

# The Treasury

## Budget 2020 Information Release

### July 2020

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- [1] 6(a) - to avoid prejudice to the security or defence of New Zealand or the international relations of the government
- [2] 6(b)(i) - to avoid prejudice the entrusting of information to the Government of New Zealand on a basis of confidence by the Government of any other country or any agency of such a Government
- [5] 6(d) - to prevent endangerment of the safety of any person
- [9] 6(e)(iv) - to prevent serious damage to the economy of New Zealand by disclosing prematurely decisions to change or continue government economic or financial policies relating to the stability, control, and adjustment of prices of goods and services, rents, and other costs, and rates of wages, salaries, and other incomes
- [23] 9(2)(a) - to protect the privacy of natural persons, including deceased people
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- [29] 9(2)(d) - to avoid prejudice to the substantial economic interests of New Zealand
- [33] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials
- [34] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions
- [35] 9(2)(g)(ii) - to maintain the effective conduct of public affairs through protecting ministers, members of government organisations, officers and employees from improper pressure or harassment;
- [37] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice
- [38] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice
- [39] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage
- [42] 18(d) - information is already publicly available or will be publicly available soon.

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## Treasury Report: Fiscal Strategy for Budget 2020 (COVID-19 update)

<b>Date:</b>	Friday 27 March 2020	<b>Report No:</b>	T2020/779
		<b>File Number:</b>	MC-1-5-2 (Fiscal strategy)

### Action sought

	Action sought	Deadline
Hon Grant Robertson <b>Minister of Finance</b>  (None)	<b>Agree</b> to recommendations	26 March 2020

### Contact for telephone discussion (if required)

Name	Position	Telephone	1st Contact
Angus Hawkins	Senior Analyst, Macroeconomic and Fiscal Policy	[39]	n/a (mob) ✓
Renee Philip	Manager, Macroeconomic and Fiscal Policy	[23]	

### Minister's Office actions (if required)

**Return** the signed report to Treasury.

Note any  
feedback on  
the quality of  
the report

**Enclosure:** No

# Treasury Report: Fiscal Strategy for Budget 2020 (COVID-19 update)

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## Purpose

1. This report covers the issues normally considered in the Treasury's 'roadcheck' advice before Budget in a more concise format. It touches only on those decisions required for the drafting of the papers to be discussed at Cabinet on 6 April.
2. You are receiving separate advice today which covers your macroeconomic strategy choices in the longer-term. These issues are not discussed in this paper.

## The fiscal strategy

3. COVID-19 requires a change to your fiscal strategy. Our latest economic forecasts, accounting for the move to alert level 4, show output falling substantially and unemployment rising over 10% in the next year. In these circumstances, large deficits are appropriate to cushion the economic impact on workers and businesses during the containment phase. Deficits will also be required to support aggregate demand in the recovery phase, especially as the limits of conventional monetary policy have been reached. Fiscal policy will not be able to offset the shock we face, but will be able to minimise lasting structural damage to the economy by reducing firm failures and job losses.
4. This justifies supportive fiscal policy, and allowing debt to rise substantially, for the duration of the economic shock. **Our current estimate is that net debt will rise to around 36% of GDP by 2021/22 based on already announced policies. The OBEGAL deficit will likely be around 5.7% of GDP (\$17 billion) in 2020/21, before reducing over the remainder of the forecast period.**<sup>1</sup> These estimates are very early, and the fiscal position will likely worsen further, both as the full economic impact becomes clear and additional money is spent in response to COVID-19. Note that this increase in the debt to GDP ratio reflects – in addition to Cabinet decisions – large falls in tax revenue, rising welfare expenditure, and (to a lesser extent) reductions in nominal GDP.
5. Our advice of last week recommended allowing forecast net debt rising to around 50% of GDP before considering if any reduction in the rate of spending is required. This remains a good point to review your approach to fiscal policy, but you should note that forecast net debt may reach this level before the Budget. There is likely space to let public debt increase beyond 50% of GDP, particularly as borrowing costs will likely remain low for a long time, supported by Reserve Bank purchases of government bonds. However, further increases in debt will require careful judgement as to how the remaining fiscal space is used, and how much of a debt buffer is left to allow for future shocks. We will provide further advice on the risks of increasing debt above 50% of GDP.
6. The period of containment and sustained deficits we recommend in the short-run will then transition to two periods with differing fiscal policies, as discussed in prior advice:
  - a A short period of further expansion to support the recovery.
  - b A longer period of consolidation to stabilise (and potentially reduce) debt, and return OBEGAL to surplus.

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<sup>1</sup> This is based on revised economic and tax forecasts as of 25 March; fiscal forecasts as of 17 March, adjusted by the cost of initiatives agreed by Cabinet as of 26 March; and the Treasury's early estimate of the impact of COVID-19 on welfare expenditure. It does not account for any changes in agency, crown entity or state-owned enterprise expenditure or revenue as a result of current events. The economic forecasts are still being revised and will be finalised on 30 March.

7. If you agree to this broad outline of a revised fiscal strategy, there are options as to how much detail you communicate through the Budget, and how you ensure your approach meets the requirements of the Public Finance Act. We will advise further on this next week.

### COVID-19 fund

8. You have indicated your intention to designate a notional fund of \$50 billion to meet COVID-19 expenses, against which already agreed COVID-19 expenses should be counted. The table below summarises the COVID-19 expenses agreed by Cabinet as of 26 March, and their estimated fiscal cost over the forecast period.

Measures	Impact on OBEGAL over the forecast period (\$million)
Funding the Public Health response	500
Expanded Provision of Sick Leave	127
Redeployment package	100
Wage subsidies	12,016
Immediate expensing for low cost assets	667
Business depreciation (industrial and commercial buildings only)	2,140
Increasing threshold for provisional tax	4
Use of money interest (UOMI) remission	no direct fiscal cost
Income support package	2,366
Winter Energy payment	480
Aviation industry relief package (incl. admin costs)	602
Bring forward R&D tax credit refundability	no direct fiscal cost
Remote access to online digital resources	28
<b>Total cost</b>	<b>19,039</b>
<b>Approximate remaining notional fund</b>	<b>30,961</b>

9. Note this table excludes capital expenditure, loans and contingent liabilities. Note also some tax measures have cash costs which will impact net debt, but will not impact OBEGAL. Several measures will also impose an ongoing cost beyond the forecast period, which is not captured in this table.
10. **Adding the remaining \$31 billion of this notional fund to the fiscal position, on the same forecast basis as above, increases net debt to around 46% of GDP in 2021/22.**<sup>2</sup> Debt rising to this level does not present any immediate risks. Debt at these levels is unlikely to prevent market access, though the speed of debt issuance required may raise some immediate challenges. We will have a better sense of this over the coming weeks as we continue to test the market appetite for further bond issuances.
11. However, the estimated increase in debt indicates you may need to decide whether you are comfortable with forecasts of net debt rising above 50% of GDP within the next few weeks. The report you have received alongside this one discusses the further advice we will provide on these issues.
12. Note also that a \$50 billion fund may not be sufficient to continue the current level of fiscal support if alert level 4 persists for a sustained period. The remaining fund would – as an example – only be sufficient to extend the current wage subsidy scheme to around Christmas of this year (at current rates of spending), with no funding remaining

<sup>2</sup> Assuming the remaining fund includes no recurring expenditure, and is spent evenly across the 2019/20 and 2020/21 fiscal years.

for further COVID-19 expenditure. In the event the current alert level continues beyond April, you may wish to change from your current your policy options. However, in any case, if the COVID-19 spending continues at the current rate beyond the 12 weeks agreed by Cabinet, a larger fund may be required, with consequent impacts on debt and the wider balance sheet.

13. **Reflecting the high degree of uncertainty, and to manage the potential need for the fund to last a long period of time, we do not recommend publically communicating the exact size of a fund ahead of Budget 2020.** Announcement of a large fund may create expectations that the money may be spent in full through the initial period of the lockdown, when the fund may in fact have to last for a sustained period of time, including beyond the Budget.
14. The exception would be an announcement to support the Government bond issuance strategy by signalling to the market how much additional borrowing the government is likely to require in the short-term. There are options as to how you communicate this, which we will advise you on in the next week.
15. Note, however, that the size of the fund agreed by Cabinet on April 6 will need to be published in the *Budget Economic and Fiscal Update* in May. After this point, however, you will likely need to increase or decrease this notional fund as the situation develops, and it becomes clearer how long the current rate of spending may need to continue.
16. [33]

### Future allowances

17. Prior advice, before the impacts of COVID-19 became clear, proposed raising future year operating allowances to around \$3 billion per annum on the basis of future cost pressures. We have not reassessed these cost pressures in light of the changed economic environment, but it is likely that some – such as expected wage growth – may fall substantially. This will reduce demand on future allowances. [33,38]
18. Stabilising debt and restoring an OBEGAL surplus following high levels of spending now will also likely require lower operating allowances in the future. This could be achieved either through stricter controls of cost pressures, reductions to current spending programmes, or increasing tax revenue. The exact level of future consolidation that will be required is impossible to know at this stage, and any out-year allowances you set will almost certainly need to be revised.
19. **Given the current uncertainty, we recommend making no change to your out-year operating and capital allowances at Budget 2020.** We recommend signalling in the Budget documents that future allowances are unlikely to remain at these exact levels, and that they will be reviewed at future fiscal events.

### Continuing to monitor the fiscal position

20. Spending decisions are being made rapidly, and it is important to monitor the impacts of these on the fiscal position. We propose we continue to send you our latest estimates of net core crown debt and OBEGAL as they develop. They may change as economic forecasts are refined; new spending decisions are made; the costs of previously agreed policies are reviewed; and the changes in tax revenues and welfare costs clarifies.

21. **We suggest we send you revised figures following any major update of our estimates, or, short of that, at least weekly.** Note that these figures are early estimates that rely on several ad-hoc adjustments and estimates made in the absence of better information. They will be superseded by the Treasury's fiscal forecasts, which will be finalised on 23 April.

## **Recommended Action**

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We recommend that you:

- a **agree** to seek Cabinet's agreement to a notional fund of \$50 billion to meet COVID-19 demands

*Agree/disagree.*

[33]

- c **note** that the required level of this fund is highly uncertain, and it may need to be increased or decreased as the health situation develops

- d **agree** to not publically announce the size of the notional fund before Budget 2020 to limit demands on the fund, except as required to support the government bond programme

*Agree/Disagree*

- e **note** that we will provide you further advice next week on what public communications will be required to support the government bond programme

- f **agree** to leave operating allowances for Budgets 2021 to 2023 and the multiyear capital allowance unchanged, but note in your Budget communications there will be a tight fiscal position after the recovery period.

*Agree/disagree.*

- g **note** that the Treasury will send you updates of our estimates of the net core Crown debt and OBEGAL position at least once a week, or after any major updates to our estimates

Renee Philip  
**Manager, Macroeconomic and Fiscal Policy**

Hon Grant Robertson  
**Minister of Finance**