The Treasury

Budget 2022 Information Release

August 2022

This document has been proactively released and is available on:

- The **Budget website** from August 2022 to May 2023 only at: **https://budget.govt.nz/information-release/2022**, and on

- the **Treasury website** from later in 2022 at: **https://treasury.govt.nz/publications/information-release/budget-2022-information-release**.

Information Withheld

Some parts of this information release would not be appropriate to release and, if requested, would be withheld under the Official Information Act 1982 (the Act).

Where this is the case, the relevant sections of the Act that would apply have been identified.

Where information has been withheld, no public interest has been identified that would outweigh the reasons for withholding it.

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

[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

[27] 9(2)(ba)(ii) - 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 otherwise to damage the public interest

[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;

[36] 9(2)(h) - to maintain legal professional privilege

[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

[40] Out of Scope

[41] 18(c)(i) - that the making available of the information requested would be contrary to the provisions of a specified enactment

[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 [1] appearing where information has been withheld in a release document refers to section 6(a).

Copyright and Licensing

Accessibility

The Treasury can provide an alternate HTML version of this material if requested. Please cite this document's title or PDF file name when you email a request to information@treasury.govt.nz.

TE TAI ŌHANGA
THE TREASURY

Treasury Report: Updating Projection Assumptions for the 2022 Budget Fiscal Strategy Model

Date:	5 May 2022	**Report No:**	T2022/1015
		File Number:	MC-1-5-2-2022

Action sought

	Action sought	Deadline
Minister of Finance **(**Hon Grant Robertson)	**Agree** to publish the Fiscal Strategy Model online alongside the Wellbeing Budget 2022. **Agree** to the proposed allowance assumptions for the Fiscal Strategy Model and Fiscal Strategy Report. **Note** that the Fiscal Strategy Model has been updated to enable it to project the new definition of net debt	9 May 2022

Contact for telephone discussion (if required)

Name	Position	Telephone		1st Contact
Matthew Bell	Senior Analyst, Modelling and Research	[39]	N/A (mob)	✓
Christie Smith	Team Leader, Modelling and Research		[35]	

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: Updating Projection Assumptions for the 2022 Budget Fiscal Strategy Model

Executive Summary

This report seeks your agreement to publish the 2022 Budget Economic and Fiscal Update (BEFU) version of the Fiscal Strategy Model (FSM) online alongside the Wellbeing Budget 2022 and other material related to the 2022 BEFU. It also seeks a decision on the operating and capital allowance assumptions to be applied in the model over the post-forecast projected years. These allowance assumptions should reflect your long-term fiscal strategy.

Operating and capital allowances, and their growth rates, are the principal policy assumptions in the FSM that you can adjust to meet your desired long-term fiscal strategy. We recommend assuming:

- new **operating allowances of $3.0 billion per year** for Budget 2026 (this is a $0.25 billion increase from the 2021 HYEFU version of the FSM).
- new **capital expenditure of $5.0 billion per year** in 2026/27 (this is a $3.0 billion decrease from the 2021 HYEFU version of the FSM).
- a **2% per annum growth rate for operating and capital allowances** (as a proxy for inflation) in the projection period (this is unchanged from the 2021 Half Year Economic and Fiscal Update (HYEFU) version of the FSM).

These proposed assumptions for the operating and capital allowances over the projection period assume that you wish to:

- maintain OBEGAL surpluses over the entire decade-long projection horizon; and
- match the annual increment for the operating allowance at the end of the forecast period (Budget 2025 is the last budget in the forecast period, with an operating allowance of $3 billion per annum).

Changes to the capital expenditure assumption will have a greater effect on OBEGAL surpluses than has been the case in the recent past. This is because interest rates are expected to rise over the forecast and projection periods, meaning that changes to debt levels will have a greater impact on finance costs. However, reducing the level of new capital expenditure assumed over the projection period may not accord with your longer-term capital spending plans. It may also result in net debt falling to levels that are not consistent with the Government's objectives by the end of the projection period (excluding the impact of expected growth in New Zealand Superannuation Fund (NZSF) assets).

An alternative is to retain your 2021 HYEFU level of annual capital expenditure, which begins at $8.0 billion, and apply operating allowances in projected years that begin at $2.85 billion. This would still allow OBEGAL surpluses to be maintained while keeping net debt-to-GDP on a higher track and allowing more funding for future capital projects. While not quite matching the end-of-forecast operating allowances of $3.0 billion, the starting projected operating allowance is still higher than that used in the 2021 HYEFU FSM.

We can also work with your office to consider different allowance assumptions if you wish.

Under the recommended allowance settings total Crown OBEGAL is projected to reach a surplus of $0.1 billion by the end of the ten-year projection period (2035/36), with the old definition of net core Crown debt, which excludes the NZSF assets and advances, reducing to 12.8% of GDP by this year. The new net debt measure, that includes the NZSF assets and advances and Crown entity borrowings as well, would be at −7.0% of GDP.

If the 2021 HYEFU capital allowances that begin at $8 billion in projected years were retained, with operating allowances starting at $2.85 billion, then OBEGAL would be at $0.5 billion by 2035/36. The old net debt measure would reduce to 17.2%, while the new one would reach −2.6% of GDP.

This report also outlines changes made to the FSM in order to be able to project, beyond its forecast base, net debt under its new definition. These modelling changes have not affected the total Crown OBEGAL projection at all and have only made very small changes to the old net core Crown debt projection.

We seek your decisions on this report by Monday 9 May in order to finalise the Budget 2022 FSM, which, if you approve, will be published online on Thursday 19 May.

Recommended Action

We recommend that you:

a **agree** to publish the Fiscal Strategy Model (FSM) online alongside the Wellbeing Budget 2022 and other material related to the 2022 Budget Economic and Fiscal Update

Agree/disagree.

b **agree** to set the allowance assumptions in the FSM as follows:

i. operating allowance of $3.0 billion for Budget 2026 growing at 2% per year (relative to $2.75 billion assumption in the 2021 Half Year Economic and Fiscal Update (HYEFU) version of the FSM)

Agree/disagree.

ii. new capital expenditure of $5 billion in 2026/27 growing at 2% per year (relative to $8 billion assumption in the 2022 HYEFU version of the FSM)

Agree/disagree.

c **indicate** if you or your advisors would like to discuss other potential combinations of projected operating and/or capital allowances with the Treasury.

Yes/no.

d **note** that the Treasury has updated the Fiscal Strategy Model in order to enable it to project the new definition of net debt.

Christie Smith
Team Leader, Modelling and Research

Hon Grant Robertson
Minister of Finance

Treasury Report: Updating Assumptions and Other Information About the 2022 Budget version of the Fiscal Strategy Model

Purpose of Report

1. This report seeks your agreement to publish the 2022 Budget Economic and Fiscal Update (BEFU) version of the Fiscal Strategy Model (FSM) online alongside the Wellbeing Budget 2022 and other material related to the 2022 BEFU. It also seeks a decision on the operating and capital allowance assumptions to be applied in the model over the post-forecast projected years, which will be included in the Fiscal Strategy Report (FSR). These allowance assumptions should reflect your long-term fiscal strategy.

2. This report also outlines changes made to the FSM in order to be able to project, beyond its forecast base, net debt under its new definition.

Background

3. The Public Finance Act (PFA) requires the Government to publish medium-term projections as part of the Fiscal Strategy Report at each Budget. The Treasury uses the FSM to produce these decade-long projections of key fiscal variables, which show likely future progress against your long-term fiscal objectives. Although not a legal requirement, the established practice has been to publish the FSM alongside the other Budget documents to illustrate the Government's long-term fiscal strategy.

4. Your long-term objectives for fiscal policy, as stated in the Fiscal Strategy section of the Wellbeing Budget 2022 are to:

    i. Maintain net debt (under its new definition) at below 30 per cent of GDP, subject to any significant shocks.

    ii. Once the operating balance (before gains and losses) has returned to a surplus, maintain an average surplus in the range of zero to two (0-2) per cent of GDP, subject to economic and fiscal conditions.

5. You are achieving both of these objectives within the forecast period of the 2022 Budget, although an OBEGAL surplus is only achieved in the final two forecast years. Budget 2022 forecasts will show the new definition of net debt peaking at 19.9% of GDP in 2023/24 before falling to 15.0% of GDP by the end of the forecast period (2025/26). For comparison the equivalent measures for the old net debt measure are 41.2% in 2023/24 and 31.9% in 2025/26. The total Crown operating balance before gains and losses (OBEGAL) is forecast to go into surplus in 2024/25 at $2.6 billion (0.6% of GDP) and reach $7.0 billion, or 1.5% of GDP, by the final forecast year.

6. Beyond the forecast period there are two principal policy assumptions in the Fiscal Strategy Model that you can adjust to meet your desired long-term fiscal strategy:

    - **Operating allowances**, reflecting yearly growth in ongoing operating expenditure. These have the largest impact on OBEGAL and net debt.
    - **Capital expenditure**, reflecting one-off yearly expenditure on capital. This affects net debt but has only a small impact on OBEGAL through finance costs.

7. The next section presents options for projected operating and capital allowances. These options are based on operating allowances that are as close as possible to those used in the final forecast years of $3 billion, and are therefore likely to be realistic, **while maintaining OBEGAL surpluses over the projected years**. Capital expenditure options are based on different rates of decline of net debt-to-GDP, while still ensuring the projected capital expenditure is at levels that could realistically be spent annually in these future years.

Options for Projected Operating and Capital Allowances

8. In all scenarios we have assumed a 2% growth rate of allowances (indexed to inflation). This is unchanged from the assumption in the 2021 HYEFU version of the FSM. Table 1 presents four alternative options for the operating allowances and new capital expenditure that are consistent with your fiscal strategy.

Table 1 – Options on operating allowance and their fiscal impact

	Assumption		Fiscal impact		
	Initial operating allowance (in 2026/27)	Initial capital expenditure (in 2026/27)	New net debt definition in 2035/36 (% GDP)	Old net debt definition in 2035/36 (% GDP)	Total Crown OBEGAL in 2035/36 (% GDP)
Option 1 (recommended)	$3.0bn	$5.0bn	-7.0%	12.8%	0.01%
Option 2	$2.85bn	$8.0bn	-2.6%	17.2%	0.07%
Option 3	$2.75bn	$8.0bn	-3.6%	16.2%	0.27%
Option 4	$3.0bn	$8.0bn	-1.2%	18.7%	-0.23%
2021 HYEFU	$2.75bn	$8.0bn	N/A	19.3%	0.24%

9. **We recommend Option 1 in Table 1, which has starting projected operating allowances of $3.0 billion per year, accompanied by capital expenditure of $5.0 billion per year,** in both cases growing at 2% per year in later projected years. This remains consistent with your fiscal strategy, allows more funding to deal with future cost pressures, and ensures adequate and realistic capital funding for a sustainable medium-term capital pipeline. Under these allowance settings OBEGAL is projected to be in surplus over the entire decade of projections and averages 0.7% of GDP over this period. The new net debt measure is negative by 2032/33, so is clearly well under the 30% of GDP ceiling in all years.

10. However, if you wish to maintain significantly higher capital funding that matches what was applied at the 2021 HYEFU, namely starting at $8.0 billion per year, Options 2, 3 and 4 all use this amount. Option 2 still allows for an increase of $0.1 billion to the operating allowances used at the 2021 HYEFU, while Option 3 retains the same level. Option 4, like Option 1, applies a starting projected operating allowance of $3.0 billion per year, which matches that of the last forecast year.

11. All four of these options have the new net debt measure turning negative by the end of the projection period and staying well below the prescribed ceiling. Options 2 and 3 maintain OBEGAL surpluses over all projected years, with Option 2 averaging 0.7% of GDP over the decade and Option 3 averaging 0.8% of GDP.

12. Option 4 is projected to have average OBEGAL surpluses of 0.5% of GDP over the ten-year projection horizon, but it does go into deficit in the last two projected years, dropping to −0.09% of GDP and −0.23% of GDP in 2034/35 and 2035/36 respectively.

Figure 1 – Total Crown operating balance before gains and losses (OBEGAL) as a percentage of GDP for different options of operating and capital allowances

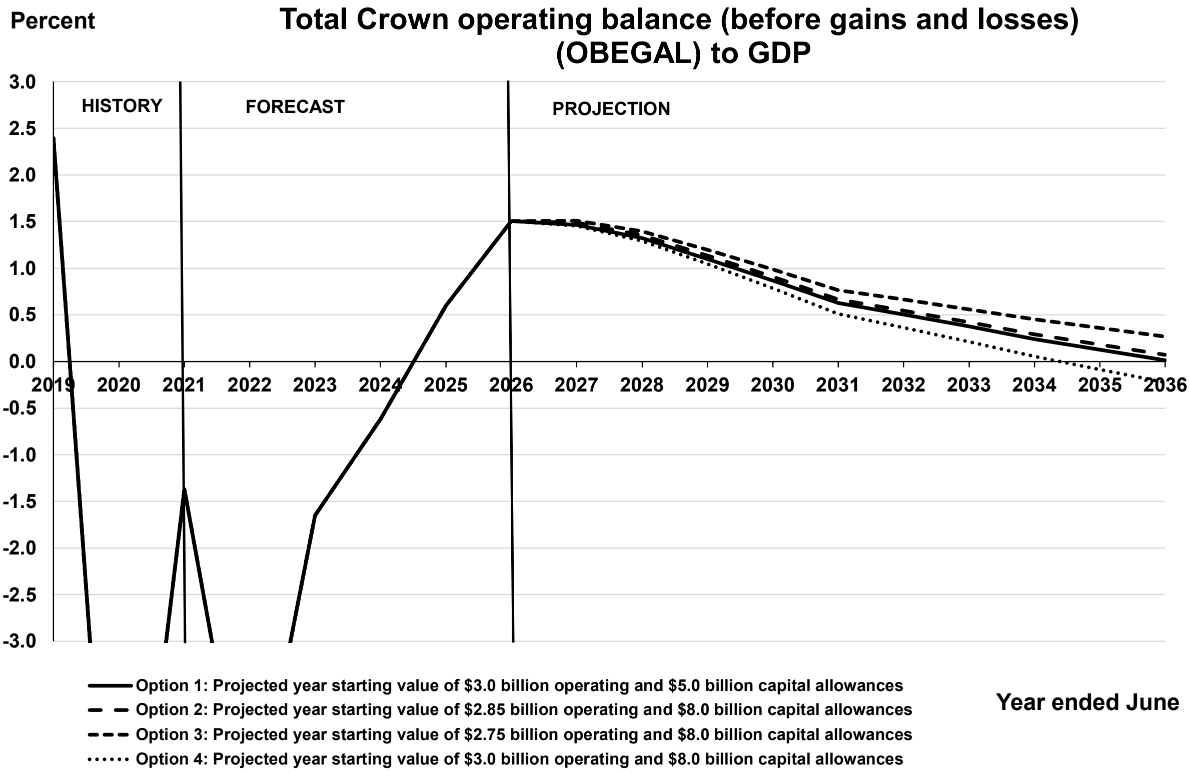


Figure 2 – New net debt measure as a percentage of GDP for different options of operating and capital allowances

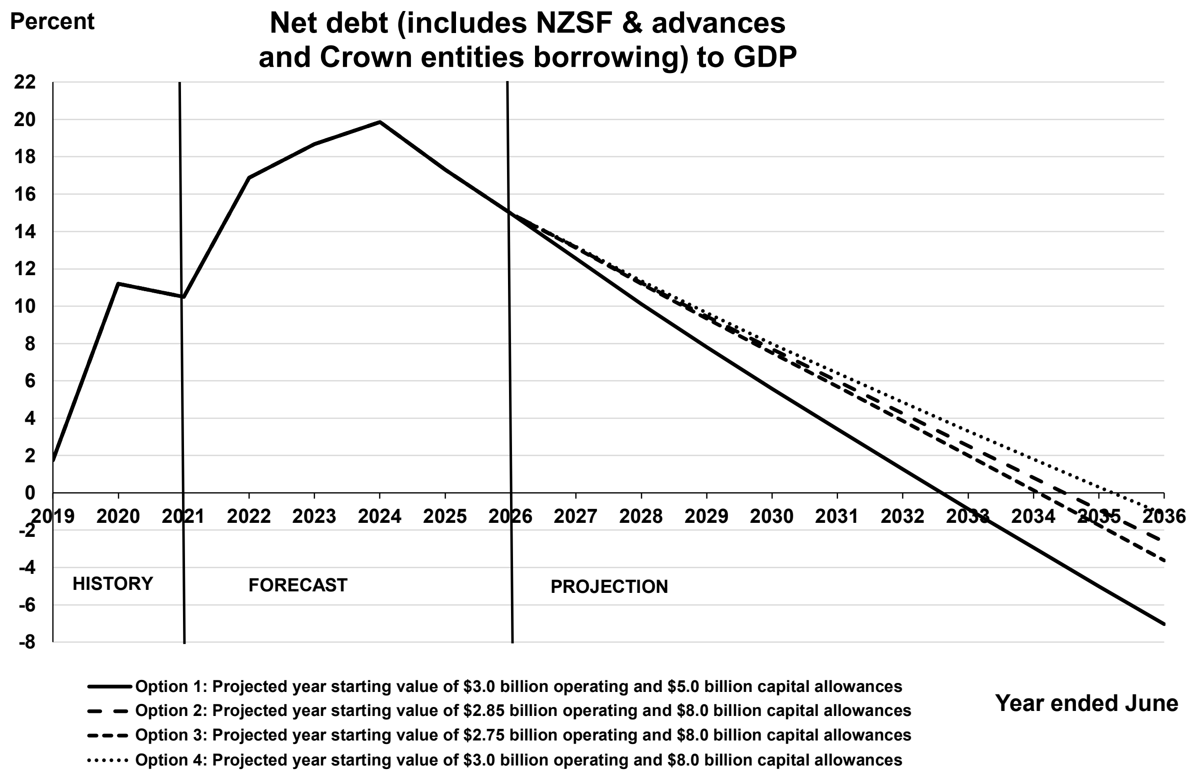
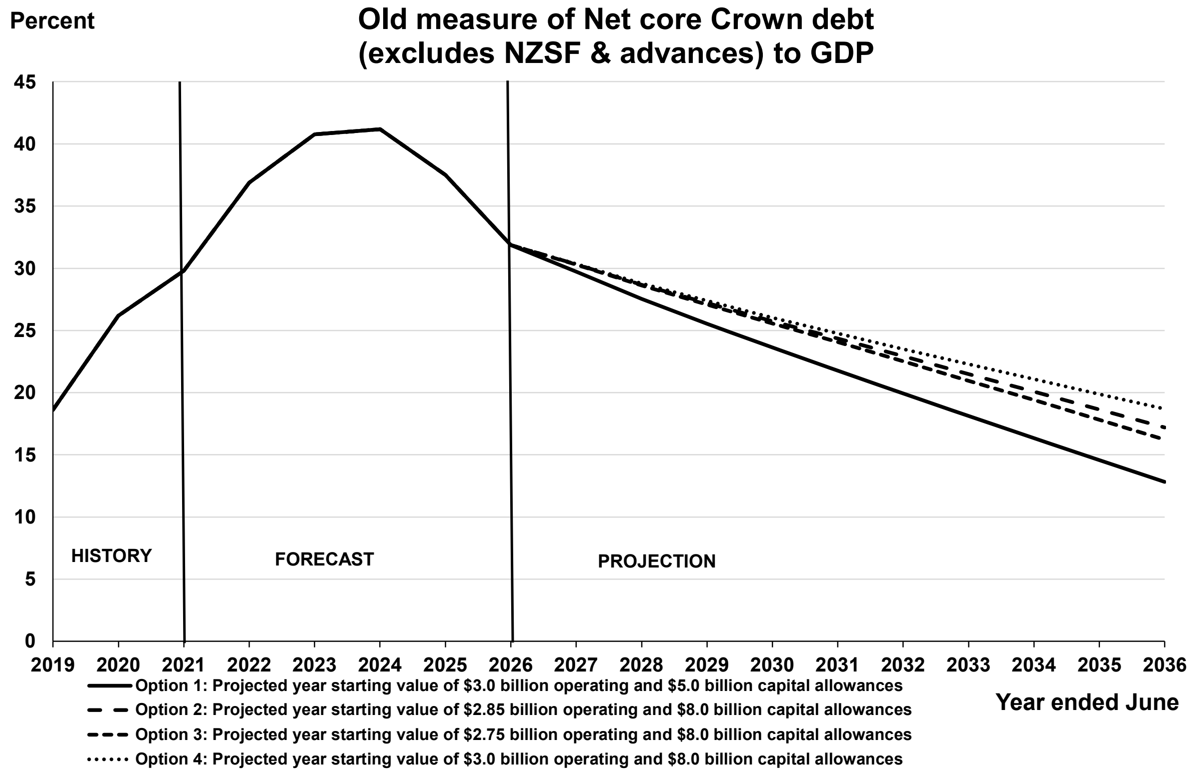


Figure 3 – Old net core Crown debt measure as a percentage of GDP for different options of operating and capital allowances



13. We can work with you and your office to illustrate different operating and/or capital allowance assumptions for projected years if you wish. We do not recommend, given cost pressures, setting allowances substantially lower than the $2.75 billion starting projected operating allowance used in Option 3 and at the 2021 HYEFU, as this may affect the credibility of the projections.

14. We also do not recommend opting for a starting projected capital allowance above the $8 billion used in Options 2, 3 and 4 and at the 2021 HYEFU. Resourcing capital expenditure beyond $5b is likely to be challenging given low levels of unemployment and disruptions to supply chains affecting access to capital.

15. The policy options and the fiscal projections presented above are based on:

- the economic and fiscal forecast base published in the 2022 Budget, and
- some updates to the Fiscal Strategy Model to enable net debt to be projected under its new definition (these updates are discussed in the next section).

Changes to the Fiscal Strategy Model to enable net debt to be projected under the new definition

16. The FSM uses numerous data and assumptions about economic and fiscal variables to produce medium-term projections of key fiscal indicators. No significant changes have been made to the modelling of economic variables since the 2021 HYEFU version of the FSM.

17. The structure of the fiscal forecasts has changed, in order to produce the new net debt measure including Crown entity borrowings, advances and NZSF assets. This has required some modelling changes to the FSM so that it can project out this new debt measure. This has made, for most fiscal variables, no difference to their projections relative to the old version of the FSM. In a few cases there have been very small changes to projected values. It has also led to some changes in the layout of the main modelling worksheet.

18. Examples of key fiscal variables that are unchanged in their projected values relative to the old version of the model are total Crown OBEGAL, core Crown revenue, core Crown expenses and core Crown residual cash.

19. An example of a fiscal variable that has slightly changed by updating the model is the old version of net core Crown debt. However, by the last year of projections, 2035/36, the modelling changes have only caused a difference between the old and new projection of less than 0.1%. Total Crown borrowings is another variable in this category, but again differences are very small, being just over 0.1% by the final projected year.

20. These small projection differences arise because of forecast data about the NZSF's financial assets and liabilities being differently divided up now to match components of the new net debt measure. This has led to the requirement to make small changes to the way in which the NZSF's financial assets and liabilities are projected, although the overall closing balance of the NZSF has not altered in projections.

21. One area that will require further research and analysis is the projection of the Crown entity borrowing that is a feature of the new net debt measure. There was limited time to work on this projection in time for BEFU. Consequently, these borrowings are projected in the 2022 Budget FSM simply by growing them at similar increments to those observed in the last three years of their forecasts. Treasury will do further work on this projection ahead of publishing the next version of the model, at the 2022 HYEFU in December

22. It should be noted, however, that without a fully modelled Crown entity cash flow statement the projection of Crown entity borrowings will always need to involve growth or other modelling assumptions to some degree. Projected core Crown and total Crown borrowings are fully modelled by the FSM, but this requires extensive fiscal forecast data at both of these levels, that are then all individually modelled in projected years. Such data is not published at the Crown entity level, and is unlikely to be in the future. As a result, it is unlikely that fully modelled Crown entity borrowings will ever be a feature of the FSM.

Next steps

23. The Treasury can work with you and your Office to set alternative allowance assumptions (for either operating or capital or both) over the projection period, should you wish to investigate different options.

24. Your decision on the operating and capital allowances will be built into the 2022 Budget version of the FSM, which will, with your permission, be published alongside the Wellbeing Budget 2022 and other material related to the 2022 Budget on the Treasury website. To enable Treasury to keep to the intended publication timeline for the budget, any feedback/decisions on operating or capital allowances should be provided to the Treasury by Monday, 9 May 2022.