HD **Budget 2014: New Zealand to beat Australia, other advanced economies to budget surplus**

BY Bree Neff
WC 1,597 words
PD 16 May 2014
SN IHS Global Insight Daily Analysis
SC WDAN
LA English

LP

New Zealand's 2014 budget released yesterday (15 May) indicates that the country will record a budget surplus in the order of 0.2% of GDP in fiscal year 2014/15. This follows days after Australia indicated its budget will not return to surplus until the early 2020s.

IHS perspective

TD

Significance

Government finances deteriorated sharply in New Zealand in the wake of stimulus measures post-global financial crisis and the two earthquakes that struck Canterbury and Christchurch. The government's ability to return the budget to surplus by 2015 is therefore a significant, yet hard-fought achievement.

Implications

With tax revenues strengthening thanks to a stronger domestic economy, the National party-led government has been able to add some additional spending to its medium-term budget proposal, while still achieving rising surpluses over the next few years.

Outlook

New Zealand's return to surplus has long been in the works thanks to spending restraint and a rebounding economy, so the 2014 budget contained few surprises. As long as New Zealand maintains its commitment to controlling expenditures, the improving budget position will be a positive for the country's sovereign credit ratings. That said the country's creditworthiness will continue to be held back by a more significant private-sector savings and investment imbalance.

In his sixth budget as finance minister, Bill English indicated that the government expects the Total Crown (general government) operating balance before gains and losses (OBEGAL) to record a surplus of NZD372 **million** (USD321.9 **million** or 0.2% of GDP) for FY 2014/15 (1 July 2014–30 June 2015). This is an upward revision from last December's projection of a NZD86-**million** surplus (see New Zealand: 19 December 2013: Strengthening economy bolsters New Zealand's mid-year budget update). The surplus is then expected to reach NZD3.5 **billion** or 1.3% of GDP by the end of the budget forecast horizon of FY 2017/18. For the current fiscal year which ends on 30 June, the government expects an OBEGAL shortfall of NZD2.4 **billion**, or 1.1% of GDP, a small revision from the December forecast of a NZD2.3-**billion** deficit.

The 2014 budget documents also point to more favourable results for government debt over the next few years. With the rising budget surpluses, the government anticipates that net core government debt will peak at 26.4% of GDP in FY 2014/15, and is on track to fall back to the government's target of under 20% of GDP by FY 2019/20. The 2013 budget had called for net debt to peak at 28.7% of GDP in FY 2014/15. It appears some of the reduction in the net debt to GDP ratio versus previous forecasts stems from faster expected growth for the economy and government assets, as the government is expecting to boost the level of borrowing somewhat over the budget forecast horizon versus previous forecasts in response to higher projected cash shortfalls.

Economic rebound bolsters budget in New Zealand as mining boom unwinds Australia's budget

New Zealand's budget outlook is positively rosy when compared to the outlook for other advanced economies. It is even better than that of neighbouring Australia, which a few years ago had anticipated returning to budget surplus by 2013. Australia now expects a budget deficit of AUD28.9 billion (USD27.8 billion or 1.8% of GDP) for FY 2014/15 and does not expect surpluses in excess of 1% of GDP until 2024/25 (see: Australia: 14 May 2014: Budget 2014: Australian government's tough "Contribute and Build" mantra sets path back to surplus).

One factor supporting the better budget outlook for New Zealand relative to its Australian counterpart is a more favourable outlook for economic growth. While Australian growth is slowing in line with the unwinding of mining sector investments, New Zealand's economy is booming after an extended period of sluggish growth including a five-quarter-long recession in 2008/09 as a result of a correction in household consumption activity and the global financial crisis. The economy was then further undermined by the 2010 and 2011 earthquakes in Christchurch and the broader Canterbury region which further slowed the country's recovery from its recession. By late 2013 as reconstruction activity was fully under way in Christchurch and Canterbury, rising house prices from housing shortages were boosting construction and consumption activity, and the agricultural sector was starting to recover from a drought that settled in earlier in the year. These elements will all be in play again in 2014/2015 resulting in robust growth expectations for the economy.

The government's budget forecasts call for real GDP growth to average 2.8% over the next four years, peaking at 4% in the year to March 2015. The government's revenue forecast reflects the strong growth as it projects annual average revenue growth of 5.1% per year for FY 2014/15 to FY 2017/18, compared to annual average revenue growth for FY 2007/08 through FY 2012/13 of 2.7%. IHS sees some risks to these forecasts; we currently forecast annual average GDP growth of 2.7% leaving room for under performance of revenues. Additionally, one major risk to the country's economic and revenue outlooks is the continued strength and appreciation of the New Zealand dollar. The currency could strengthen further against its Australian and American counterparts as the current policy settings set forth by the government and the Reserve Bank of New Zealand make investing in New Zealand attractive (see New Zealand: 13 March 2014: New Zealand commences what should be a significant monetary tightening cycle). Such currency strength could in turn undermine export demand from China and Australia, New Zealand's top two export markets, and in turn reduce tax revenues. A similar risk could arise if the terms of trade were to collapse from sharp falls in agricultural product demand from China or other emerging economies.

Fiscal prudence through "zero budgets" further bolstered New Zealand's fiscal position

Restraint in government spending was promoted by what the government termed zero budgets in 2012 and 2013 where new spending initiatives were financed by reprioritising spending (see New Zealand: 25 May 2012: Budget 2012: New Zealand "Zeros In" on Return to Surplus). Another critical move by the government to shore up the country's finances was the decision to privatise three state-owned energy companies and sell down its stake in Air New Zealand which provided the government with a cash infusion of NZD4.7 billion in FY 2013/14, which it plans to use over the next few years (see New Zealand: 17 May 2013: Budget 2013: New Zealand remains on track for surplus by 2015).

Between spending reprioritisation and privatisation of state assets, the government was able to finance cash payments totalling NZD6.6 billion on Canterbury's earthquake reconstruction needs between 2011 and 2013 as well as a few other small initiatives. The 2014 budget outlines the government's continued commitment to spending restraint with the administration planning to boost new operating expenditures by just NZD1 billion for FY 2014/15. It will then boost operating expenditures by NZD1.5 billion in FY 2015/16, and by just 2% per year thereafter. As a result the government sees Core Crown (central government) expenditures easing from an estimated 31% of GDP in FY 2013/14 to 29.9% in FY 2017/18.

Small number of policy sweeteners added ahead of election

Even with the spending restraint put forth in the budget, the government managed to sneak in a few spending initiatives to bolster voter sentiment towards the National party ahead of the September election. One key area targeting voters is the government's initiatives to make housing more affordable, following the run-up in prices during 2013 which stemmed from housing shortages in Canterbury and Auckland. The government's housing initiatives focus on lowering the cost of building materials by dropping tariffs on imported building materials, increased housing assistance for high-need families, and potentially freeing up housing supply by releasing more land for construction. The government also put forth a number of initiatives to support families and their children including boosting parental tax credits, extending maternity and paternity leaves, increased spending on education from early-education to tertiary education, and providing free doctors visits for children under 13 years old. There are also a number of initiatives funding transportation infrastructure construction, education and health infrastructure, and research and development.

Outlook and implications

Overall the 2014 budget held few significant surprises and broadly sticks to the path laid out by previous budgets for the government's return to fiscal surplus. Barring another collapse in the global economy or a collapse in agricultural goods prices, New Zealand should be able to return a small budget surplus in the coming fiscal year. If the government finds that revenues are falling short of expectations, IHS expects that the government would pull back some of the sweeteners introduced in the budget, or commit to additional spending reprioritisation. With regards to the country's sovereign credit risks, we do not see the budget plan fundamentally changing the country's risk outlook. This is because the path to surplus has not changed and is now looking very likely to succeed. Furthermore, the country's sovereign credit risks are less influenced by fiscal issues and government borrowing than by significant private-sector borrowing on international markets to finance savings shortfalls.

NS e1101 : Economic Growth | e11 : Economic Performance/Indicators | ecat : Economic News | e1108 : Budget Account | e21 : Government Finance | e211 : Government Taxation/Revenue

RE austr : Australia | nz : New Zealand | apacz : Asia Pacific | ausnz : Australia/Oceania

IPD Main Story

PUB Global Insight Limited

AN Document WDAN000020140516ea5g00013

