



economics

# BERL BUDGET COMMENTARY

MAY 2010

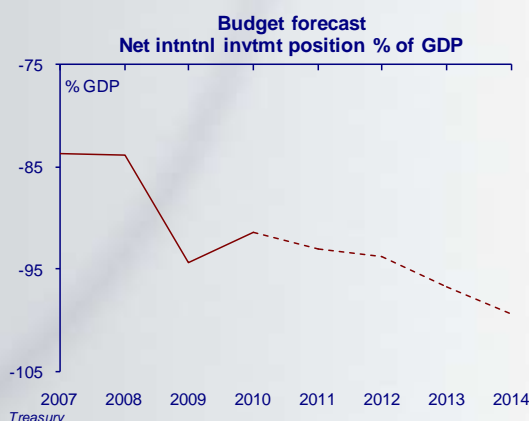
## Top marks, but ...

Top marks to the Finance Minister for today bringing to the fore New Zealand's net external debt. Not just government debt, but the net debt of NZ Inc. To quote from the Minister's Budget Speech:

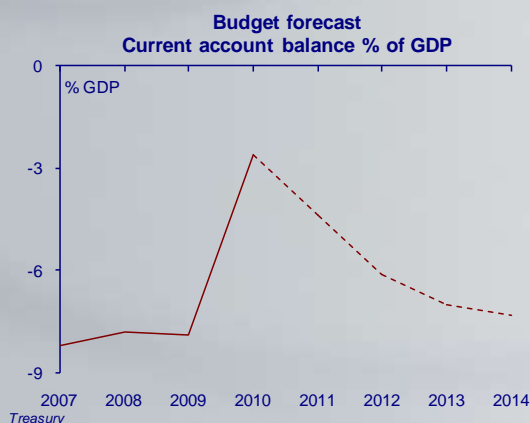
**"New Zealand's largest single vulnerability is now its large and growing net external liabilities. New Zealand now owes the world \$168bn, or around 90 per cent of GDP."**

It has been a long time since this issue has been rightfully acknowledged in the New Zealand policy arena – so, yes, full applause here.

But, having identified the 'largest single vulnerability' facing the nation, the Budget does what appears to be little about it. Moreover, it even acknowledges that this vulnerability is going to get worse over the next few years. As the chart shows, from the current 90 per cent of GDP, the Treasury forecast this vulnerability to deteriorate to 99.4% of GDP by 2014.

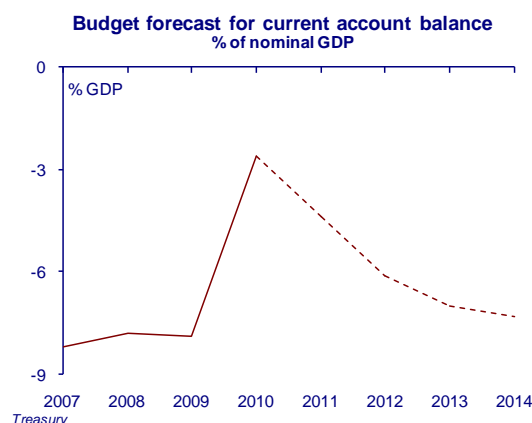


We are not even making progress to turn this juggernaut around!



And you don't even have to agree with our analysis/interpretation of the Budget, just look at the Treasury's own forecasts. The long-awaited re-balancing of growth towards exports succeeds, according to the Treasury, for only one out of the next four years. That is, the net contribution from the external sector (i.e. exports minus imports) to GDP growth is not forecast to be positive again until 2014.

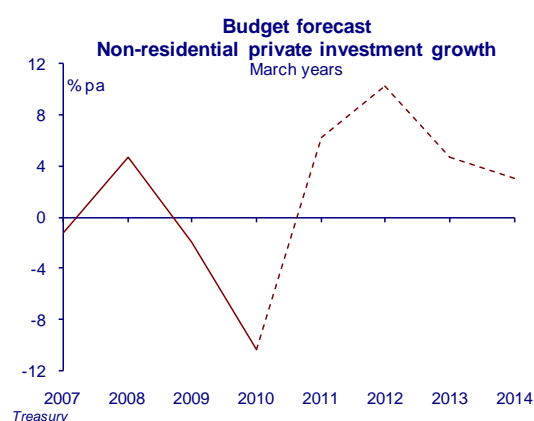
Consequently, as depicted, the deficit on the current account deteriorates. From the recession-induced low of 2.6% in the March 2010 year, it reaches 4.4% of GDP in the March 2011 year, and then climbs to 6.1%, 7.0% and 7.3% in each of the next three March years. This lacklustre performance from the export sector lies at the heart of our growing vulnerability.



Note, this is not picking holes in the Treasury forecast. It is assessing the soundness of the Treasury forecast because this is what underpins the forecast revenue stream to government, which ultimately determines the affordability, or not, of the announced tax cuts.

### Affordability of tax cuts contingent on recovery in business investment

So, if the net external sector is not the lead driver of Treasury's growth forecast, what is? Our reading indicates the growth forecast relies heavily on a noticeable rebound in business investment. In particular, from a 10.4% decline in the year to March 2010, this component is forecast to grow 6.2% in the current March 2011 year; followed by growth of 10.3%, 4.7% and 3.0% in each of the following March years.



Admittedly, business confidence levels are much higher than this time last year.

However, there are few signs that this is being translated into investment spending plans.

This issue is compounded by cash flow considerations and the difficulties to access credit for such expansion. This was reinforced in yesterday's release from the Manufacturers and Exporters Association, "*The stories we are hearing from those involved in the tradable*

*sector suggest that these problems still remain. The banks remain particularly hesitant to lend to firms with currency exposure.*"

Yes, an investment rebound of this magnitude would be welcome news indeed. We are just unsure as to how confident we are of it occurring. But, it is the basis upon which government revenue forecasts and, hence, the affordability of the tax cuts rests.