Fiscal Strategy Report

Hon Steven Joyce
Minister of Finance

25 May 2017

ISBN: 978-0-947519-73-5 (print) 978-0-947519-74-2 (online)

Guide to the Budget Documents

A number of documents are released on Budget day. The purpose of these documents is to provide information about the Government's fiscal intentions for the year ahead and the wider fiscal and economic picture. The documents released on Budget day are as follows:

Budget at a Glance

The *Budget at a Glance* is the overview of all the Budget information and contains the main points for the media and public. This summarises the Government's spending decisions and key issues raised in the *Budget Speech*, the *Fiscal Strategy Report,* and the *Budget Economic and Fiscal Update*.

Capital at a Glance

The *Capital at a Glance* is the overview of the Government's capital investment and contains the main points for the media and public. This summarises the Government's new capital investment decisions in Budget 2017 and the overall actual and forecast investment of the Government as a whole.

Budget Speech

The *Budget Speech* is the Budget Statement the Minister of Finance delivers at the start of Parliament's Budget debate. The Budget Statement generally focuses on the overall fiscal and economic position, the Government's policy priorities and how those priorities will be funded.

Summary of Budget Initiatives

The *Summary of Budget Initiatives* lists and describes the new initiatives included in Budget 2017.

Fiscal Strategy Report

The *Fiscal Strategy Report* sets out the Government's fiscal strategy in areas such as the balance between operating revenues and expenses, and its debt objectives. The report includes the Government's long-term fiscal objectives and short-term fiscal intentions plus fiscal trends covering at least the next 10 years.

The Government must explain changes in the *Fiscal Strategy Report* from the *Budget Policy Statement* and the previous year's *Fiscal Strategy Report* and any inconsistencies between these documents.

Budget Economic and Fiscal Update

The *Update* includes the Treasury's economic forecasts and the forecast financial statements of the Government incorporating the financial implications of government decisions and other information relevant to the fiscal and economic outlook.

The Estimates of Appropriations

The *Estimates* outlines for the financial year about to start (the Budget year) expenses and capital expenditure the Government plans to incur on specified areas within each Vote, and capital injections it plans to make to individual departments. The *Estimates* is organised into 10 sector volumes, with each Vote allocated to one sector. Supporting information in the *Estimates* summarises the new policy initiatives and trend information for each Vote and provides information on what is intended to be achieved with each appropriation in a Vote and how performance against each appropriation will be assessed and reported on after the end of the Budget year.

Also released on Budget day

The Supplementary Estimates of Appropriations

The *Supplementary Estimates* outlines the additional expenses, capital expenditure and capital injections to departments required for the financial year about to end. Supporting information for each Vote provides reasons for the changes to appropriations during the year, related changes in performance information and full performance information for new appropriations.

To download these documents and explore additional interactive content visit **www.budget.govt.nz**

Fiscal Strategy Report

Summary

The economic and fiscal outlook is positive. The Government is focused on making investments to support a growing economy and rebuilding its fiscal capacity to respond to future shocks.

The Government is on target to meet its fiscal objectives, operating surpluses are growing and net debt is on a downward trajectory with forecasts showing it falling below 20 per cent of GDP by 2020/21.

Budget 2017 provides for an increase in operating and capital spending allowances focused on investing in the public services and infrastructure required for a growing country, as well as addressing the implications of the Kaikōura earthquake.

Budget 2017 also includes the Family Incomes Package aimed at boosting the after tax incomes of low and middle income households and providing greater rewards for hard work. The Budget lifts the two lower income tax thresholds and implements targeted increases to the family tax credit component of Working for Families and the Accommodation Supplement.

To reflect the improvements to the fiscal outlook and the Government's intention to build fiscal resilience, the Government's long-term debt objective has been updated. The Government now aims to reduce net debt to between 10 per cent and 15 per cent of GDP by 2025, after the current target of around 20 per cent of GDP by 2020 has been achieved.

Reducing debt to this level will allow the Government to have the capacity to support New Zealand communities following a significant adverse economic shock or natural disaster.

Fiscal Performance

As a result of the recession of 2008/09 and the effects of the global financial crisis, fiscal projections prepared in early 2009 showed that, without a policy response, net debt would increase to over 60 per cent of GDP. Instead, as a result of the Government's ongoing programme of responsible fiscal management, operating surpluses are growing and net debt peaked at 26 per cent of GDP and is now falling.

Immediately following the recession, the Government supported New Zealanders and the economy by running deficits. The operating deficit reached a peak of $18.4 billion in 2010/11 following the Canterbury earthquakes, and between 2007/08 and 2012/13 net debt increased by 20 percentage points of GDP.

Over time it was necessary to make well-considered expenditure changes to reduce the operating deficit while continuing to improve public services.

New spending allowances were reduced, efficiency savings were made across the public sector and specific programmes were altered to control long-term costs. Contributions to the New Zealand Superannuation Fund (NZS Fund) were suspended, and new capital spending in Budgets 2012 to 2015 was funded through capital recycling rather than additional borrowing.

As a result of these changes the operating deficit was eliminated and the Government delivered a $1.8 billion surplus last year. Net debt is now falling as a proportion of GDP and is forecast to shrink in dollar terms from 2019/20 onwards.

Economic Context

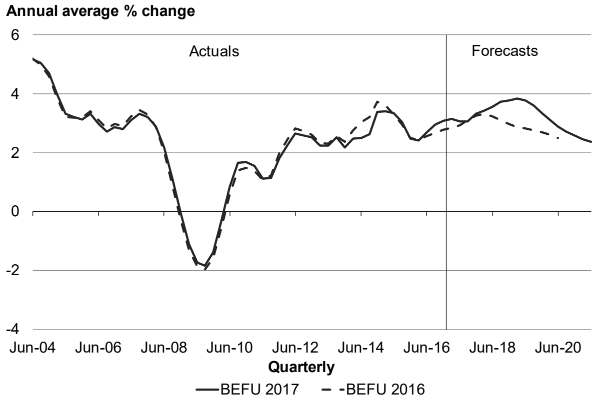
The economic outlook is positive, supported by exports (particularly tourism), construction activity, high levels of inward migration, and low interest rates.

Real GDP grew 3.1 per cent in the year ended December 2016. Annual economic growth is forecast to average over 3 per cent over the next four years, peaking at around 3.8 per cent in 2019 (Figure 1).

Over this period, employment is forecast to continue to grow strongly, with the number of people employed increasing by 215,000 over the forecast period, while unemployment is forecast to gradually decline. Wages are forecast to grow over the forecast period, with average wages expected to be over $64,000 by the end of the forecast period (Figure 2).

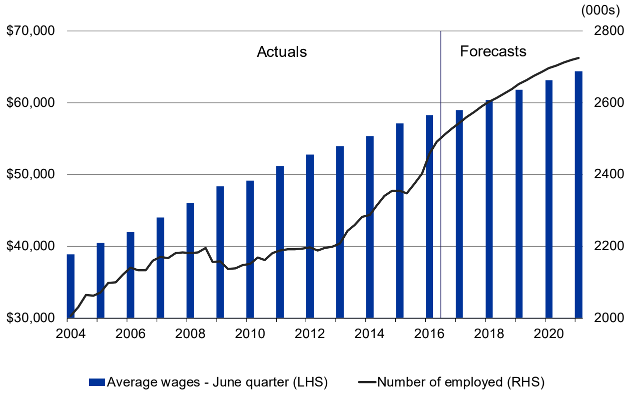
Consumer price inflation is expected to pick up over the forecast period as spare capacity is used up, stabilising around an annual rate of 2 per cent (Figure 3).

Figure 1 – Real GDP growth



Sources: StatsNZ, the Treasury

Figure 2 – Employment and wages



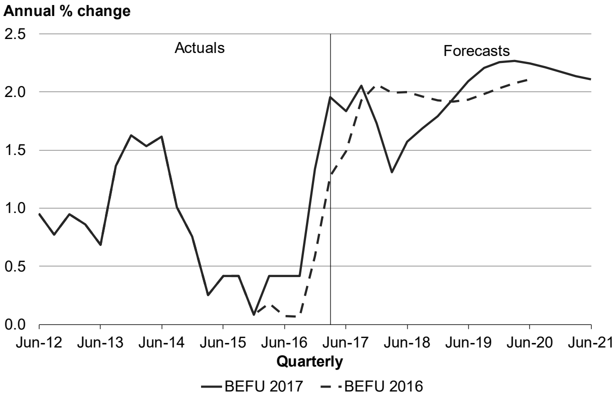
Sources: StatsNZ, the Treasury

The strong outlook for real GDP growth, along with an improved terms of trade, helps drive a significantly higher level of nominal GDP than was expected in the Treasury's *Half Year Update*. Compared with the *Half Year Update*, nominal GDP is forecast to be a cumulative $23.9 billion higher over the five years to June 2021. The current account deficit is expected to widen but remain below 4 per cent of GDP.

New Zealand's net international investment position has improved significantly since 2009: from a net liability position of 84 per cent of GDP in early 2009 to a net liability position of around 60 per cent of GDP at the end of 2016. Over the forecast period, the net international investment position is expected to remain broadly stable as a percentage of GDP.

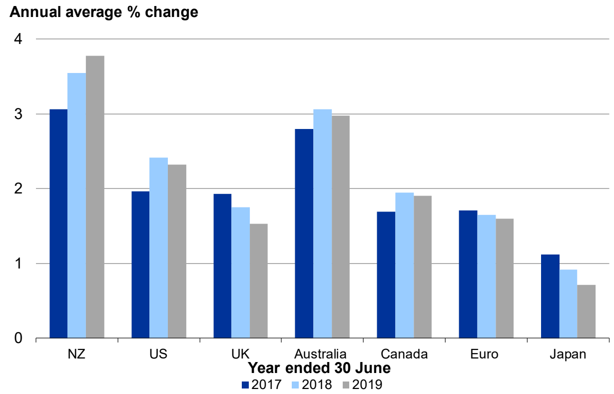
Continued global risks underline the need for maintaining prudent fiscal policy. Growth has slowed in Australia but this has been offset by faster growth in other advanced economies. Uncertainty remains around Brexit, the continued imbalances in the Chinese economy and future US economic, trade and fiscal policy. Domestically, net migration flows, house price inflation and the construction cycle could also differ from those assumed in forecasts.

Figure 3 – CPI inflation



Sources: StatsNZ, the Treasury

Figure 4 – New Zealand and trading partner GDP growth forecasts



Sources: IMF, the Treasury

Table 1 – Summary of the Treasury's economic forecasts in the *Budget Update* (BEFU)

Year ended 30 June	2016 Actual	2017 Forecast	2018 Forecast	2019 Forecast	2020 Forecast	2021 Forecast
Real GDP growth (annual average % change)	2.7	3.1	3.5	3.8	2.9	2.4
Consumer price inflation (annual % change)	0.4	1.8	1.6	2.1	2.2	2.1
Unemployment rate (June quarter)	5.0	5.0	5.0	4.6	4.3	4.3
Current account (% of GDP)	-2.9	-2.8	-3.0	-3.3	-3.7	-3.9

Sources: StatsNZ, the Treasury

The Government's Fiscal Priorities

Long-term Objectives

The Government's finances continue to improve as a result of ongoing responsible expenditure management.

Reflecting this improvement, and the importance of building fiscal resilience, the Government has updated its long-term debt objective. The Government now plans to reduce net debt to between 10 per cent and 15 per cent of GDP over the long term, and aims to be within this band by 2025. The short-term target of reducing net debt to around 20 per cent of GDP in 2020 remains unchanged.

The new net debt objective will allow the Government to continue to support New Zealand communities following future significant adverse events. Should an economic shock occur it may be appropriate for net debt to rise above the targeted level for a period of time – preventing the Government from having to cut vital public services or infrastructure investments.

The new net debt objective complements the Government's other long-term objectives, which remain unchanged: keeping core Crown expenses below 30 per cent of GDP and ensuring operating balances are sufficient to meet net capital requirements, including NZS Fund contributions.

Short-term Priorities

The Government's short-term priorities have been updated to reflect the new debt target and to show the priorities for any additional fiscal headroom:

- Maintain rising OBEGAL[1] surpluses over the forecast period so that cash surpluses are generated and net debt begins to reduce in dollar terms.
- Reduce net debt to around 20 per cent of GDP in 2020, and to between 10 per cent and 15 per cent of GDP by 2025.
- Invest in the public services and infrastructure needed for a growing country.
- As fiscal conditions allow, adjust tax and transfer settings to improve family incomes and simplify the income tax and transfer system.

The Government intends to use any positive cyclical revenue surprises to strengthen the resilience of the balance sheet.

1 Operating balance before gains and losses.

Budget Allowances

Operating and capital allowances have been updated since the *Budget Policy Statement* (Table 2). This is in part to recognise that, as well as increasing tax revenues, higher-than-expected population growth is increasing demand for health, education and other expenditures, and also to allow for further investment in infrastructure and improving public services.

Budget 2017 has an operating allowance of $1.8 billion per year. For Budget 2018 it has been set at $1.7 billion per year, growing at 2 per cent each Budget until Budget 2020.

Capital allowances for Budgets 2017 to 2020 have been increased to $11 billion in total in order to provide for greater infrastructure investment over the next four years. This includes $4 billion for Budget 2017, which has been increased by $1 billion largely in response to the Kaikōura earthquake.

Table 2 – Budget operating and capital allowances

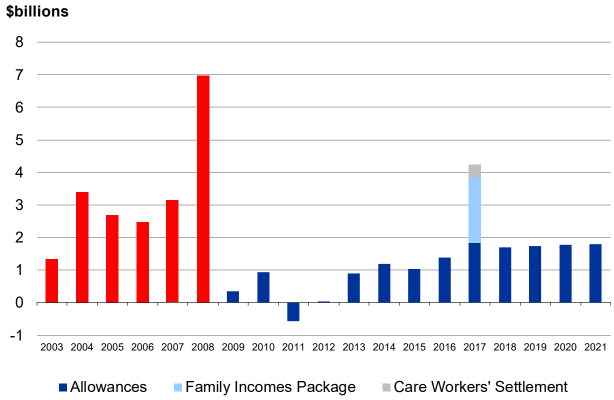
$billions	Budget 2017	Budget 2018	Budget 2019	Budget 2020
Operating allowances at *Budget Policy Statement 2017*	1.50	1.50	1.50	1.50
Operating allowances at *Budget 2017*	1.80	1.70	1.73	1.77
Capital allowances at *Budget Policy Statement 2017*	3.00	2.00	2.00	2.00
Capital allowances at *Budget 2017*	3.98	2.00	2.50	2.50

Source: The Treasury

Budget 2017 also includes the Family Incomes Package – which is aimed at sharing the gains of the growing economy. The package boosts the after-tax incomes of low and middle income households and provides greater rewards for hard work by increasing the bottom two income tax thresholds and implementing targeted increases to Working for Families and the Accommodation Supplement.

Operating allowances remain well below those adopted in the mid-2000s (Figure 5).

Figure 5 – New operating allowances in each Budget (final year impact)

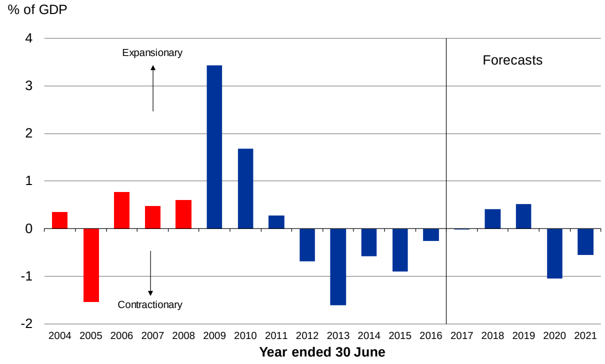


Source: The Treasury

Budget 2017 remains consistent with the Government's fiscal strategy. Economic and fiscal forecasts, accompanied by medium-term projections to 2030/31, show the Government is on track to meet its short-term fiscal intentions and long-term fiscal objectives.

The Treasury estimates that the Government's fiscal settings have a moderately expansionary impact on the economy in the short term and a moderately contractionary impact towards the end of the forecast period (Figure 6). This is expected to add slightly to interest rate pressures in the short term, although the impact unwinds over the forecast period. This is in the context of a significant period of historically low interest rates and weak inflation pressures, high population growth and the need to respond to the Kaikōura earthquake.

Figure 6 – Fiscal Impulse[2]



Sources: The Treasury

Fiscal Forecasts and Projections

For Budget 2017, fiscal forecasts have been prepared for the period 2016/17 to 2020/21 (Table 3). Medium-term projections have been prepared through to 2030/31.

Table 3 – Summary of the fiscal outlook

	Actual			*Forecast*		
$billions, year ended 30 June	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**
Total Crown OBEGAL	1.8	1.6	2.9	4.1	6.1	7.2
Core Crown residual cash	(1.3)	0.1	(1.8)	(1.6)	1.7	1.4
Net core Crown debt[1]	61.9	62.3	64.1	65.7	64.2	62.8
Net worth attributable to the Crown	89.4	100.0	105.6	112.6	122.1	133.0
Core Crown expenses	73.9	77.5	80.5	83.5	86.2	89.2
Core Crown revenue	76.1	80.8	83.8	87.5	92.5	96.8
% of GDP, year ended 30 June						
Total Crown OBEGAL	0.7	0.6	1.0	1.4	2.0	2.2
Core Crown residual cash	(0.5)	0.0	(0.6)	(0.5)	0.5	0.4
Net core Crown debt	24.4	23.2	22.8	22.1	20.6	19.3
Net worth attributable to the Crown	35.3	37.2	37.5	37.9	39.2	40.9
Core Crown expenses	29.2	28.8	28.6	28.1	27.7	27.5
Core Crown revenue	30.1	30.0	29.7	29.5	29.7	29.8

Note: 1 Net core Crown debt excluding the NZS Fund and advances.

Source: The Treasury

2 Fiscal impulse for core Crown and Crown Entities adjusted for EQC and Southern Response payments and receipts.

Core Crown revenue is now expected to fall to just below 30 per cent of GDP over the forecast period, largely as the result of the Family Incomes Package, reversing the increase forecast at the time of the *Half Year Update.*

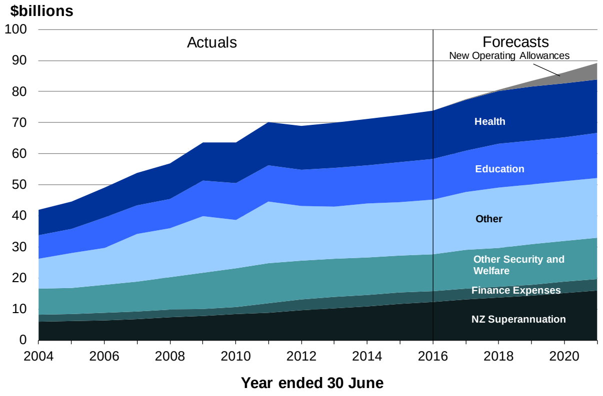
Core Crown expenses are rising in dollar terms (Figure 7) but falling as a share of GDP, having reduced from 33.6 per cent of GDP in 2008/09 to 29.2 per cent of GDP in 2015/16. They are expected to continue to decline as a share of GDP, meeting the Government's long-term objective to maintain core Crown expenses below 30 per cent of GDP (Figure 8).

The operating balance before gains and losses (OBEGAL) is forecast to rise from 2016/17 with surpluses reaching $7.2 billion (around 2.2 per cent of GDP) by the end of the forecast period (Figure 9). A residual cash surplus is forecast from 2019/20 (Figure 10).

OBEGAL surpluses are projected to continue to rise, and are at levels sufficient to meet net capital requirements, including NZS Fund contributions.

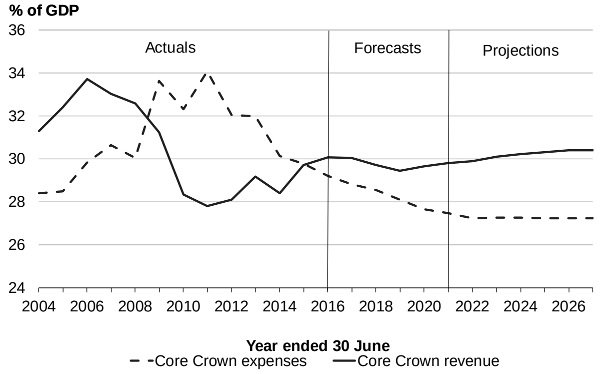
Net debt has peaked as a share of GDP and is now on a downward trajectory. It is forecast to decline to 19.3 per cent of GDP by 2020/21 in line with the Government's short-term debt intention (Figure 12). Contributions to the NZS Fund are expected to resume in 2020/21.

Figure 7 – Core Crown expenses



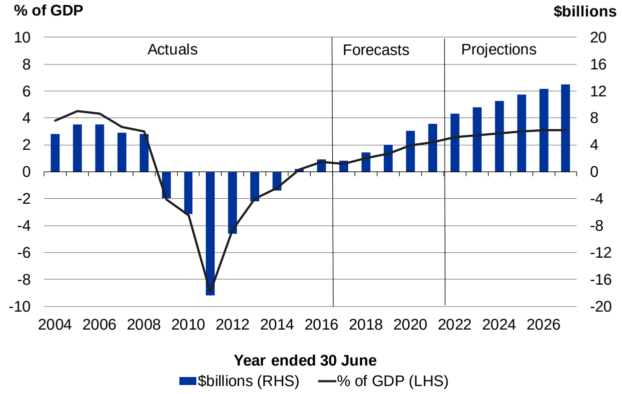
Source: The Treasury

Figure 8 – Core Crown revenue and expenses



Source: The Treasury

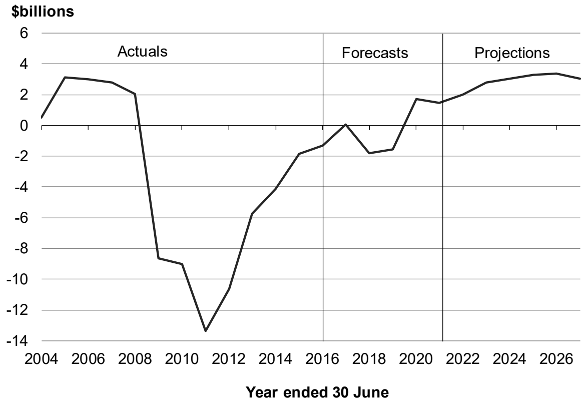
Figure 9 – Total Crown operating balance (before gains and losses)



Source: The Treasury

Beyond 2020/21, projections show net debt continuing to fall and surpluses growing. The projections assume increases in operating and capital allowances beyond 2020/21 so that operating expenses stabilise as a share of GDP at the end of the forecast period and net debt is within the target range of 10 per cent to 15 per cent between 2025 and 2027.

Figure 10 – Core Crown residual cash

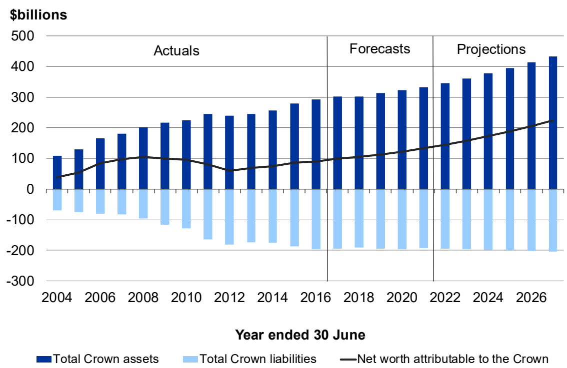


Source: The Treasury

If these projections come to pass, the Government intends to use the fiscal headroom, reflected in these higher allowances, to keep adding investment to infrastructure and public services as required, and also adjusting the tax and transfer system to increase the rewards for hard work.

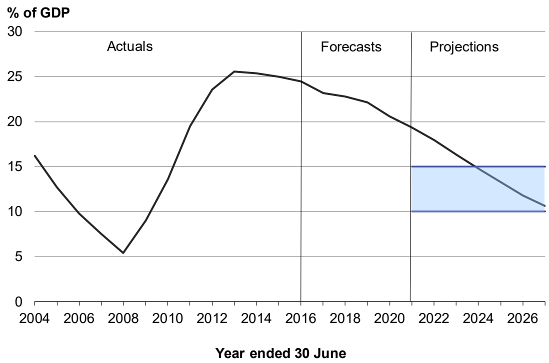
Forecasts and projections are uncertain. The Government's strategy is to take a medium-term approach to economic and fiscal management, looking through any temporary ups and downs and focusing on the overall path of the Crown's finances.

Figure 11 – Net worth attributable to the Crown



Source: The Treasury

Figure 12 – Net core Crown debt



Source: The Treasury

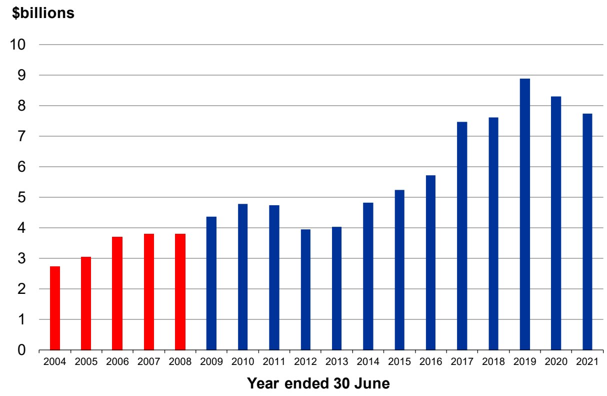
Managing the Crown's Assets and Liabilities

The Crown's assets support the delivery of valuable public services. Its liabilities help to fund these services and consist mostly of debt issued by the Crown.

The most recent year-end results show the Crown owns $293 billion of assets and has $197 billion of liabilities. The difference between these two numbers reflects the Crown's net worth.

Between Budget 2017 and Budget 2020 the Government intends to commit a further $11 billion in new capital investment. As a result, the Crown's investment in new infrastructure, excluding investments by State-owned Enterprises (SOEs) except KiwiRail, will be around $32.5 billion over the next four years (Figure 13).

Figure 13 – Crown infrastructure investment



Source: The Treasury

The Government has many liabilities requiring careful management. They mostly consist of debt, but can also result from other contractual obligations such as government employee superannuation schemes or insurance obligations such as the Accident Compensation Commission (ACC) and Earthquake Commission (EQC). In addition, the Government is exposed to contingent liabilities such as Crown guarantees, and a range of commitments driven by existing policy settings, the largest of which is New Zealand Superannuation.

The Government has been taking a more consistent and deliberate approach to balance sheet management. This involves improving long-term planning, introducing private sector capital and disciplines where appropriate, improving monitoring, increasing transparency and more systematically considering financial risks across the balance sheet.

Disciplined balance sheet management will ensure the Government gets the best value possible from its capital spending, and from the Government's existing assets.

Budget 2017 forecasts the Government's fiscal position to continue strengthening, with both core Crown net and gross debt beginning to decline in dollar terms within the forecast period.

New Zealand government bonds (NZGBs) account for the vast majority of core Crown gross debt and are the Government's main debt funding tool.

The Government recognises the importance of maintaining a sustainable NZGB market. This is necessary to:

- ensure ongoing government access to debt funding, supporting fiscal resilience in the event of future economic shocks

- reduce volatility of government borrowing programmes through economic cycles, and
- provide wider capital markets benefits, including reliable pricing benchmarks for other issuers.

The Government therefore intends to maintain levels of NZGBs on issue at not less than 20 per cent of GDP over time.

Maintaining the size of the NZGB market will generate equivalent increases in core Crown liquid assets. As a result this commitment will have no impact on the Government's overall fiscal strategy, including the profile of net core Crown debt and the timing of resuming contributions to the NZS Fund.

Based on current projections, levels of NZGBs on issue are not expected to fall to 20 per cent of GDP until the mid-2020s.

Managing the Crown’s Revenue and Expenses

The Government’s success in delivering results for New Zealanders whilst also achieving its fiscal targets depends on the continued ability to manage Crown revenue and expenses.

Expenditure control is key to achieving the Government's fiscal objectives. The policy of fixed nominal baselines means that the amount of funding an agency receives each year does not automatically increase to adjust for inflation. Instead, a specific policy decision is required to increase most expenditure items.

The Government is committed to keeping a tight rein on expenditure, and targeting spending to where it has the largest impact for New Zealanders. This approach has helped move the finances back to surplus, giving the Government flexibility to make the investments that support the infrastructure and public services needed by a growing country.

The Government will continue to increase investment in core social services as New Zealand’s population grows. However, it also expects to see ongoing improvements in productivity in the provision of public services, particularly as a result of big investments in digital technology and other infrastructure.

The Government is increasingly taking a long-term view to improving outcomes for New Zealanders, both fiscal and social, in an approach which is known as social investment. Social investment at its most simple is about investing earlier, and more effectively, in the lives of those who may otherwise be on track to experience poor outcomes so they achieve better longer-term outcomes and at a lower total cost.

The Government supports a broad-base, low-rate tax system that responds to New Zealand’s medium-term needs in a planned and coherent way, minimises economic distortions, rewards effort, has low compliance and administrative costs and minimises opportunities for tax avoidance and evasion.

As fiscal conditions allow, the Government intends to continue to adjust tax and transfer settings to improve family incomes and simplify the income tax and transfer system, with a particular focus on low and middle income earners.

Details on the Government’s revenue strategy can be found at www.treasury.govt.nz/government/revenue/strategy

The current tax policy work programme focuses on three areas:

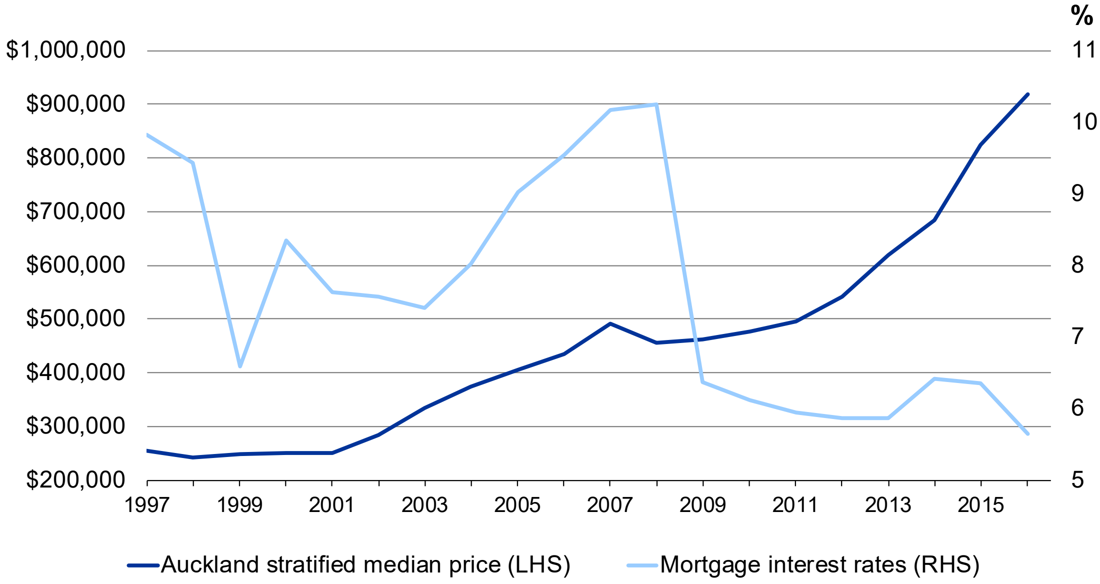
- enhancements to tax policy within the Government's broad-base, low-rate tax framework
- using Inland Revenue's business transformation programme to modernise and simplify tax policy and tax administration settings, and
- dealing with issues relating to international tax and base erosion and profit shifting.

New Zealand's Housing Market

A well-functioning housing market is important for New Zealand's social and economic wellbeing. Housing market trends, especially those relating to housing costs and affordability, are therefore a major focus for the Government.

The strong pace of recent house price growth has been partially the result of strong demand-side pressures, such as households taking advantage of historically low interest rates, and strong economic growth driving population growth and rising incomes. In a well-functioning housing market, these demand pressures and rising prices would encourage an expansion in the housing supply and limit overall price gains.

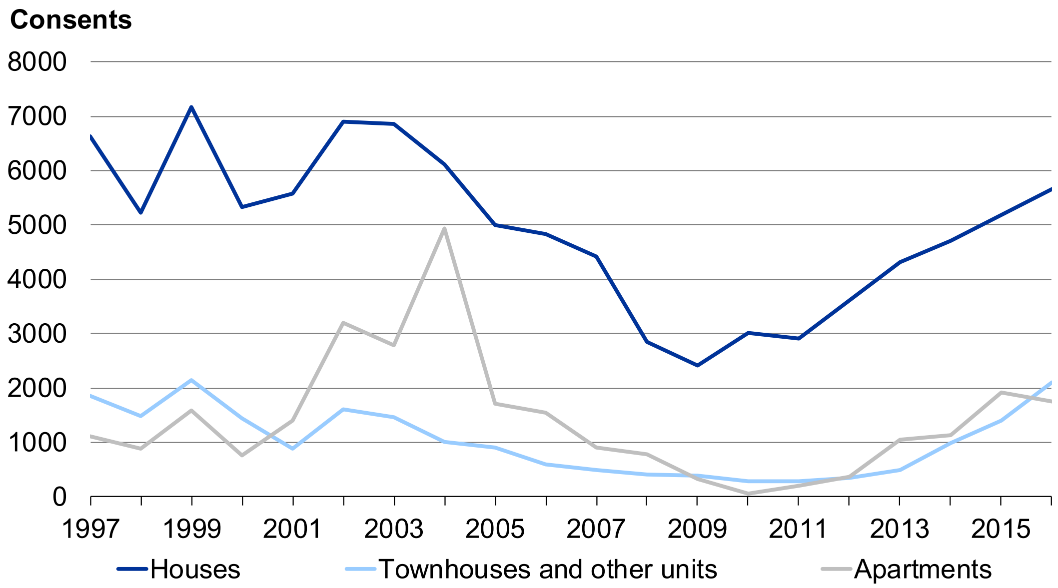
Figure B1 – Mortgage rates and Auckland housing prices



Sources: RBNZ, REINZ, Haver Analytics, the Treasury

However, the supply-side response in New Zealand's housing market has been relatively weak over a long period as a result of restrictions on land availability. The number of consents issued for new houses in Auckland declined steeply from 2003 until 2009. They have recovered strongly again since then but further response is needed.

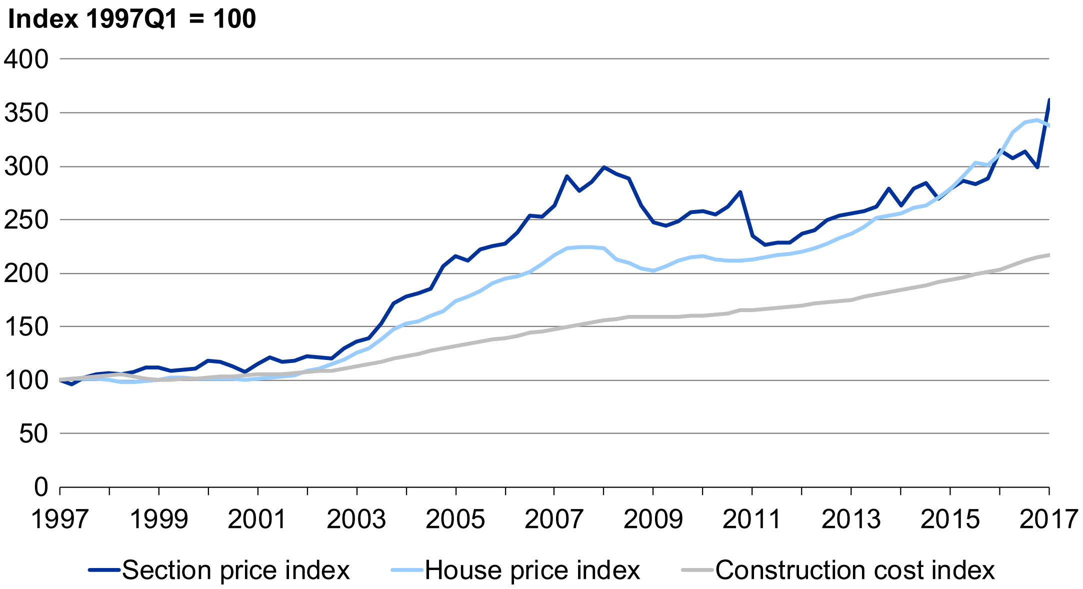
Figure B2 – Building consents



Sources: StatsNZ, the Treasury

Availability of land for development is critical to how the housing market responds to stronger demand. Restrictions on urban development created by excessively restrictive zoning and slow responsiveness in the provision of new infrastructure are contributing to limited competition among landowners.

Figure B3 – Section, construction and housing price indices



Sources: REINZ, RBNZ, QV, StatsNZ, Haver Analytics

The Government has a number of policies to reduce barriers and create incentives to increase the supply of land available for housing. These include legislating to create Special Housing Areas, accelerating the adoption of Auckland's new unitary plan and making amendments to the Resource Management Act. The Government has created the National Policy Statement on Urban Development Capacity, to ensure growth in the supply of urban land for development by councils, and developed the Housing Infrastructure Fund to accelerate the provision of infrastructure for housing in fast-growing areas.

The Government has also freed up significant Crown-owned land for residential development and has developed the Auckland Crown Building Project with Housing New Zealand and others, to build 34,000 new homes in Auckland over the next decade, including replacing 8,300 old rundown houses.

The Government is currently considering whether to adopt the recommendations from the Productivity Commission's *Better Urban Planning* report, to create a better functioning housing market for all New Zealanders.

Annex 1: Short-term Fiscal Intentions and Long-term Fiscal Objectives

The Government's short-term fiscal intentions have been updated since the previous *Fiscal Strategy Report* to reflect the continued focus on net debt reduction to build resilience. The Government's short-term intentions are consistent with the long-term objectives.

Table A1.1 – Short-term fiscal intentions

Fiscal Strategy Report 2017 (May 2017)	*Budget Policy Statement 2017 (Dec 2016)*
Debt Our intention is to reduce net debt to around 20 per cent of GDP in 2020 and to between 10 per cent and 15 per cent of GDP by 2025. Gross sovereign-issued debt (including Reserve Bank settlement cash and Reserve Bank bills) is forecast to be 26.3 per cent of GDP in 2020/21. Net core Crown debt (excluding NZS Fund and advances) is forecast to be 20.6 per cent of GDP in 2019/20 and 19.3 per cent in 2020/21. It is projected to be 13.3 per cent in 2024/25 and 11.8 per cent in 2025/26.	***Debt*** Our intention is to reduce net debt to around 20 per cent of GDP in 2020. Gross sovereign-issued debt (including Reserve Bank settlement cash and Reserve Bank bills) is forecast to be 28.8 per cent of GDP in 2019/20. Net core Crown debt (excluding NZS Fund and advances) is forecast to be 22.2 per cent of GDP in 2018/19, 20.3 per cent of GDP in 2019/20 and 18.8 per cent in 2020/21.
***Operating* balance** Our intention is to maintain rising operating surpluses (before gains and losses) so that net core Crown debt begins to reduce in dollar terms (subject to any significant shocks to the economy). The operating balance (before gains and losses) is forecast to be 0.6 per cent of GDP in 2016/17, rising to 1.0 per cent of GDP in 2017/18 and 2.2 per cent of GDP in 2020/21. This is consistent with the long-term objective for the operating balance. The operating balance is forecast to be 3.3 per cent of GDP in 2020/21.	***Operating balance*** Our intention is to maintain rising operating surpluses (before gains and losses) so that net core Crown debt begins to reduce in dollar terms (subject to any significant shocks to the economy). The operating balance (before gains and losses) is forecast to be 0.2 per cent of GDP in 2016/17, rising to 1.2 per cent of GDP in 2017/18 and 2.7 per cent of GDP in 2020/21. This is consistent with the long-term objective for the operating balance. The operating balance is forecast to be 3.8 per cent of GDP in 2020/21.
Expenses Our intention is to support fiscal surpluses by restraining the growth in core Crown expenses and reducing these to below 30 per cent of GDP. Core Crown expenses are forecast to fall from 28.8 per cent of GDP in 2016/17 to 27.5 per cent of GDP in 2020/21. Total Crown expenses are forecast to be 35.2 per cent of GDP in 2020/21. This assumes new operating allowances of $1.7 billion per year in Budget 2018, growing at 2 per cent per Budget until Budget 2020.	***Expenses*** Our intention is to support fiscal surpluses by restraining the growth in core Crown expenses and reducing these to below 30 per cent of GDP. Core Crown expenses are forecast to fall from 29.6 per cent of GDP in 2016/17 to 27.7 per cent of GDP in 2020/21. Total Crown expenses are forecast to be 35.5 per cent of GDP in 2020/21. This assumes new operating allowances of $1.5 billion per year in Budgets 2017 to 2020.

Fiscal Strategy Report 2017 (May 2017)	*Budget Policy Statement 2017 (Dec 2016)*
Revenues Our intention is to support fiscal surpluses by growing revenue in dollar terms, although maintaining it at broadly the same proportion of GDP. Total Crown revenues are forecast to be 37.6 per cent of GDP in 2020/21. Core Crown revenues are forecast to be 29.8 per cent of GDP in 2020/21. Core Crown tax revenues are forecast to be 27.7 per cent of GDP in 2020/21.	***Revenues*** Our intention is to support fiscal surpluses by growing revenue in dollar terms, although maintaining it at broadly the same proportion of GDP. Total Crown revenues are forecast to be 38.4 per cent of GDP in 2020/21. Core Crown revenues are forecast to be 30.6 per cent of GDP in 2020/21. Core Crown tax revenues are forecast to be 28.3 per cent of GDP in 2020/21.
Net worth Our intention is to strengthen the Crown's balance sheet as a buffer against future adverse shocks. Total net worth attributable to the Crown is forecast to be 40.9 per cent of GDP in 2020/21. Total Crown net worth is forecast to be 42.7 per cent of GDP in 2020/21.	***Net worth*** Our intention is to strengthen the Crown's balance sheet as a buffer against future adverse shocks. Total net worth attributable to the Crown is forecast to be 40.7 per cent of GDP in 2020/21. Total Crown net worth is forecast to be 42.5 per cent of GDP in 2020/21.

The Government's long-term objectives relate to the 10 years beginning in 2017/18. These have been updated since the previous *Fiscal Strategy Report* to provide for a focus on a tighter range of net debt than the previous 0 per cent to 20 per cent range and to make it clear that the Government intends to further reduce net debt after the 20 per cent of GDP target has been met. The other objectives are unchanged and are consistent with the new net debt objective.

Table A1.2 – Long-term fiscal objectives

Fiscal Strategy Report 2017
Debt Manage total debt at prudent levels. Reduce net debt to within a range of 10 per cent to 15 per cent of GDP.
Operating balance Return to an operating surplus sufficient to meet the Government's net capital requirements, including contributions to the NZS Fund, and ensure consistency with the debt objective.
Operating expenses To meet the operating balance objective, the Government will control the growth in government spending so that, over time, core Crown expenses are reduced to below 30 per cent of GDP.
Operating revenues Ensure sufficient operating revenue to meet the operating balance objective.
Net worth Ensure net worth remains at a level sufficient to act as a buffer to economic shocks. Consistent with the debt and operating balance objectives, the Government will start building up net worth ahead of the full fiscal impact of the demographic change expected in the mid-2020s.

These short-term intentions and long-term objectives are consistent with each other and with the principles of responsible fiscal management as set out in the Public Finance Act 1989. More detailed information on the principles can be found at www.treasury.govt.nz/publications/guidance/publicfinance/fiscalpolicyframework/

Contributions to the NZS Fund

The Government is focused on reducing net debt before re-starting Crown contributions to the NZS Fund. Contributions to the NZS Fund are forecast to resume in 2020/21 when net debt falls below 20 per cent of GDP. The contribution in 2020/21 is forecast to be $2.2 billion, based on the Government's policy to lift the age of eligibility for New Zealand Superannuation (NZS) to 67 years by 2040/41.

This delay in contributions will not affect New Zealanders' entitlement to NZS, either now or in the future. Low debt is equally as important as NZS Fund assets in meeting some of the future fiscal pressures from population ageing.

Table A1.3 shows the contributions that would be required if NZS Fund contributions started again in 2017/18.

Table A1.3 – NZS Fund calculation ($billions), year ended 30 June

Calculations of annual contributions if they were to resume in 2017/18, year ended 30 June	**2018**	**2019**	**2020**	**2021**
Under the Government's policy to lift the age of eligibility for NZS to 67 years by 2040/41	1.8	1.8	1.9	1.9
If the age of eligibility for NZS did not increase to 67 by 2040/41	2.4	2.5	2.7	2.7
Forecast contribution	-	-	-	2.2

Fiscal Projections and Assumptions

Fiscal projections to 2031 are made using the final forecast year (2021) as a base. These projections are constructed using the Fiscal Strategy Model (FSM). The main changes to fiscal projections, since the *Fiscal Strategy Report 2016*, are the changes to the assumptions for the operating and capital allowances across the projection horizon. These changes have been adopted to be consistent with projecting a stable expenses-to-GDP ratio and the long-term objective for net debt. Other changes reflect changes to economic and fiscal forecasts, including changes to the outlook for nominal GDP, the profiles for the operating and capital allowances and the impact of the Family Incomes Package.

The full set of modelling assumptions is outlined on the Treasury website at www.treasury.govt.nz/government/fiscalstrategy/model. Key assumptions include:

- Non-welfare spending growth is largely determined by operating allowances.
- Operating allowances are $1.8 billion in Budget 2017 and $1.7 billion in Budget 2018, growing at 2 per cent each Budget until Budget 2020.
- For the projection period, starting in Budget 2021, operating allowances are $2.0 billion and they grow at a rate of 4 per cent per year for each subsequent Budget. These have been set so that core Crown expenses stabilise at approximately 27 per cent of GDP across the projection period.
- New capital spending allowances are $4.0 billion in Budget 2017, $2 billion in Budget 2018, $2.5 billion in Budget 2019 and Budget 2020.

- For the projections, new capital spending allowances are $4.0 billion in Budget 2021, growing at 20 per cent per year for subsequent Budgets. These have been set so tha net core Crown debt is within the target range of 10 per cent to 15 per cent of GDP between 2025 and 2027. These higher allowances reflect the headroom Government has to keep investing in infrastructure and public services, as required, and to adjust the tax and transfer system to increase the rewards for hard work.
- The economy is assumed to grow at trend growth rates with no economic cycles three years after the forecast period.

Table A1.4 – Summary of fiscal projections, as percentages of GDP

	2017	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**	**…**	**2031**
Year ending 30 June	**Forecasts**					**Projections**							
Core Crown revenue	30.0	29.7	29.5	29.7	29.8	29.9	30.1	30.2	30.3	30.4	30.4	…	30.4
Core Crown expenses	28.8	28.6	28.1	27.7	27.5	27.2	27.3	27.3	27.2	27.2	27.2	…	27.2
Total Crown revenue	38.3	37.7	37.4	37.6	37.6	37.8	38.0	38.1	38.2	38.3	38.3	…	38.3
Total Crown expenses	37.5	36.6	35.9	35.5	35.2	35.1	35.2	35.2	35.1	35.1	35.1	…	35.0
Total Crown OBEGAL[1]	0.6	1.0	1.4	2.0	2.2	2.6	2.7	2.9	3.0	3.1	3.1	…	3.2
Total Crown operating balance[2]	3.5	2.0	2.4	3.0	3.3	3.5	3.8	3.9	4.1	4.3	4.3	…	4.5
Gross sovereign-issued debt[3]	35.4	32.2	30.7	29.0	26.3	25.2	23.9	22.6	21.2	19.8	18.6	…	16.2
Net core Crown debt[4]	23.2	22.8	22.1	20.6	19.3	17.9	16.3	14.8	13.3	11.8	10.6	…	8.2
Total Crown net worth	39.4	39.5	39.9	41.0	42.7	44.5	46.4	48.4	50.5	52.7	54.9	…	63.3
Net worth attributable to the Crown	37.2	37.5	37.9	39.2	40.9	42.7	44.7	46.8	48.9	51.2	53.4	…	61.9

Notes:

1 Operating balance (before gains and losses).

2 Excludes minority interests.

3 Whilst these projections show Gross sovereign-issued debt (the majority of which is New Zealand government bonds) falling below 20 per cent of GDP, the Government intends to maintain levels of NZGBs on issue at not less than 20 per cent of GDP over time.

4 Excludes financial assets of the NZS Fund and core Crown advances.

Source: The Treasury