its optimised depreciated replacement cost, this cost is based on the estimated present cost of constructing the existing item of PPE by the most appropriate method of construction, less allowances for physical deterioration and optimisation for obsolescence and relevant surplus capacity. Where an item of PPE is recorded at its optimised depreciated replacement cost, the cost does not include any borrowing costs.

When an item of property, plant and equipment is revalued, any accumulated depreciation at the date of revaluation is eliminated against the gross carrying amount of the asset and the net amount restated to the revalued amount of the asset.

Unrealised gains and losses arising from changes in the value of PPE are recognised as at balance date. To the extent that a gain reverses a loss previously charged to the statement of financial performance for the asset class, the gain is credited to the statement of financial performance. Otherwise, gains are added to an asset revaluation reserve for that class of asset. To the extent that there is a balance in the asset revaluation reserve for the asset class, any loss is deducted from that reserve. Otherwise, losses are reported in the statement of financial performance.

Depreciation

Depreciation is charged on a straight-line basis at rates calculated to allocate the cost or valuation of an item of PPE, less any estimated residual value, over its remaining useful life. Typically, the estimated useful lives of different classes of PPE are as follows:

| Class of PPE | Estimated useful lives |
|-------------------------------------|-------------------------------|
| Buildings | 25 to 150 years |
| Specialist military equipment (SME) | 5 to 55 years |
| State highways: | |
| Pavement (surfacing) | 7 years |
| Pavement (other) | 50 years |
| Bridges | 70 to 105 years |
| Rail Network: | |
| Track and ballast | 40 to 50 years |
| Tunnels and bridges | 75 to 200 years |
| Overhead traction and signalling | 15 to 80 years |
| Aircraft (excluding SME) | 10 to 20 years |
| Electricity distribution network | 2 to 80 years |
| Electricity generation assets | 25 to 100 years |
| Other plant and equipment | 3 to 30 years |

Specified heritage and cultural assets are generally not depreciated.

Impairment

For assets held at cost, where an asset's recoverable amount is less than its carrying amount, it is reported at its recoverable amount and an impairment loss is recognised. The main reason for holding some assets (for example, electricity generation assets) is to generate cash. For these assets the recoverable amount is the higher of the amount that could be recovered by sale (after deducting the costs of sale) or the amount that will be generated by using the asset through its useful life. Some assets do not generate cash (for example, state highways) and for those assets, depreciated replacement cost is used. Losses resulting from impairment are reported in the statement of financial performance, unless the asset is carried at a revalued amount in which case any impairment loss is treated as a revaluation decrease.

Disposal

Realised gains and losses arising from disposal of PPE are generally recognised in the statement of financial performance when the significant risks and rewards of ownership of the asset have transferred to the acquirer. Any balance attributable to the disposed asset in the asset revaluation reserve is transferred to taxpayer funds.

Public private partnerships

A public private partnership (also known as a service concession arrangement) is an arrangement between the Government and a private sector partner in which the private sector partner uses specified assets to supply a public service on behalf of the Government for a specified period of time and is compensated for its services over the period of the arrangement. The costs of the specified assets are financed by the private sector partner, except where existing assets of the Government (generally land) are allocated to the arrangement. Payments made by the Government to a private sector partner over the period of a service concession arrangement cover the costs of the provision of services, interest expenses and repayment of the liability incurred to acquire the specified assets.

The assets in a public private partnership are recognised as assets of the Government. If the assets are progressively constructed, the Government progressively recognises work-in-progress at cost and a financial liability of the same value is also recognised. When the assets are fully constructed, the total asset cost and the matching financial liability reflect the value of the future compensation to be provided to the private-sector partner for the assets.

Subsequent to initial recognition:

- the assets are accounted for in accordance with the accounting policy applicable to the classes of property, plant and equipment that the specified assets comprise, and
- the financial liabilities are measured at amortised cost.

Equity accounted investments

NZ GAAP determines the combination bases for entities that make up the Government reporting entity and is used by public benefit entities to determine whether they control another entity.

However, NZ GAAP is not clear about how the definitions of control and significant influence should be applied in some circumstances in the public sector, for example, where legislation provides public sector entities with statutory autonomy and independence, in particular with Tertiary Education Institutions. Treasury's view is that because the Government cannot

determine their operating and financing policies, but does have a number of powers in relation to these entities, it is appropriate to treat them as associates.

Biological assets

Biological assets (eg, trees and sheep) managed for harvesting into agricultural produce (eg, logs and wool) or for transforming into additional biological assets are measured at fair value less estimated costs to sell, with any realised and unrealised gains or losses reported in the statement of financial performance. Where fair value cannot be reliably determined, the asset is recorded at cost less accumulated depreciation and accumulated impairment losses. For commercial forests, fair value takes into account age, quality of timber and the forest management plan.

Biological assets managed for harvesting into agricultural produce, or being transformed into additional biological assets are reported as other assets. Other biological assets are recorded as other property, plant and equipment in accordance with the policies for property, plant and equipment.

Intangible assets

Intangible assets are initially recorded at cost.

The cost of an internally generated intangible asset represents expenditure incurred in the development phase of the asset only. The development phase occurs after the following can be demonstrated: technical feasibility; ability to complete the asset; intention and ability to sell or use; and development expenditure can be reliably measured. Research is “original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding”. Expenditure incurred on the research phase of an internally generated intangible asset is expensed when it is incurred. Where the research phase cannot be distinguished from the development phase, the expenditure is expensed when incurred.

Where an intangible asset with a market value is internally generated for nil or nominal consideration it is initially reported at cost, which by definition is nil/nominal.

The Government’s holdings of assigned amount units arising from the Kyoto protocol are reported at fair value. Other intangible assets with finite lives are subsequently recorded at cost less any amortisation and impairment losses. Amortisation is charged to the statement of financial performance on a straight-line basis over the useful life of the asset. Typically, the estimated useful life of computer software is three to five years.

Intangible assets with indefinite useful lives are not amortised, but are tested at least annually for impairment.

Realised gains and losses arising from disposal of intangible assets are recognised in the statement of financial performance when the significant risks and rewards of ownership have transferred to the acquirer.

Intangible assets with finite lives are reviewed at least annually to determine if there is any indication of impairment. Where an intangible asset’s recoverable amount is less than its carrying amount, it is reported at its recoverable amount and an impairment loss is recognised. Losses resulting from impairment are reported in the statement of financial performance.

Goodwill is tested for impairment annually.

Non-current assets held for sale and discontinued operations

Non-current assets or disposal groups are separately classified where their carrying amount will be recovered through a sale transaction rather than continuing use; that is, where such assets are available for immediate sale and where sale is highly probable. Non-current assets held for sale, or disposal groups, are recorded at the lower of their carrying amount and fair value less costs to sell.

Investment property

Investment property is property held primarily to earn rentals or for capital appreciation or both. It does not include property held primarily for strategic purposes or to provide a social service (eg, affordable housing) even though such property may earn rentals or appreciate in value – such property is reported as property, plant and equipment.

Investment properties are measured at fair value. Gains or losses arising from fair value changes are included in the statement of financial performance. Valuations are undertaken in accordance with standards issued by the New Zealand Property Institute.

Employee benefits

Pension liabilities

Obligations for contributions to defined contribution retirement plans are recognised in the statement of financial performance as they fall due. Obligations for defined benefit retirement plans are recorded at the latest actuarial value of the Crown liability. All movements in the liability, including actuarial gains and losses, are recognised in full in the statement of financial performance in the period in which they occur.

Other employee entitlements

Employee entitlements to salaries and wages, annual leave, long service leave, retiring leave and other similar benefits are recognised in the statement of financial performance when they accrue to employees. Employee entitlements to be settled within 12 months are reported at the amount expected to be paid. The liability for long-term employee entitlements is reported as the present value of the estimated future cash outflows.

Termination benefits

Termination benefits are recognised in the statement of financial performance only when there is a demonstrable commitment to either terminate employment prior to normal retirement date or to provide such benefits as a result of an offer to encourage voluntary redundancy. Termination benefits settled within 12 months are reported at the amount expected to be paid, otherwise they are reported as the present value of the estimated future cash outflows.

Insurance contracts

The future cost of outstanding insurance claims liabilities are valued based on the latest actuarial information. The estimate includes estimated payments associated with claims reported and accepted, claims incurred but not reported, claims that may be re-opened, and the costs of managing these claims. Movements of the claims liabilities are reflected in the statement of financial performance. Financial assets backing these liabilities are designated at fair value through the operating balance.

Reinsurance

Premiums paid to reinsurers are recognised as reinsurance expense in the statement of financial performance. Premiums are measured from the attachment date over the period of indemnity of the reinsurance contract, in accordance with the expected pattern of the incidence of risk. Prepaid reinsurance premiums are included in prepayments in the statement of financial position.

Reinsurance and other recoveries receivable

Reinsurance and other recoveries receivable on paid claims and outstanding claims, are recognised as revenue in the statement of financial performance.

Recoveries receivable are assessed in a manner similar to the assessment of outstanding claims and are measured as the present value of the expected future receipts.

Leases

Finance leases transfer, to the Crown as lessee, substantially all the risks and rewards incident on the ownership of a leased asset. Initial recognition of a finance lease results in an asset and liability being recognised at amounts equal to the lower of the fair value of the leased property or the present value of the minimum lease payments. The capitalised values are amortised over the period in which the Crown expects to receive benefits from their use.

Operating leases, where the lessor substantially retains the risks and rewards of ownership, are recognised in a systematic manner over the term of the lease. Leasehold improvements are capitalised and the cost is amortised over the unexpired period of the lease or the estimated useful life of the improvements, whichever is shorter. Lease incentives received are recognised evenly over the term of the lease as a reduction in rental expense.

Other liabilities and provisions

Other liabilities and provisions are recorded at the best estimate of the expenditure required to settle the obligation. Liabilities and provisions to be settled beyond 12 months are recorded at the present value of their estimated future cash outflows.

Contingent liabilities and contingent assets

Contingent liabilities and contingent assets are reported at the point at which the contingency is evident or when a present liability is unable to be measured with sufficient reliability to be recorded in the financial statements (unquantifiable liability). Contingent liabilities, including unquantifiable liabilities, are disclosed if the possibility that they will crystallise is more than remote. Contingent assets are disclosed if it is probable that the benefits will be realised.

Commitments

Commitments are future expenses and liabilities to be incurred on contracts that have been entered into at balance date.

Commitments are classified as:

- Capital commitments: aggregate amount of capital expenditure contracted for but not recognised as paid or provided for at balance date.
- Lease commitments: non-cancellable operating leases with a lease term exceeding one year.

Cancellable commitments that have penalty or exit costs explicit in the agreement on exercising the option to cancel are reported at the value of those penalty or exit costs (ie, the minimum future payments).

Interest commitments on debts, commitments for funding, and commitments relating to employment contracts are not separately reported as commitments.

Comparatives

When presentation or classification of items in the financial statements is amended or accounting policies are changed voluntarily, comparative figures have been restated to ensure consistency with the current period unless it is impracticable to do so.

Comparatives referred to as Previous Budget were forecasts published in the 2016 Budget Economic and Fiscal Update.

Segment analysis

The Government reporting entity is not required to provide segment reporting as it is a public benefit entity. Nevertheless, information is presented for material institutional components and major economic activities within or undertaken by the Government reporting entity. The three major institutional components of the Crown are:

- **Core Crown:** This group, which includes Ministers, government departments, Offices of Parliament, the Reserve Bank of New Zealand and the New Zealand Superannuation Fund most closely represents the budget sector and provides information that is useful for fiscal analysis purposes. Investments in Crown entities and SOEs are reported at historic cost with no impairment. This ensures losses in those entities are reflected in the appropriate segment.
- **Crown entities:** This group includes entities governed by the Crown Entities Act 2004. These entities have separate legal form and specified governance frameworks (including the degree to which each Crown entity is required to give effect to, or be independent of, government policy).
- **State-owned Enterprises:** This group includes entities governed by the State-owned Enterprises Act 1986, and (for the purposes of these statements) also includes Air New Zealand, Mighty River Power (now Mercury NZ Limited), Meridian Energy and Genesis Energy. This group represents entities that undertake commercial activity.

Functional analysis is also provided of a number of financial statements items. This functional analysis is drawn from the Classification of the Functions of Government as developed by the Organisation for Economic Co-operation and Development (OECD).