

New Zealand economic update

2008 Budget Outcome

New Zealand's Finance Minister Michael Cullen today delivered his ninth Budget. According to the minister, the Budget focused on providing a "fair deal" for all New Zealanders and planning for a strong and sustainable future.

The Budget centered on five key areas: responding to families needing relief from price pressures; a fair, longer term tax programme; maintaining social services; sensible fiscal management; and an integrated programme to build a stronger, sustainable economy.

The key points are outlined below.

Economic Outlook – Budget forecasts

- GDP growth will slow to 1.5% in the year to March 2009, before picking up to 2.3% in 2009/10 and 3.2% in 2010/11. These compare to JPMorgan's GDP growth forecasts of 1.4% in 2008 and 2.3% in 2009.
- Unemployment will trend up toward 4.5% over the next three years, from 3.4% currently.
- Inflation will moderate over the next three years, falling back within the RBNZ's target range in 2009/10. We currently forecast inflation at 3.2% in 2008 and 2009.
- The current account deficit will remain above 7% of GDP over the next three years.

Economic forecasts			
%oya year ending March 31	2008/09	2009/10	2010/11
Economic growth (annual average)	1.5	2.3	3.2
Economic growth (annual)	1.6	2.9	3.2
Unemployment	3.7	4.4	4.5
Inflation	3.2	2.8	2.8
Current account (% of GDP)	-7.2	-7.2	-7.1
Private consumption	1.9	1.9	1.6
Exports	-0.9	4.0	4.4
Imports	0.9	1.3	1
90-day bank bill	8.5	7.9	7.9
TWI	68.6	63.1	59.1

Income tax relief

Tax cuts will total NZ\$10.6 billion over four years, commencing October 1. Tax cuts were made mainly via adjustments to income tax thresholds, although the lower tax rate was reduced.

- The bottom tax rate will fall from 15% to 12.5% and the amount a person can earn before higher tax rates cut in will rise from \$9,500 to \$14,000.
- The 21% tax rate threshold will be raised from \$38,000 to \$40,000 on October 1, and again to \$42,500 on April 1, 2011.
- The 33% tax rate threshold will be raised from \$60,000 to \$70,000 on October 1, and again to \$75,000 on April 1, 2010, and to \$80,000 on April 1, 2011.
- The 39% tax rate threshold will be raised from over \$60,000 to over \$70,000 on October 1, and to over \$75,000 on April 1, 2010, and to over \$80,000 on April 1, 2011.
- The changes mean that a worker earning \$50,000 a year will receive an extra \$16 a week, an extra \$22 a week from April 1, 2010, and an extra \$32 a week from April 1, 2011.
- A single income family on \$40,000 a year with two young children would be better off by \$1603 a year from October and \$2967 a year from April 1.

Tax rates			
	New tax rate thresholds from:		
Current rates	1-Oct-08	1-Apr-10	1-Apr-11
15% to \$9500	12.5% to \$14000	12.5% to \$17500	12.5% to \$20000
21% to \$38000	21% to \$40000	21% to \$40000	21% to \$42500
33% to \$60000	33% to \$70000	33% to \$75000	33% to \$80000
39% over \$60000	39% over \$70000	39% over \$75000	39% over \$80000

Other highlights

- The indexation of Working for Families (a package designed to help make it easier to work and raise a family) to take account of cost of living increases is to be brought forward to October 1 from April 1

next year. A second round of Working for Families indexation would occur on April 1, 2011.

- Funding of \$500 million allocated to facilitate high speed broadband in urban areas and extend the reach of broadband into under-served regions over the next five years.
- \$168 million to improve literacy and numeracy in the workforce to help alleviate the skills shortage.
- The New Zealand Fast Forward fund to boost innovation in the pastoral and food industries receives \$700 million in capital.
- The government's purchase of Toll New Zealand's rail and ferry business will be funded with \$690 million in the 2007/08 year.
- \$750 million a year (or \$3 billion over four years) to improve health and related services, including a new vaccination programme to fight cervical cancer.
- \$182 million in operating funding to reduce year one class sizes.
- \$180 million in operating funding for more police.
- A 10% rise in the parental income threshold for a full student allowance from next January, benefiting 12,000 students a year.
- \$276.4 million to develop defence capability.
- \$165.2 million to strengthen the nation's presence in the international community.
- \$124.4 million to develop arts and culture.

Short term fiscal intentions

- The operating balance after one off gains and losses (OBEGAL) excluding NZS Fund revenue is forecast to be around 3.6% of GDP in 2007/08, decreasing to 1.7% of GDP by 2011/12.
- Total debt (including Reserve Bank settlement cash) is forecast to be 24.7% of GDP in 2011/12.
- Gross sovereign-issued debt including net settlement cash is forecast

to be 18.6% of GDP in 2011/12. Excluding net settlement cash, gross sovereign-issued debt is forecast to be 15.6% of GDP in 2011/12

Expenses

- Total Crown expenses are forecast to be 41.8% of GDP in 2011/12.
- Core Crown expenses are forecast to average 32.5% over the forecast period and be 33% of GDP in 2011/12.
- This assumes new operating expense amounts of \$2 billion in 2008 and 2009, and \$2.1 billion in the 2010 Budget.

Revenues

- Total Crown revenues are forecast to be 41.8% of GDP in 2011/12. Within this, core Crown revenues are forecast to be 34.3% of GDP in 2011/12.
- This assumes new revenue initiatives resulting in a \$1.5 billion reduction in revenue per year from April 2009, plus the previously announced Business Tax Reform resulting in a \$1.13 billion reduction in revenue in 2008/09.

Net worth

- Total Crown net worth is forecast to be 58.5% of GDP in 2007/08, rising to 60.6% of GDP in 2011/12.
- Excluding NZS Fund assets, total Crown net worth is forecast to be 46.0% of GDP in 2011/12.
- Core Crown net worth is forecast to be 34.9% of GDP in 2011/12.

Impact on monetary policy

The significant loosening of fiscal policy via larger than expected income tax relief delivered in Budget 2008, and the significant increase in government spending, will leave little scope for the RBNZ to cut interest rates in coming months. Futures market pricing implies rate cuts could come as early as next month, but this now looks much less likely.

Expectations of a near term boost to disposable income should boost

household confidence, but the rising costs of staples, such as food and energy, will mean that the RBNZ probably will offer some interest rate relief later this year. Our forecast calls for the RBNZ to cut the OCR 25bp in October and by another 25bp in December, taking the key rate to 7.75% by year end.

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