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THE TREASURY

Reference: 20220161

8 June 2022

[redacted]

Dear [redacted]

Thank you for your Official Information Act request, received on 6 May 2022. You requested:

> *copy of any briefing material Treasury sent to external stakeholders to explain the 2nd of May announcement relating the changed balance sheet and borrowing arrangements.*

On 11 May 2022 the request was clarified to

> *a copy of any briefing material Treasury sent to external stakeholders to explain the 3rd of May announcement relating to the new fiscal rules.*

Please find enclosed the following document which was sent to Credit Rating Agencies to communicate the Government's key messages on new fiscal rules ahead of the publication of the Government's Fiscal Strategy Report:

Item	Date	Document Description	Decision
1.	Tuesday, 3 May 2022	Introducing New Fiscal Rules Slide pack	Release in full

Information publicly available

The following information is also covered by your request and is publicly available on the Treasury website:

Item	Date	Document Description	Website Address
2.	Thursday, 5 May 2022	Investor Update	https://debtmanagement.treasury.govt.nz/investor-resources/investor-update
3.	Tuesday, 3 May 2022	Treasury's Media advisory	https://www.treasury.govt.nz/publications/media-advisory/treasury-publishes-

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https://treasury.govt.nz

			summary-its-advice-new-fiscal-rules
4.	Tuesday, 3 May 2022	Treasury's Summary Note	https://www.treasury.govt.nz/publications/guide/treasurys-analysis-and-recommendations-fiscal-rules

Accordingly, I have refused your request for the documents listed in the above table under section 18(d) of the Official Information Act:

- the information requested is or will soon be publicly available.

Please note that this letter (with your personal details removed) and enclosed documents may be published on the Treasury website.

This reply addresses the information you requested. You have the right to ask the Ombudsman to investigate and review my decision.

Yours sincerely

Katy Simpson
Team Leader, Macroeconomic and Fiscal Policy

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Introducing New Fiscal Rules

New Zealand Treasury

3 May 2022

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The Treasury’s Budget 2022 forecasts are under embargo until the Government’s Budget is released on 19 May 2022. This slide pack only references publicly available data, with the most recent Treasury economic and fiscal forecasts from the December 2021 *Half Year Update*.

Key messages

- The New Zealand Government is adopting two new fiscal rules:
  - a rule for the operating balance position before gains and losses (OBEGAL). This will focus on **targeting a small operating surplus over time, as the main fiscal rule.**
  - a **net debt ceiling** that complements the OBEGAL target, while allowing more fiscal space to fund high-quality capital investments that improve productivity and lift living standards.
- Overall, **this approach moves New Zealand's fiscal strategy more explicitly towards a 'golden rule',** where the Government may fund new capital investment from increases in debt but does not borrow to fund current operating expenses.
- **This is a shift from the previous approach, which emphasised a binding debt target as the central focus for fiscal strategy decisions.** If fiscal rules are too binding, it can lead to sub-optimal policy decisions and underinvestment, where updates to forecasts can drive the level of investment rather than assessments of value for money and the impact on living standards.
- While the fiscal rules over the past decade have helped maintain net debt at low levels, this has at times come at the cost of wellbeing-enhancing investments that could have addressed long-term challenges, such as the climate transition or gaps in New Zealand's infrastructure.

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Background

New Zealand’s fiscal framework

- **New Zealand does not state fiscal rules in its legislation.** Governments adopt their own fiscal strategies in line with the principles of responsible fiscal management set out in Part 2 of the Public Finance Act 1989.
- Section 26G(1) sets out these principles:

To address fiscal sustainability:

a) Reduce public debt to prudent levels so as to provide a buffer against factors that may impact adversely on the level of debt in the future

b) Maintain debt at prudent levels by balancing operating revenue and operating expenses on average over time

c) Achieve and maintain net worth as a buffer

d) Manage prudently fiscal risks

g) Have regard to the likely impact of fiscal strategy on present and future generations

To address fiscal structure:

e) Revenue should be raised with regard to efficiency and fairness, including reasonable predictability about the level and stability of tax rates

h) Ensure the Crown’s resources are managed effectively and efficiently

To address stabilisation:

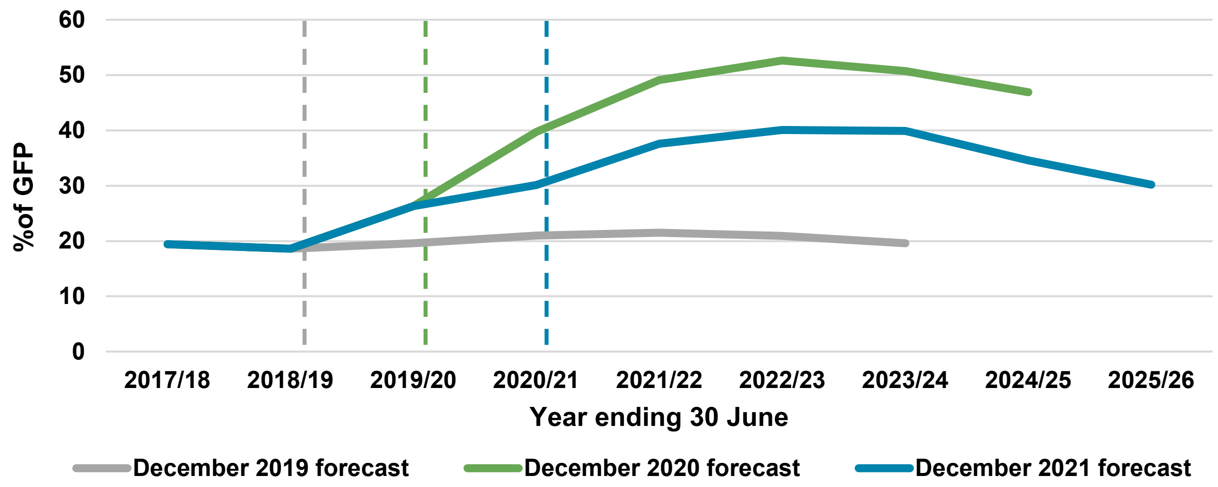
f) When formulating fiscal strategy, have regard to the interaction between fiscal policy and monetary policy

New Zealand's Fiscal Strategy through COVID-19

- Prior to COVID-19, the Government was committed to a set of Budget Responsibility Rules, including:
  - **Debt**: Reducing the level of net debt to 20% of GDP and maintaining net debt within the range of 15 and 25% of GDP thereafter. (*This goal had been achieved by 2019, with net debt forecast to remain around 20% of GDP*)
  - **Operating balance**: Delivering a sustainable operating surplus across an economic cycle. (*This goal was also being achieved, with small surpluses forecast of around 1% of GDP on average*)
- Since Budget 2020 (delivered during New Zealand's first COVID-19 outbreak), the Government's fiscal strategy has reflected the need for fiscal policy to support the response to, and recovery from, the pandemic while maintaining a commitment to responsible fiscal management.

  Fiscal rules over this time have been necessarily flexible and relatively permissive. While this led to a worsening of the fiscal position, it supported a faster-than-expected economic recovery and resilient demand throughout the pandemic.
- Since initial estimates at the onset of COVID-19, the Treasury's economic and fiscal forecasts have reflected improvements in the outlook as pandemic-related uncertainty has reduced and economic conditions have begun to stabilise.

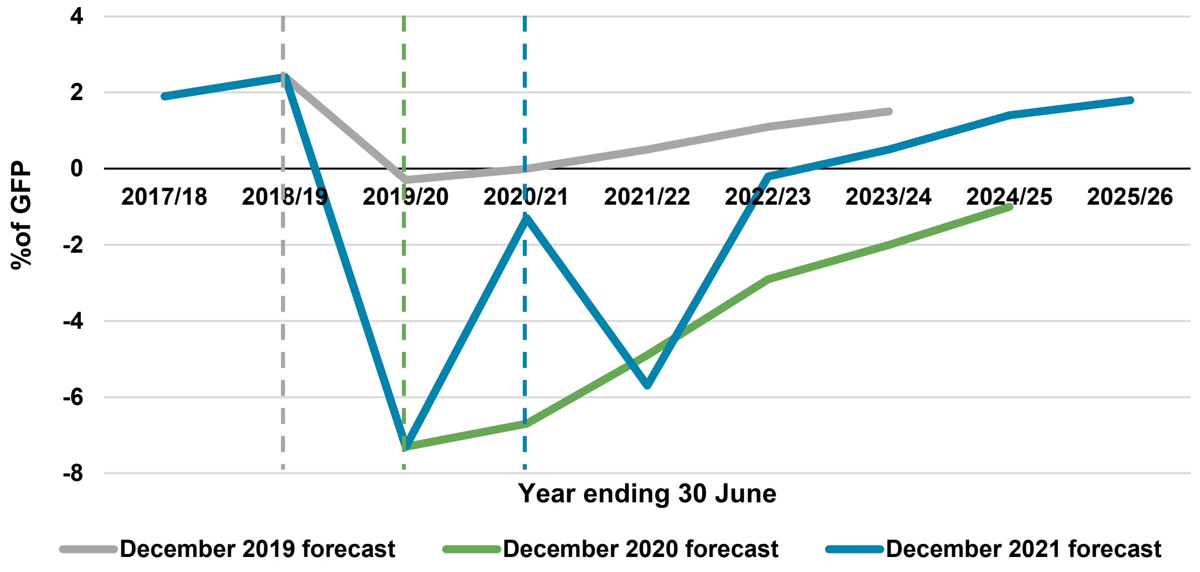
Figure 1: Forecasts for net core Crown debt before and during the pandemic



Moving beyond the pandemic response and recovery

- The Government's fiscal strategy was last updated in February 2021, ahead of Budget 2021. The main fiscal rules were:
  - **Debt –** Debt will rise in the short-term to fight COVID-19 and support the recovery. In the long-term, the Government will stabilise net core Crown debt as a percentage of GDP by the mid-2020s and then reduce it as conditions permit.
  - **Operating balance** – Deficits are planned in the short-term, to fight COVID-19 and support the recovery, but should be reduced over the forecast period as economic conditions allow. The long-term objective is to run an operating balance consistent with meeting the long-term debt objective.
- The Government is on track to meet these targets and **is shifting its focus to medium-term structural challenges.** These include investing more to address the gaps in New Zealand's infrastructure, supporting the climate transition, and reforming the healthcare system.
- To ensure fiscal sustainability while also enabling high-value, long-term capital investments, **the Government is setting new fiscal rules at Budget 2022,** as signalled in the 2022 *Budget Policy Statement* (released in December 2021).

Figure 2: Forecasts for OBEGAL before and during the pandemic



New net debt indicator

- The Treasury has concluded a review of the appropriateness of the current suite of fiscal indicators.
- We recommended a shift to a new, broader net debt indicator. This indicator has been adopted by the Government for use from Budget 2022 onwards (although the existing indicator will continue to be published).

	Existing net debt indicator	New net debt indicator
Name of indicator	Net core Crown debt	Net debt
Coverage of indicator	Core Crown borrowings, net of core Crown financial assets (excluding advances and NZSF financial assets).	Net core Crown debt, plus: • Crown entity borrowings (*mainly Kāinga Ora (Housing Corp) and Waka Kotahi (Transport Agency) borrowings*) • Advances (*mainly Reserve Bank 'Funding for Lending' loans and student loans)* • The New Zealand Super Fund (NZSF)
Difference in measures, based on HYEFU forecasts	29.8% of GDP at 30 June 2021 (actual) 40.1% of GDP at 30 June 2023 30.2% of GDP at 30 June 2026	10.5% of GDP at 30 June 2021 (actual) 17.5% of GDP at 30 June 2023 12.5% of GDP at 30 June 2026

- The review recommended leaving other headline indicators unchanged, including the Operating Balance before Gains and Losses (OBEGAL), which will continue to be used for fiscal targets.

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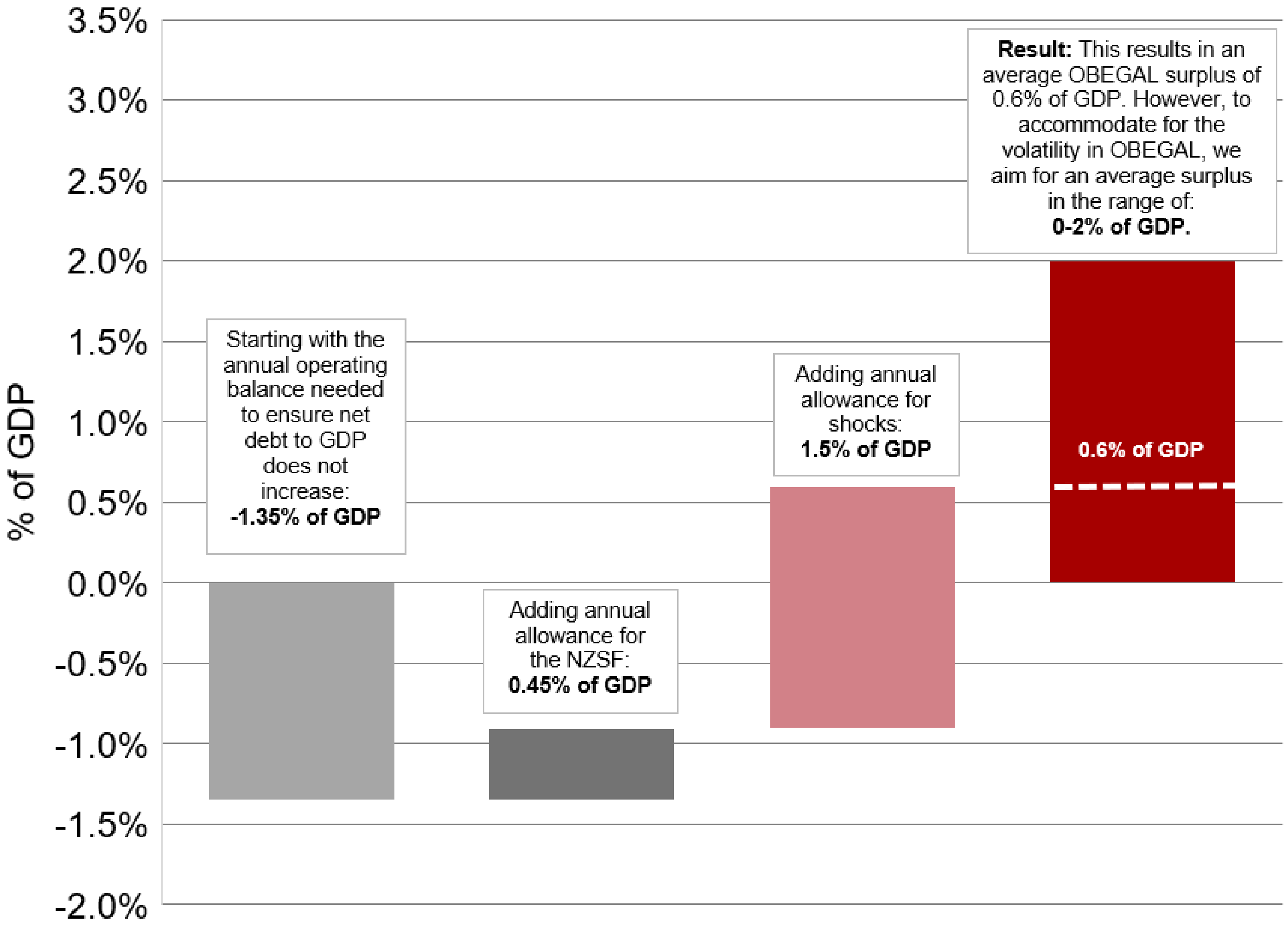
Operating Balance before Gains and Losses (OBEGAL) Rule

The new OBEGAL target as the main fiscal rule

- With significant and rising cost pressures to deliver government services, it is appropriate for the new fiscal rules to place more emphasis on managing costs on the operating side.
- The Government will therefore target a level of OBEGAL that ensures that, over time, operating expenses do not add to net debt as a share of GDP.
- This supports intergenerational equity by requiring current generations to pay for their own consumption. It will also likely result in a fiscally sustainable position as current expenses will funded by current revenues and not debt.
- The primary fiscal rule will be to **maintain small OBEGAL surpluses in the range of 0-2% of GDP** over time. This means that deficits can be run following shocks if needed.
- As depreciation (the consumption of a capital asset) must be paid for by operating revenue under this rule, it makes sure that capital investment is fiscally sustainable too. The initial cost of investment can be funded by debt, but the asset is still paid for by revenue over time by the generations that get the benefit from using it.

Calibrating the OBEGAL target

Figure 3: Calibrating the OBEGAL target



<u>The range of 0-2% of GDP was reached by</u>:

- **Calculating the operating balance that stabilises net debt to GDP** in the long term. This assumes a long-run nominal GDP growth rate of 4.5% and a starting net debt level of approximately 30% of GDP.
- Adding an allowance of **0.45% of GDP** per year for the Government's **contribution to the NZ Super Fund.**
- Adding a buffer of **1.5% of GDP** per year to address average **economic shocks.**
- This results in an average OBEGAL surplus of **0.6% of GDP** required over the long term.
- Given the volatility in OBEGAL and the need to run counter-cyclical policy, it would be difficult to achieve a specific point target in a given year. Targeting an average OBEGAL surplus in the range of **0-2% of GDP** will ensure the Government is **running operating surpluses on average**, while allowing some **flexibility to manage volatility**.

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Net Debt Ceiling

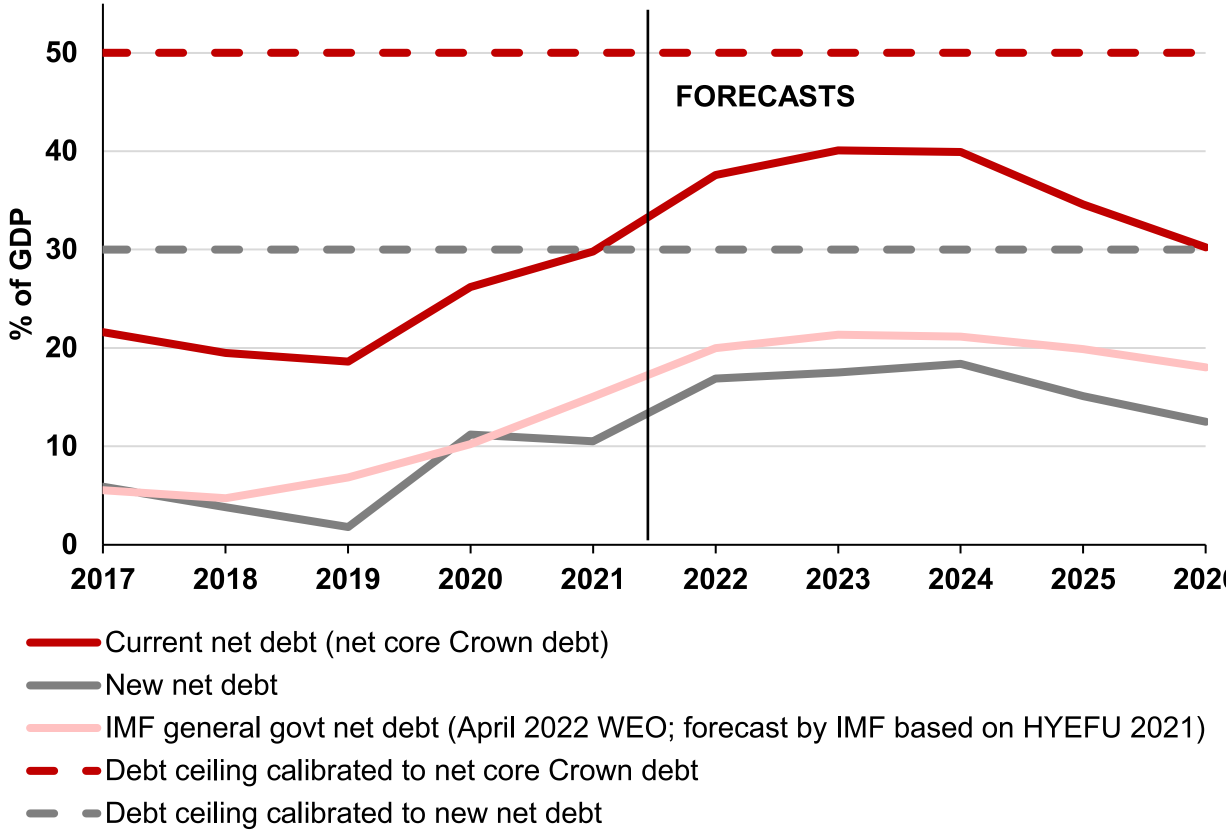
A net debt ceiling to complement the OBEGAL target

- The OBEGAL rule will be complemented by a ceiling on net debt, which will provide a backstop against any accumulation of deficits and will ensure that debt remains fiscally sustainable. It also helps ensure that there is a sufficient fiscal buffer in place to address significant economic shocks or natural disasters.
- The new debt ceiling is **not a target** for the Government to aim for but the level that the Government will aim to keep debt below.
- This new debt ceiling provides fiscal headroom to invest to tackle long-term challenges and respond to shocks. We consider that it is appropriate to take on debt to finance such capital investments that also create long-term assets – which future generations both pay for and benefit from.
- However, **fiscal headroom should only be used to fund good quality, long-term capital investments that enhance productivity and improve living standards**. Capital investments need to be supported by rigorous value-for-money assessments, as well as considerations of the current macroeconomic environment – including inflationary pressures and constraints to market capacity to deliver capital projects.

Setting the net debt ceiling

- The Treasury has recommended setting the debt ceiling at 50% of GDP based on the ‘old’ net debt measure that excluded the NZSF.
- This is based on a sustainability analysis with conservative assumptions about interest and growth rates. This shows that, even when interest rates are assumed to be substantially higher than growth rates, the Government could stabilise and reduce debt levels even if they were to reach 90% of GDP (based on the old net debt measure).
- Building in a large fiscal buffer of 40% of GDP, **the Treasury considers that a debt ceiling of up to 50% of GDP (based on the old net debt measure) is sustainable and prudent.**
- Adopting the new headline net debt measure will mean **setting the net debt ceiling at 30% of GDP** (equivalent to 50% under the current measure). This ensures that the Government does not borrow against the NZSF.

Figure 4: Net debt indicators and corresponding debt ceiling (2021 HYEFU forecasts)

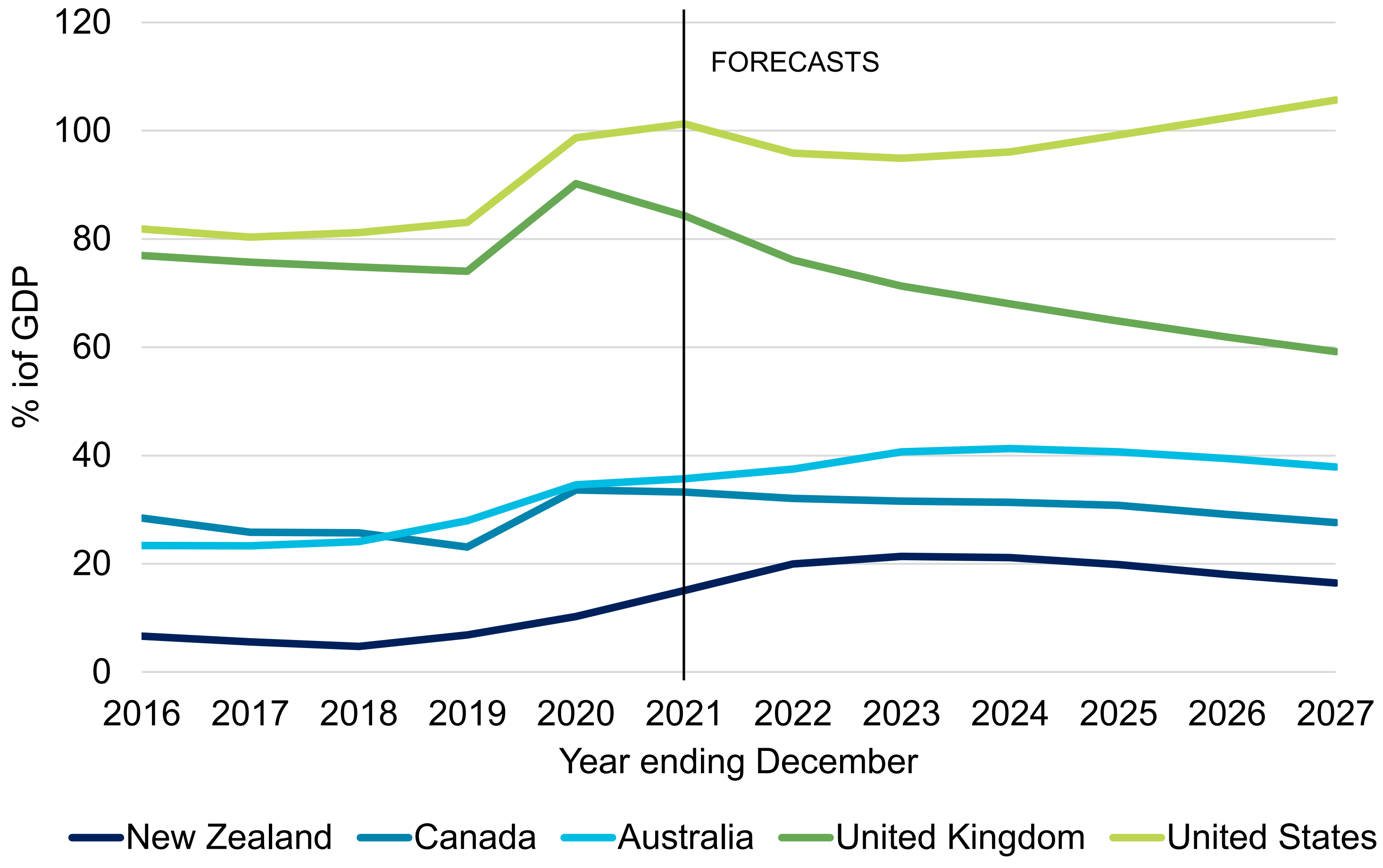


Source: New Zealand Treasury and International Monetary Fund World Economic Outlook Database, April 2022
Annual figures relate to years ending 30 June, except for IMF figures which are years ending 31 December

International comparison of the new net debt ceiling

- Even at its peak, New Zealand’s net debt as a share of GDP remains low compared to many of our international peers.
- The IMF’s general government net debt indicator shows New Zealand’s debt at 18.0 per cent of GDP in 2026, compared to 29.1% in Canada, 39.4% in Australia, 61.9% in the UK and 102.4% in the US.

Figure 5: IMF general government net debt in 2026



Source: International Monetary Fund, World Economic Outlook Database, April 2022

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Next Steps

Budget 2022 will operationalise the new fiscal targets

- The Government's fourth Wellbeing Budget will be announced on 19 May 2022. Updated forecasts will show how the Government is tracking against the new fiscal rules.
- The Public Finance Act 1989 requires the Government to specify short-term intentions and long-term objectives for fiscal policy in its Fiscal Strategy Report (published on Budget Day). These will be updated to reflect the new fiscal rules.
- The Fiscal Strategy Report will also detail any changes in the Government's fiscal strategy, including future operating and capital allowances.
- We will meet with you as usual following the release of the Budget to discuss key highlights, the Treasury's latest economic and fiscal forecasts, and any questions you may have.

The Treasury's advice and analysis on the new fiscal rules is detailed further in an analytical note released on the Treasury website to coincide with the 3 May 2022 announcement. This note can be found at *https://www.treasury.govt.nz/publications/guide/treasurys-analysis-and-recommendations-fiscal-rules*

Questions