BUDGET 2020

Wellbeing 2020: Rebuilding Together

ECONOMIC FORECASTS BEFORE COVID-19

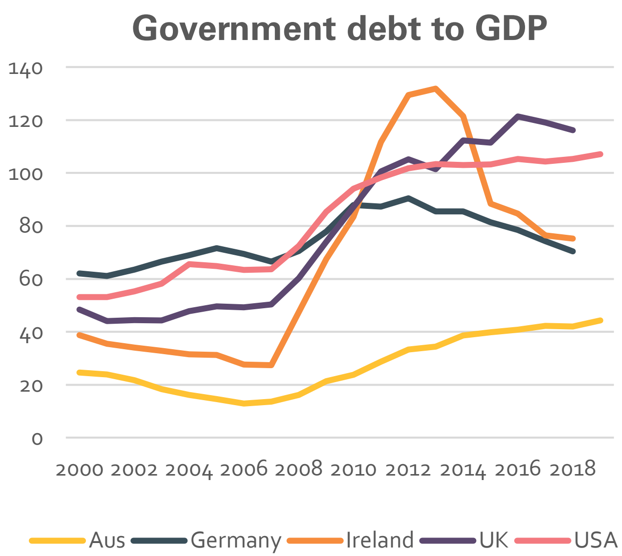
BEFORE THE PANDEMIC, THE GOVERNMENT'S FINANCES WERE WELL PLACED TO RESPOND TO AN ECONOMIC SHOCK

Government finances were in a strong position before COVID-19, and this has enabled the country to respond to the pandemic with significant spending.

Since 2014, NZ governments have recorded budget surpluses. In the past two years those surpluses have been substantial – $5.5B and $7.3B respectively for the 2017/18 and 2018/19 financial years.

The Government had a target of keeping the ratio of debt to GDP between 15 and 25%. Forecasts for debt to GDP were close to 20% before the pandemic, although March results saw a rise in net debt due to the Wage Subsidy payments.

New Zealand is in a good financial position compared to other similar countries, with low debt relative to GDP. Even Australia, with traditionally low debt levels, has a debt to GDP ratio over 40%, nearly twice New Zealand's level.



Election year Budgets in 'normal' times typically include promises of increased spending, and the Government had already announced a significant infrastructure package of up to $12B in December 2019.

As a consequence of the announced infrastructure spending, the Treasury had already been forecasting a small deficit for the 2019/20 year at the time of its half-year economic and fiscal update (HYEFU), in December.

Summary of the Treasury's fiscal forecasts before COVID-19

Year ending 30 June % of GDP	2019 Actual	2020 Forecast	2021 Forecast	2022 Forecast	2023 Forecast	2024 Forecast
Total Crown OBEGAL	2.4	(0.3)	0.0	0.5	1.1	1.5
Net core Crown debt	19.0	19.6	21.0	21.5	20.9	19.6

FIGHTING THE VIRUS IN WAVES

THE GOVERNMENT HAS ANNOUNCED A THREE-WAVE RESPONSE TO COVID-19 AS PART OF BUDGET 2020

Wave 1: Fight the virus and cushion the blow

This wave has focused on immediate public health measures to stamp out COVID-19, and on doing as much as possible to limit the economic impact of the virus.

Three key principles informed the economic decisions in Wave 1:

- Act swiftly with no regrets
- Improve cashflow and confidence
- Act in coordination to secure and support our financial and business sector.

The Wage Subsidy was crucial to the economic response in this phase. By 8 May, more than $10.6B in wage subsidies had been paid to support 1.7 million employees (close to 60% of NZ’s total estimated workforce).

Wave 2: Kickstart the economy

This phase supports businesses as lockdown ends and the economy opens up, but with restrictions affecting how business is done.

A significant focus during this phase will likely be on preparing ‘shovel ready’ infrastructure projects to begin as soon as possible. This has included changes to the Resource Management Act to fast-track these projects.

There are also a range of other programmes sitting in this space, including:

- Establishing an Economically Significant Business Group
- Projects to not only drive jobs, but also deal with long-term issues and challenges
- Critical training and employment support.

Wave 3: Reset and revitalise

This wave will be about the long-term fundamentals of the economy and the sectors within it, and about addressing long-term issues with the economy.

It’s about considering what type of economy the country wants to have.

While many economic indicators were strong before the pandemic – low debt, low unemployment, rising wages and government surpluses – there is also now a recognition that the economy was not working for all New Zealanders.

The Budget includes a large fund that, if used wisely, could address these long-term issues and support the transition to a more productive, sustainable and inclusive economy.

A $52 BILLION RECOVERY FUND

THE GOVERNMENT HAS SET ASIDE $52B IN A COVID-19 RESPONSE AND RECOVERY FUND AS PART OF BUDGET 2020

HOLDING $20B IN RESERVE

The Government has committed $30B to the COVID-19 Response and Recovery Fund, but another $20B has also been set aside without decisions yet on how and where this funding will be targeted.

This is, of course, similar to how the Government established the Provincial Growth Fund, but more quickly and on a much larger scale.

The Government announced an initial $12.1B support package to respond to COVID-19 in March. It has now also announced **further spending of up to $50B**.

This additional spending includes significant commitments already:

- **Nearly $4B in additional health spending**, for DHBs to respond to pressing health needs
- **A further $2.8B for the Wage Subsidy**, targeted at industries that will need it most, like tourism and hospitality
- **$3B in infrastructure and a further $5B public housing investment** to build 8,000 new state houses.
- **$1.1B for creating environmental jobs** in the regions.

The $20B set aside is likely to be **committed over the next few months,** with significant announcements expected before the election. This will form the next phase of the Government's response to the pandemic and accompanying economic support.

The budget is heavy on dollars but **light on specifics for infrastructure investment**, beyond the announced public housing investment. This indicates that substantial infrastructure investment and spending decisions are still to come, likely from shovel-ready proposals.

Early indications are that up to $136B in projects have been proposed through the shovel-ready process, so the new funding committed in this Budget for infrastructure represents a relatively small share of what has been signalled through these processes.

THIS BUDGET SEES BIG INCREASES IN SPENDING AND DEFICITS

GOVERNMENT SPENDING IS FORECAST TO INCREASE TO $114B, UNEMPLOYMENT IS FORECAST TO PEAK AT 9.8% IN SEPT 2020, AND THE DEFICIT WILL BE $28B IN FY 2020

For Budget 2020/21, the Government expects to collect $82.3B in revenue, and have $114.0B in core Crown expenses, for a **deficit of $28.3B** – or **9.6% of GDP**. The forecasts also include multiple years of deficit spending, with debt to GDP peaking at more than 50% by 2024.

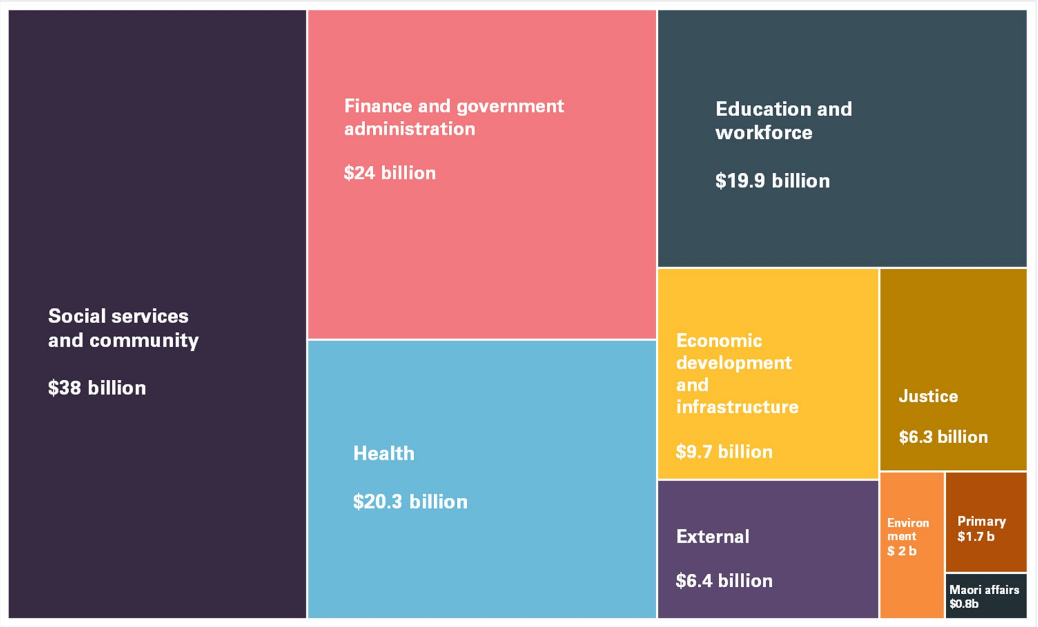
This will be the first deficit run by a New Zealand government since the response to the Canterbury Earthquakes in 2014.

However, **these deficit levels are not unprecedented** – the deficit was 8.9% of GDP in 2010/11 following the earthquakes, and deficit levels were above 6% of GDP during major economic reforms in the 1980s.

Treasury is forecasting unemployment to **increase to 9.8%** by September 2020, before decreasing to 4.8% by March 2024. Treasury's forecasts include a **strong rebound** in economic activity in 2021 and 2022.

Downside risks to these forecasts remain real, particularly downside risks from global economic conditions.

The diagram below shows a breakdown by sector of the proposed spending in 2020/21.



Source: Estimates of Appropriations, 2020/21 (note that these figures include non-departmental output expenses that are not included in the total core Crown expense figure)

BUT IS IT TRANSFORMATIVE?

DESPITE THE SIGNIFICANT INCREASES IN SPENDING, THERE ARE ONLY SMALL SIGNS OF ECONOMIC TRANSFORMATION IN THE ANNOUNCED SPENDING

If there can be one criticism of the Budget, it is that it appears narrowly focused on using the Crown's strong balance sheet to fill the economic hole created by the pandemic.

This investment is probably necessary, but the investment itself doesn't yet seem to be transformative. The committed investment appears focused on 'typical' government spending – core infrastructure and the Wage Subsidy scheme, which is, in effect, an unemployment benefit.

However, this Budget was of course pulled together at great pace – it was finalised only **three days before Budget day**, whereas Budgets are usually finalised six weeks in advance.

The commitments announced to date address important short-term issues, in particular cushioning the impact on businesses and jobs.

But there is little in the Budget that points to **longer-term transformation** of the economy.

This is where **'Wave 3' and the uncommitted $20B** comes in. How much of this is committed, and what it is spent on, will be a defining feature of how this Budget will be judged in the future.

The Government should look for opportunities that have **dual objectives** of supporting the economy in the short term while also addressing long-term challenges.

SOME KEY QUESTIONS

What is the future for **domestic and international tourism** in NZ?

What is the balance between helping people **simply find a job vs preparing for the future of work?**

How does government continue to maintain **social cohesion and social welfare needs** as our economy recovers from COVID-19?

What are the key infrastructure and investment needs for **local government**?

What is the future of our **public health needs** in our post-lockdown world?

Climate change isn't going away – how can investment in infrastructure be used to support a transition to a 'cleaner' economy?

MINI-BUDGETS AS PART OF A 'ROLLING MAUL'

WITH THE $20B SET ASIDE, AND THE NEED FOR WELL-TARGETED ECONOMIC TRANSFORMATION, WE EXPECT A SERIES OF 'MINI-BUDGETS' IN THE COMING MONTHS

With the significant amount set aside as part of the COVID-19 Response and Recovery fund, we expect the Government to move swiftly in the coming weeks to commit to additional spending.

We expect this spending to **align with Waves 2 and 3** of the Government's response.

In effect, these funding rounds will function as **mini-budgets** over the next several months, in the lead-up to the election period.

This approach will also give the Government the flexibility to respond to **emerging economic and social needs,** as the country hopefully continues to move further away from lockdown and back to a more 'normal' economy.

But we can expect the new economy to be quite different from the pre-pandemic 'normal'.

The Budget lays out starkly that **our economy is in for a challenging time** – probably the most challenging economic period we have all seen in our lifetimes.

But despite this challenge, New Zealand is well-positioned to respond: its public health response has been cited as **one of the best in the world,** and the Crown's balance sheet can help cushion much of the immediate blow.

The big questions in the months ahead will be **how productive** that additional $20B in spending is, and whether it is used to **truly transform** the economy.

Significant announcements to come

We expect a series of significant investments to be announced in the coming months, including:

- Further infrastructure investments made as the shovel-ready projects list is agreed
- Further investment to come in health and our public health response
- Probably more to come in social support and services
- Further targeted support for sectors hit hard by the virus, similar to what we have already seen for sport and media.

MARTIN JENKINS

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