The Treasury

Budget 2022 Information Release

August 2022

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[23] 9(2)(a) - to protect the privacy of natural persons, including deceased people

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[33] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials

[34] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions

[35] 9(2)(g)(ii) - to maintain the effective conduct of public affairs through protecting ministers, members of government organisations, officers and employees from improper pressure or harassment;

[36] 9(2)(h) - to maintain legal professional privilege

[37] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice

[38] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice

[39] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage

[40] Out of Scope

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TE TAI ŌHANGA
THE TREASURY

Reference: T2022/758 MC-1-5-4

Date: 31 March 2022

To: Minister of Finance
(Hon Grant Robertson)

Deadline: None
(if any)

Aide Memoire: New Net Debt Indicator – Information for Budget Ministers 6 Meeting

This aide memoire responds to your request at Budget Matters on Tuesday 29 March 2022 for talking points on the new net debt indicator ahead of the Budget Ministers 6 meeting on Friday 1 April 2022. This aide memoire covers:

- How the new indicator is different to net core Crown debt
- Why the Treasury has recommended these changes, and
- What the risks and potential criticisms of these changes are, and responses the Government is taking to manage these risks and potential criticisms.

What are the changes to the net debt indicator?

- **The old net debt indicator (referred to as 'net core Crown debt') was calculated as core Crown borrowings with core Crown financial assets netted off**. It did not net off advances or NZ Super Fund (NZSF) financial assets (although a separate indicator with NZSF assets included has also been published).
- **The new net debt indicator includes all the assets and liabilities in the net core Crown debt indicator, and broadens it to include three more**:
    - Crown entity (CE) borrowings (this is mainly Kāinga Ora and Waka Kotahi debt)
    - Advances, which will now be netted off (mainly Reserve Bank Funding for Lending Programme (FLP) loans and student loans)
    - The NZSF, which will also now be netted off.
- **The new net debt measure is expected to peak in 2023/24 at 19.7% of GDP**. This is around 22 percentage points lower than the peak in net core Crown debt.

Why have we recommended these changes?

- **Overall, we consider that the new, broader net debt indicator is a better measure of New Zealand's fiscal sustainability** for use in fiscal management, while being more closely aligned with the measures used by Australia and the IMF.

- **There have been big changes in the composition of the government's balance sheet since the net debt indicator was chosen in 2009**. CE borrowings are larger, advances have temporarily grown a lot due to the Reserve Bank's FLP, and the NZSF is a lot larger.

- **The broader coverage of the new net debt indicator makes it a better measure of New Zealand's fiscal sustainability for use in fiscal management** (ie, it captures debt that is under the control of the Government, and assets that provide an offset to those debts). Specifically:

    - CE borrowings have a similar impact on fiscal sustainability as core Crown borrowings.

    - Advances and the NZSF both provide an offset to debt as they are financial assets that are reasonably liquid (in the case of the NZSF) and/or can be reliably recovered over time (in the case of advances).

- **These qualities mean the new net debt measure creates better incentives for fiscal management.** For example:

    - The impact of alternative monetary policy tools on government debt is better captured in the new net debt measure, supporting co-ordination of monetary and fiscal policy.

    - Decisions to pay down debt or save through NZSF contributions are more equally captured in the new net debt indicator.

- **The changes also bring the coverage of the net debt indicator closer to the net debt measures used by Australia and the IMF**.

    - The equivalent of CE borrowings and advances are included in Australia's measure and the IMF's internationally comparable measure (Government Finance Statistics (GFS) general government net debt). Many other countries include them too.

    - Including the NZSF also brings New Zealand's methodology closer to Australia's as Australia currently includes about 70% of their sovereign wealth fund (the Future Fund) in their headline net debt measure.

    - The IMF's forecast of New Zealand's net debt under their methodology peaks at 26.2% of GDP in 2025, which is much closer to the level of the new net debt measure than our old one. The IMF measure includes many assets not captured in the old net debt indicator, including the fixed interest assets of the NZSF and ACC. (Note that there are still several offsetting methodological differences between the IMF's measure and the new net debt measure – key differences are listed in the risks section below).

- Nevertheless, each jurisdiction has its own accounting standards and particular method for calculating net debt, making universal comparability difficult.

What are the risks of the change?

The table below outlines the key risks and potential criticisms of the shift to the new net debt indicator, and notes responses the Government is taking to manage these risks and potential criticisms.

Risk	Response
The new net debt indicator risks encouraging more borrowing as it is about 20 percentage points of GDP lower than the old one.	**The Government will manage the public finances by working towards an OBEGAL surplus.** **The Government has also set the debt ceiling lower as a result of the change in the measure** - at 30% of GDP, rather than 50% if had it continued using net core Crown debt.
Growth in the NZSF will lower debt over time, encouraging offsetting borrowing in the future.	As in the row above, but also: The adjustment to the debt ceiling from 50% to 30% with the change in net debt measures was based on the levels of each measure at the end of the forecast period at HYEFU. Therefore, the adjustment accounts for four years' growth in the NZSF.[1] When the ceiling is reviewed over the longer term, the Treasury expects to account for growth in the NZSF in its advice to the Government.
The new net debt indicator is likely to be more volatile due to movements in the value of NZSF assets. These movements may add to the pro-cyclicality of net debt.	**We expect volatility in net debt to be less of an issue than in the past** due to shifting focus to OBEGAL and aiming to keep debt well below the ceiling. Furthermore, net debt already moves with the economic cycle, and New Zealand governments have nevertheless successfully run countercyclical fiscal policy over recent decades.[2]
Changing the debt metric may be seen as untransparent.	**The Treasury will continue to calculate and publish the old net debt measure alongside the new measure.**

[1] Specifically, the new net debt measure was 17.4 percentage points of GDP lower than the old measure at the end of the HYEFU forecast period (2025/26). The reduction in the debt ceiling by 20 percentage points therefore more than compensates for the difference in the measures, even though the forecasts include the next 5 years' growth in the NZSF. The difference in the net debt measures is similar in the BEFU Preliminary forecasts, at 17.8 percentage points of GDP.

[2] This note assesses the cyclicality of fiscal policy in New Zealand: https://www.treasury.govt.nz/sites/default/files/2021-06/enhancing-role-fiscal-policy-macro-stabilisation.pdf

Risk	Response
	The Treasury will also publish the new measure excluding the NZSF so the effect of the NZSF on net debt can be easily monitored.
Including the NZSF does not align exactly with the IMF's GFS methodology.	**The new net debt metric is similar in level to the IMF GFS measure.** We considered adopting more of the IMF's GFS methodology but concluded that the changes we have made result in a net debt measure that better represents New Zealand's fiscal sustainability. Aspects of the IMF GFS methodology that we thought would <u>not</u> be useful were: - Netting off significant ACC fixed interest assets - Only including the fixed interest assets of the NZSF rather than the whole fund - Excluding the Reserve Bank - Excluding Kāinga Ora - Including local government debt

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