

Economic Update – First Impressions.

20 May 2021



New Zealand Government Budget 2021.

- The 2021 Budget delivered an increase in government spending that was in line with our expectations.
- The key Budget initiative is a broad and significant lift to benefit rates. Benefits will lift on 1 July 2021 and again on 1 April 2022.
- The Budget was underpinned by tax revenue forecasts that we found to be surprisingly conservative, given a similar economic outlook to us.
- We expect that revenue will continue to surprise to the upside, providing scope for more ambitious spending and debt reduction plans in future updates.

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Budget 2021 forecasts

	2020 (a)	2021	2022	2023	2024	2025
	Actual	F/cast	F/cast	F/cast	F/cast	F/cast
Economic (June years, %)						
Real GDP growth	-1.7	2.9	3.2	4.4	3.3	2.9
Unemployment rate	4.0	5.2	5.0	4.4	4.2	4.2
CPI inflation	1.5	2.4	1.7	1.8	2.0	2.1
Fiscal (June years, % of GDP)						
Total Crown OBEGAL	-7.3	-4.5	-5.3	-2.6	-1.4	-0.6
Net core Crown debt	26.3	34.0	43.8	48.0	46.9	43.6
Government bonds (June years, \$ bn)						
Bond programme	29	45	30	25	25	25

The Government has outlined Budget 2021 spending and investment initiatives broadly in line with our expectations. Budget 2021 includes an operating allowance of \$3.8 billion or around \$1 billion more than initially announced in the Budget Policy Statement back in February. This increase was equal to what we had factored into our forecasts prior to today's announcement.

The key spending highlight was a boost to welfare spending. Weekly benefit rates will lift by between \$32 and \$55 per adult. Student living support will also increase by \$25 per week. Effectively, in making these changes the Government has adopted a key recommendation of the Welfare Expert Advisory Group, with the aim of lifting up to 33,000 children out of poverty.

The Government's capital expenditure plans were also as big as we expected them to be. The multi-year capital allowance has been increased from \$8 billion to \$12 billion. Key initiatives announced in Budget 2021 include \$810 million for KiwiRail,



\$761 million of capital for Education, including for schools, and \$700 million for District Health Boards. All up, the Government has now included \$57.3 billion of infrastructure investment plans into this Budget.

Where we were surprised was the lack of a significant upgrade to the Treasury's revenue projections, despite a similar set of GDP forecasts to us. Tax revenue has consistently surprised to the upside in recent months, but the Treasury's projections assume that this won't continue.

Indeed, the projected OBEGAL actually worsens in the coming year, due to both the front-loaded nature of the additional spending and the lack of a significant lift in revenue. Combining the front-loading of expenditure with the stronger than expected starting OBEGAL also has the effect of amplifying the lift in the OBEGAL in the later years of the forecast period.

Factoring in the above, the reduction in Government bond issuance was much more modest than we had anticipated. The forecast bond programmes for 2022/23 and 2023/24 have been decreased by \$5 billion each, while the 2020/21 and 2024/25 programmes are unchanged. Net debt peaks at a lower level than the Treasury forecast back in the Half-Year Update (48% versus 52.6%), but higher than we expected.

These Budget announcements have few implications for our OCR view. Looking at the amount of economic stimulus in dollar terms, today's announcements are largely in line with what we had already factored in. That said, the lift to benefit rates will provide an immediate boost to household spending. In other words, the composition, if not the magnitude, of spending initiatives is arguably on the stimulatory side of our expectations.

We believe that the Government's books will improve at a considerably faster pace than the Treasury expects. As that becomes apparent, there will be scope for both more substantial spending plans and faster debt reduction.

We will provide a fuller assessment of the Budget in our bulletin later today.

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