

The Treasury

Budget 2020 Information Release

July 2020

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Key to sections of the Act under which information has been withheld:

- [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
- [25] 9(2)(b)(ii) - to protect the commercial position of the person who supplied the information or who is the subject of the information
- [26] 9(2)(ba)(i) - to protect information which is subject to an obligation of confidence or which any person has been or could be compelled to provide under the authority of any enactment, where the making available of the information would be likely to prejudice the supply of similar information, or information from the same source, and it is in the public interest that such information should continue to be supplied
- [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.

Where information has been withheld, a numbered reference to the applicable section of the Act has been made, as listed above. For example, a [23] appearing where information has been withheld in a release document refers to section 9(2)(a).

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Treasury Report: COVID-19: Next steps on macroeconomic advice

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|--------------|---------------|---------------------|-----------|
| Date: | 27 March 2020 | Report No: | T2020/784 |
| | | File Number: | MC-1-5-2 |

Action sought

| | Action sought | Deadline |
|----------------------------------------------|-----------------------------------------|----------|
| Hon Grant Robertson (Minister of Finance) | note the contents of this report | None |

Contact for telephone discussion (if required)

| Name | Position | Telephone | 1st Contact |
|---------------|-------------------------------------------------------|-----------|----------------|
| Nathan Spence | 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: COVID-19: Next steps on macroeconomic advice

Purpose of Report

1. This report responds to your request for advice about the broad range of macroeconomic policy options to support the response to COVID-19. It presents advice and signals future work on:
 - a How to use fiscal policy relative to monetary policy.
 - b How much fiscal headroom is available.
 - c How to prioritise the use of fiscal headroom over the COVID-19 containment and post-containment recovery period.
2. We will continue to develop this advice over the coming weeks as the situation develops, we gather more information and have more time to consider the judgements and analysis underlying the advice.

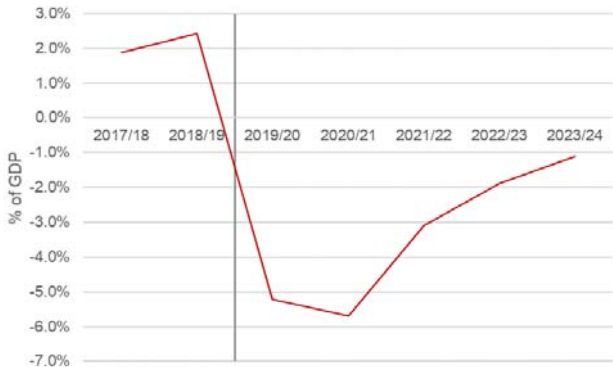
The country is experiencing an enormous economic shock

3. The country is experiencing an enormous economic shock which is unlike anything we have seen before. There is still a great deal of uncertainty about the exact economic and fiscal impacts of COVID-19, however it is clear that we will experience a sharp and large increase in net core Crown debt, increasing to around 36% of GDP by 2021/22, and a significant OBEGAL deficit, decreasing to around -5.7% of GDP by 2021/22 as illustrated by figures 1 and 2.
4. It is important to note that the figures are based on early estimates, 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 (only \$19 billion of the planned \$50 billion contingency is included in these numbers, spending all of the contingency will likely take net debt up to around 46% of GDP in 2021/22).

Figure 1: Net core Crown debt



Figure 2: OBEGAL



Monetary policy should operate freely to ease the burden on fiscal policy

5. Monetary policy and fiscal policy are working in tandem and supporting each other. Ensuring monetary and fiscal policy work together is important as neither tool will be able to fully close the output gap in the near term (it is worth noting that the objective is not to close the output gap while in level 4).
6. The use of alternative monetary policy (AMP) tools does not crowd out your fiscal policy options. At the moment, AMP is playing a crucial role in helping ease the pressure on fiscal policy, such as through easing debt-financing costs by reducing New Zealand Government Bond yields. Monetary policy also has specific benefits that are hard to replicate through fiscal policy, such as the broad easing of credit conditions. That being said, fiscal policy can address some of the problems we currently face such as worker attachment and firm continuity in a way that monetary policy cannot.
7. It is possible that the Bank may seek to use further AMP tools. Delivering on the announcement to purchase \$30 billion of New Zealand government debt is likely the most effective thing the Bank can do in the short-term. Beyond this, they might consider expanding asset purchases to other assets, such as local government debt. As the situation evolves, we will continue to consider the potential effectiveness of AMP tools and advise you in the event that the MPC requests an additional indemnity.
8. The Treasury will also look at what can be done to enhance co-ordination between monetary and fiscal policy. This reflects the likelihood that fiscal policy will become a primary stabilisation tool in future, which would warrant a greater degree of coordination with the Reserve Bank. This could include evaluating the merits of “helicopter money”, which is where the central bank would be directed to directly fund fiscal stimulus (different to the Reserve Bank delivering stimulus directly). Such an option could be considered in extreme events, such as if the Government lost access to debt markets and needed the Reserve Bank to purchase government debt in the primary market.
9. In the longer term, the Treasury will work with the Reserve Bank to explore the options to reduce the constraints on monetary policy. Initially this could mean enabling negative interest rates; in the long-term it could involve considering more radical options such as creating a cost for holding large amounts of cash.

Debt can rise to 50%, above this level further work and evaluation is needed

10. The Treasury recommends expansionary fiscal policy for the duration of the economic shock. We recommend allowing debt to rise substantially, and we expect it will need to rise in excess of 50% of GDP. Last year the Treasury advised that a prudent upper limit for debt is around 50 to 60% of GDP. We recommended this upper limit not because we thought New Zealand would lose access to debt markets but because we considered that the costs would likely outweigh the benefits beyond this level. As a number of important factors that feed into this assessment have changed, we are revisiting this advice.
11. Our initial assessment is that the benefits of well-targeted spending during the containment and recovery phases will outweigh the costs of debt rising above 50% of GDP. Among other factors, this reflects that the economy is likely to be operating well below full potential for some time and that interest rates will be very low. However, given the wide range of risks in going over 50% of GDP, we recommend exercising caution in going above this level. We will provide further advice on the risks of increasing debt above 50% of GDP.

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Prioritise the use of fiscal headroom for the containment period

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14. After subtracting the COVID-19 expenses agreed by Cabinet as of 26 March there is \$31 billion remaining in the contingency. This is a sizeable sum of money to cushion the impact of the containment phase. However, it is likely to be used quickly if there is a long period (say 6 months or more) of moving up and down between containment levels 2-4.
15. We will undertake more work to understand the economic impacts of the public health response under different scenarios. This will inform our advice on the appropriate economic response for different phases of the shock: how spending is allocated between phases, and how spending is targeted to regions and sectors of the economy that are worst affected. It will also allow us to better evaluate the economic costs of extending the time spent in, say, level 4, or moving between levels, to ensure those costs are factored into decisions about the public health response.
16. Spending all of the contingency will likely take net debt up to around 46% of GDP in 2021/22. At this level it is unlikely market access would be affected (though the speed of debt issuance required may raise some immediate challenges), but it would be an appropriate point to review how much further debt should be allowed to rise.
17. [33]
and ensuring new expenditure is time-limited as this will make returning to surplus a lot easier once the economy begins to recover. In addition to *time-limited*, ensuring additional spending is well *targeted* to address the problems faced during the containment and recovery periods will help maximise the impact of the spending.
18. The Treasury is working to identify how much headroom is likely to be used over the containment and post-containment recovery phases. We will provide more detailed advice on this in the coming weeks. The Treasury's very initial assessment is that debt may need to increase by approximately 10 to 20% of GDP to support the post-containment recovery depending on the size of the output gap. We are also refining this assessment.
19. The Treasury will continue tracking spending against fiscal headroom, as well as developing recovery measures that will be appropriate for the different phases of the recovery.
20. Early next week we will send you a slide pack on the wider COVID-19 economic policy response, including how this aligns with the macroeconomic strategy.

Recommended Action

- a **note** that the Treasury views fiscal policy and monetary policy as complementary, and that monetary policy should be used to help ease the pressure on fiscal policy.
- b **note** that the Treasury will look at what can be done to enhance co-ordination between monetary and fiscal policy, and in the longer term will work with the Reserve Bank to explore options to reduce the constraints on monetary policy.
- c **note** that last year the Treasury advised that a prudent upper limit for debt is around 50 to 60% of GDP. This was not because we thought New Zealand would lose access to debt markets but because we considered that the costs would likely outweigh the benefits beyond this level.
- d **note** that given the economy is likely to operate well below potential for a long time, the benefits of a well-designed fiscal stimulus could deliver large benefits to the economy, even if this pushes debt significantly above 50% of GDP. We will provide further advice on this and the risks over going above 50% in the coming weeks.
- e **note** that the Treasury recommends prioritising the planned \$50 billion COVID-19 contingency to cushion the impact of containment, in particular ensuring that households and firms remain solvent as this will make the post-containment recovery a lot easier.
- f **note** that spending all of the planned \$50 billion COVID-19 contingency will likely take net debt up to around 46% of GDP, at this level it would be an appropriate point to review how much further debt should be allowed to rise.
- g [33]

and ensuring new expenditure is
time-limited to make returning to surplus a lot easier once the economy begins to
recover.
- h **note** that the Treasury's very initial assessment is that debt may need to increase by approximately 10 to 20% of GDP to support the post-containment recovery.
- i **note** that early next week we will send you a slide pack on the wider COVID-19 economic policy response, including how this aligns with the macroeconomic strategy.

Renee Philip
Manager, Macroeconomic and Fiscal Policy

Hon Grant Robertson
Minister of Finance