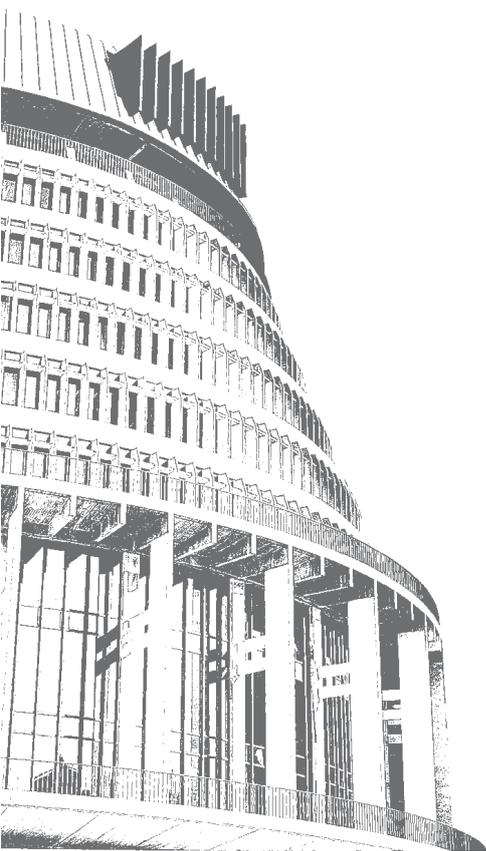




Hon Dr Michael Cullen
MINISTER OF FINANCE



Budget Policy STATEMENT 2008

Half Year Economic & Fiscal UPDATE 2007

18 December 2007

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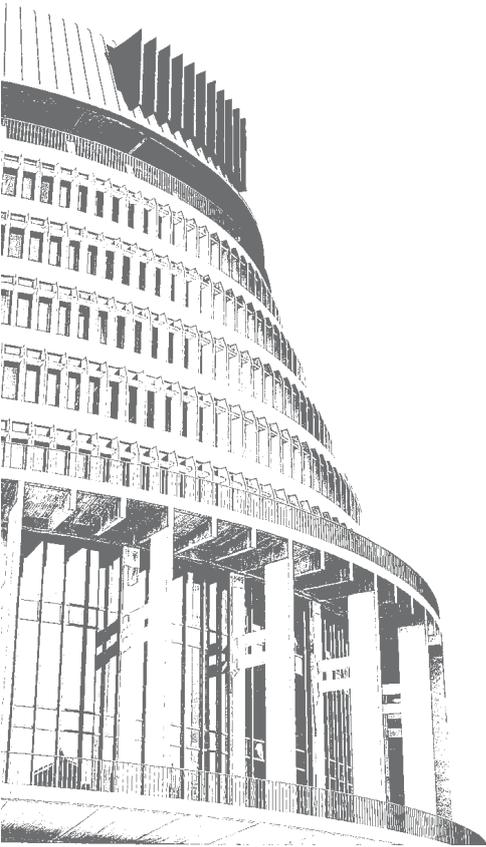
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Hon Dr Michael Cullen
MINISTER OF FINANCE



Budget Policy STATEMENT 2008

18 December 2007

The Public Finance Act 1989 specifies principles of responsible fiscal management and sets out reporting requirements on the Minister of Finance and the Treasury. The reporting requirements on the Minister include two fiscal responsibility documents: the *Budget Policy Statement* (BPS) and the *Fiscal Strategy Report* (FSR). These documents focus on different aspects of the Government's fiscal policy. The BPS has a shorter-term focus. It sets out the overarching policy goals that will guide the Government's Budget decisions and the Government's priorities for the forthcoming Budget. The FSR sets out the Government's long-term fiscal strategy and explains how that strategy accords with the principles of responsible fiscal management.

The reporting requirements on the Treasury include the publication of economic and fiscal forecasts (*Economic and Fiscal Update*) twice each financial year: at the time of the Budget and again before the end of the calendar year. The Treasury must also publish an Update prior to a general election. In addition, the Treasury is required to publish, at least every four years, a *Statement on the Long-term Fiscal Position* looking out at least 40 years. The first Statement was presented to Parliament in June 2006. The horizon covered by the Statement means that it has a different character to the BPS, the FSR, and the Updates, as it extends across the terms of many more governments, with potentially many different policy regimes.

The following table summarises the legislated requirements for each document*.

* For full information see Public Finance Act 1989 Part 2 sections 26F-26Z.

| Budget Policy Statement | Fiscal Strategy Report | Statement on the Long-term Fiscal Position |
|--|---|---|
| Produced annually before the end of March. | Produced annually with the Budget. | Produced at least every four years. |
| <p><i>Requirements:</i></p> <ul style="list-style-type: none"> • State broad strategic priorities for the forthcoming Budget. • State any changes to long-term objectives. • State any changes to short-term intentions. • Explain how the changes in objectives and short-term intentions accord with the principles of responsible fiscal management. | <p><i>Requirements:</i></p> <ul style="list-style-type: none"> • State long-term objectives for fiscal policy. • Explain how the objectives accord with the principles of responsible fiscal management. • Provide projections over at least 10 years showing likely progress against long-term fiscal objectives. • State short-term intentions (three or more years) and their consistency with long-term objectives and the <i>Economic and Fiscal Update</i> (EFU). | <p><i>Requirements:</i></p> <ul style="list-style-type: none"> • Prepare a statement on the long-term fiscal position relating to a period of at least 40 years. • Disclose significant assumptions. • The Treasury to use its best professional judgements about the risks and the outlook. |
| Economic and Fiscal Updates | | |
| <i>Budget</i> (published with the Budget). | <i>Half-Year</i> (published between 1 November and 31 December, usually in conjunction with the BPS). | <i>Pre-election</i> (published not earlier than 30 or later than 20 working days before polling day). |
| <p><i>Requirements:</i></p> <ul style="list-style-type: none"> • Economic and fiscal forecasts for the current financial year and each of the next two financial years. The economic forecasts must include forecasts of major economic aggregates (output, inflation, employment, current account) and a statement of significant assumptions. The fiscal forecasts must include: forecast financial statements; a statement of specific fiscal risks relating to Government decisions and any other contingent liabilities; and a statement of significant accounting policies and changes in policies. The <i>Budget Economic and Fiscal Update</i> (BEFU) must include a statement of tax policy changes. | | |

Budget Policy Statement

Introduction

The economy is experiencing a period of sustained growth – the longest since the early 1970s

We are currently enjoying a sustained period of economic expansion – the longest since the 1970s. The economy is 28% larger since this Government came to office in 1999, and New Zealand's average growth rate has been faster than that in Australia, the US, the UK, the EU average, and the OECD average.

This performance has led to high labour force participation and the lowest unemployment rate ever recorded in the Household Labour Force Survey. In fact, we have one of the lowest unemployment rates in the OECD. This has made a real difference to the living standards of New Zealanders – average household incomes have increased by more than 25% in real terms under this Government. Fiscally it has reduced the pressure on benefit expenditure, and increased tax revenue.

The Treasury's updated forecasts indicate that real and nominal GDP growth will be higher over 2007/08 and 2008/09 than was expected at Budget 2007. This is owing to stronger consumption and investment growth with consumers and businesses responding to continued strength in the labour market, as well as the income gains coming from the higher terms of trade.

Overall, the economy's export performance has proved relatively resilient to the high exchange rate. Since mid-2005 the level of real goods exports has been stable or growing slowly. Looking forward, the Treasury forecasts the level of exports to be higher than at Budget 2007 over most of the forecast period. This reflects in part a world economy which, despite showing some vulnerabilities, is expected to exhibit robust rates of growth.

The higher terms of trade (at a 30-year high), and in particular higher world dairy prices (which have doubled in the past year), have been key drivers of the higher than expected nominal economy.

However, the economy's strong performance has come with some challenges. Macroeconomic imbalances and long-term expenditure pressures must continue to be addressed. In particular:

- The current account deficit remains high.
- Skills shortages and wage pressures have emerged with the strong labour market, and this is contributing to inflation pressures.

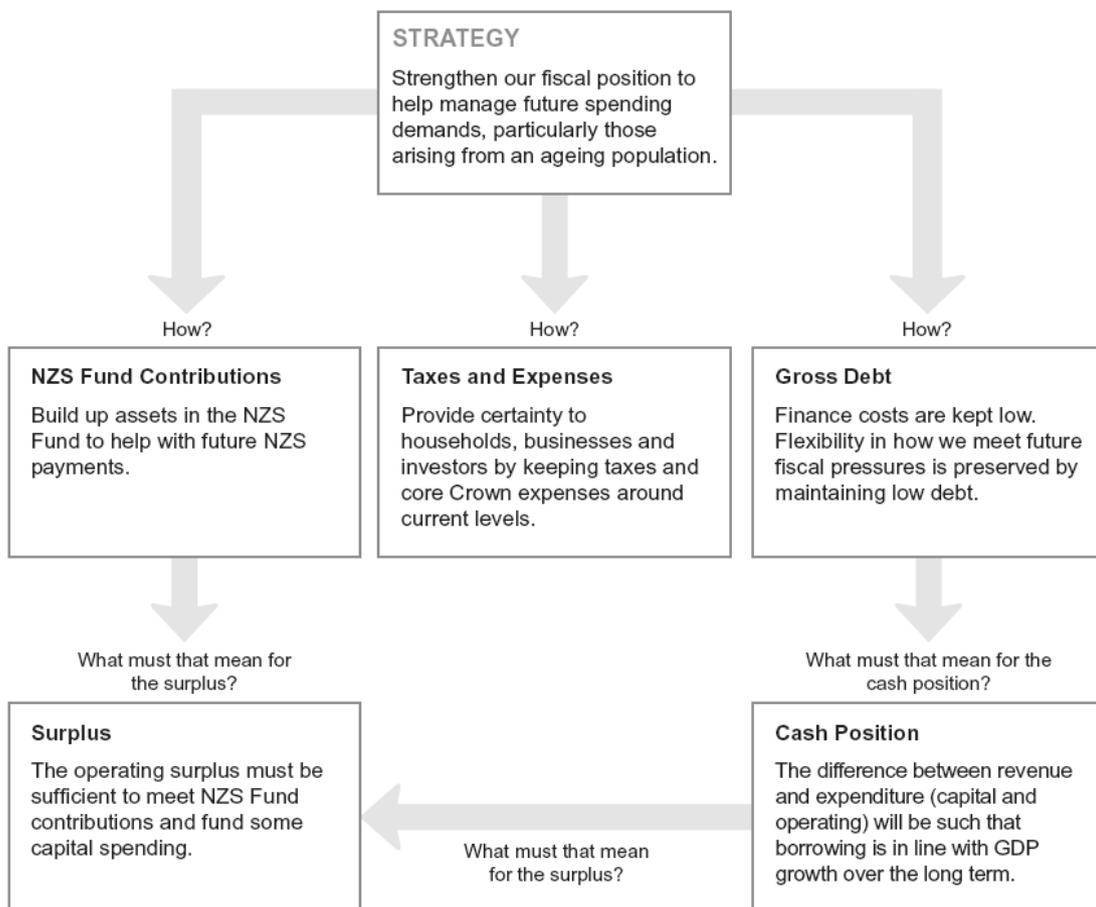
- Some long-term fiscal challenges remain, including the projected long-term rise in health expenditure.

Continued strong fiscal management is needed to ensure these issues are able to be properly addressed.

The Government’s fiscal management has made New Zealand well placed for the long term

The Government’s fiscal strategy continues to focus on strengthening the fiscal position to help manage future spending demands – which means maintaining a fiscal position that is strong and sustainable in the long term. This strategy is implemented through maintenance of a prudent level of debt, and the accumulation of financial assets (primarily in the NZS Fund).

Figure 1 – Fiscal strategy at a glance



Source: The Treasury

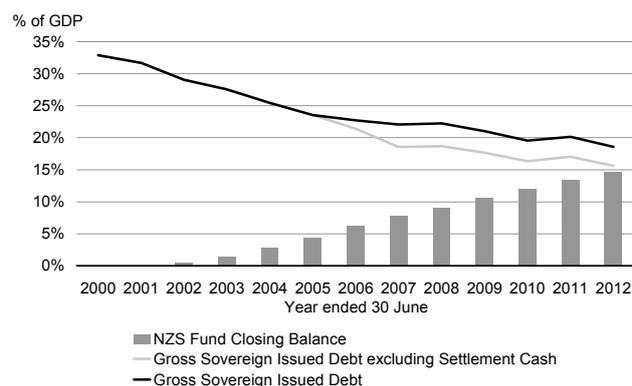
Gross sovereign-issued debt (excluding Reserve Bank settlement cash) as a percentage of GDP stood at 18.5% in June 2007, and is forecast to be 15.6% at June 2012. The assets in the NZS Fund are forecast to increase from 7.8% of GDP at 30 June 2007, to 14.6% over the same period. The Crown’s positive net financial asset position (that is, its net debt position adjusted to take account of the assets held in the NZS Fund) is expected to strengthen to 12.4% of GDP (from 4.9%) over the forecast period.

Our approach helps prepare New Zealand for future fiscal pressures. This is especially important as we prepare for the challenges of an ageing population. Our approach will also help us to cope with economic shocks – sustaining a low level of debt retains the capacity for us to increase debt when we really need it.

Over the term of this Labour-led Government, at a time when the economy has been running near capacity, fiscal policy has withdrawn resources from the economy in net terms (see Figure 3). This is evidenced by sustained operating and cash surpluses. Indeed, the accumulated cash surpluses as well as contributions to the NZS Fund over the past five years exceed \$20 billion.

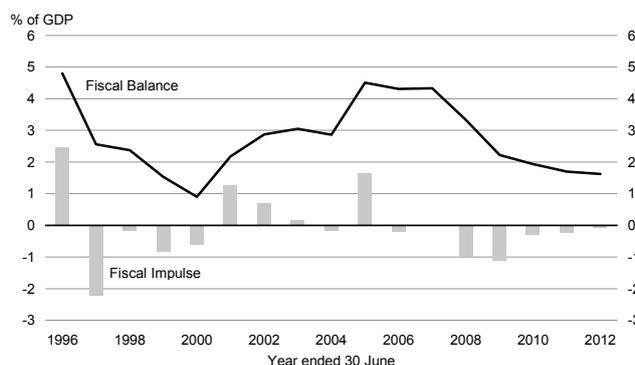
We have also been able to begin tackling some long-term challenges, including bold moves towards ensuring the sustainability of decent living standards for New Zealanders in retirement. New Zealand superannuation settings are socially sustainable, providing universal access to a basic retirement income, indexed to the average wage. We have helped to make these settings fiscally sustainable by establishing the NZS Fund to smooth the impact of an ageing population. In addition, we have encouraged personal responsibility for savings to enjoy a higher standard of living in retirement through the State Sector Retirement Savings Scheme and KiwiSaver, including the KiwiSaver enhancements announced in Budget 2007.

Figure 2 – NZS Fund and Gross Sovereign Issued Debt (excluding Settlement Cash)



Source: The Treasury

Figure 3 – The Government is continuing to run a firm fiscal policy stance



Source: The Treasury

Budget 2008

This Government has consistently sought to tackle the major policy challenges facing our economy and our society

Since 1999 this Government has implemented a new policy agenda and launched innovative responses to the policy challenges we face as a nation. We have made significant investments in New Zealand's health and education sectors:

- Our investment in primary health has cut the cost of seeing the doctor by around half, and has lowered prescription charges from \$15 to \$3 for all New Zealanders.
- New Zealand had only one in 10 students leaving school with little or no formal qualification last year, down from one in five students in 2002. This improvement is a huge achievement considering the very little progress for the previous 20 years. Literacy and Numeracy Professional Development projects are also successfully boosting achievement especially for the lowest 20% of achievers.
- We have this year begun providing 20 hours free early childhood education for three- and four-year-olds and, starting next year, there will be smaller class sizes for all new entrants.

These examples give a sense of the importance we place on families and wellbeing. Budgets 2004 and 2006 introduced and extended Working for Families – tax relief benefiting literally hundreds of thousands of family budgets. More recently, policy reforms have focused on giving our children the best possible start in life – such as the introduction of paid parental leave, enabling our working parents to have more time with their new babies.

This Government has also had a strong focus on transforming our economy - we have been proactive in helping businesses foster skills and innovation. Since 1999 the number of trainees in industry has almost doubled, and apprenticeship programmes are creating more career choices for young people. Our tax relief for business in Budget 2007 further underscores our commitment to economic transformation.

Importantly, we have also been proactive in building a truly sustainable New Zealand and developing responses to climate change. In September this year we launched our proposal for an Emissions Trading Scheme for New Zealand – covering all sectors of the economy and all greenhouse gases. Under our New Zealand Energy Strategy 90% of New Zealand's electricity will be generated from renewable sources by 2025, and the electricity sector will be carbon neutral. By 2040 we aim to reduce our per capita emissions from transport by half, and for carbon neutrality in that sector too.

Budget 2008 will continue to deliver on our long-term policy agenda in key areas...

Budget 2008 will build on our achievements since 1999 and continue the Government's focus on long-term policy goals. We will be guided by an overarching principle of developing a truly sustainable New Zealand.

Sustainable economic transformation remains an ongoing priority for the Government. Budget 2008 will continue our work in this area by improving New Zealand's productivity and growth trajectory, strengthening New Zealand's ability to compete internationally, and capturing value from opportunities presented by climate change and environmental sustainability.

Families – Young and Old also remains an important theme for the Government. We are phasing the implementation of priorities in this area across years, focusing on Early Years, Effective Interventions, and Eliminating Family Violence in Budget 2008.

New Zealand’s transformation must continue to be based on opportunity and security for all. Confidence and Supply agreements will feature prominently in Budget 2008, with our agreements with NZ First to keep NZ Super at 66% of the average wage and to phase in the final tranche of the 1,000 frontline police and 250 non-sworn staff.

The Health package for 2008 will be \$750 million per annum and, along with our commitment to world-class education and social services, will continue to reinforce the foundations needed for a successful modern nation.

In Budget 2008 we will continue our strong focus on building on New Zealand’s unique national identity.

Understanding our past is central to this, and as such the Government will focus on connecting with, understanding, and celebrating our heritage. We will continue to advance initiatives which promote a cohesive society – one which has a strong sense of community, and a relationship between Māori and the Crown where both parties look forward to the potential of the future.

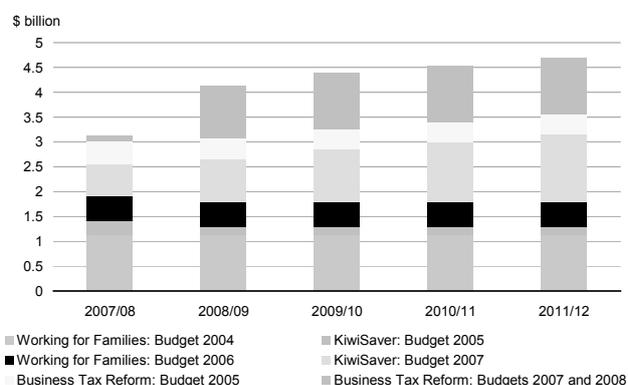
We also intend to continue to strengthen New Zealand’s presence on the world stage, so that we are recognised as a nation with a principled and independent perspective, and which maintains the quality of our environment.

...including setting out the next step in our ongoing programme of tax reform – the long-term programme around personal income taxation

Budget 2008 will also outline the Government’s long-term programme for personal income tax. Changes to personal income tax will continue an ongoing programme of tax reform. In addition to increasing social expenditure, successive budgets have seen us introduce tax relief for families, for businesses, and for savers. KiwiSaver has proved more popular than we had originally anticipated, with over 316,000 already enrolled. The total amount of tax relief, including KiwiSaver, already delivered has been considerable; and will amount to some \$4.7 billion or 2.2% of GDP in 2011/12.

Personal tax is the next logical step in our programme of reform. The Labour-led Government’s personal tax package will be consistent with our overarching goals by focusing primarily on fairness, without sacrificing quality public services. The package will be consistent with our medium-term approach to fiscal policy of having gross debt excluding Reserve Bank settlement cash as a proportion of GDP broadly stable at around 20%. And we will be cognisant of short-term imbalances in the economy by not running a lower fiscal balance than previously forecast.

Figure 4 – The Government’s recent tax initiatives



Source: The Treasury

In short, we have four tests in designing the shape and scope of our personal tax package:

- We will cut taxes without increasing borrowing.
- We will cut taxes without cutting public services.
- We will cut taxes in a way that does not exacerbate inflationary pressures.
- We will cut taxes in a way that does not lead to greater inequalities in our society.

Revenue forecasts are being revised upwards, but considerable uncertainty surrounds these

The higher than expected forecasts of nominal GDP have resulted in the Treasury's central forecast of tax revenue being revised upwards from the Budget 2007 forecast.

However, there is currently considerable uncertainty regarding some of the factors underpinning the economic forecasts that drive the revised forecast revenue track, particularly:

- the influence of recent international developments on world financial markets and the US housing market on the world's real economy, and
- the ongoing path of commodity prices (particularly dairy), in terms of both the magnitude and duration of the increase in the terms of trade (which could move up or down or be shorter or longer respectively than currently forecast).

The forecasts assume a relatively muted impact on global growth from current events but a less benign picture is certainly possible, and if this were to eventuate it could adversely affect New Zealand's growth. The terms of trade are assumed to eventually give up some of the current gains being recorded but still be higher in 2011/12 than they have been over the past decade. This is driven mainly by a view on dairy prices. Such an outcome would be very positive for New Zealand – but, as we are seeing with oil prices, predicting commodity price movements is far from a precise science.

There is also uncertainty about the impact of monetary policy tightening on the domestic economy.

The Treasury considers that revenue will be higher than forecast at Budget 2007 but nevertheless the forces described above mean that the economy and revenue could be significantly different from that forecast in this *Half-Year Economic and Fiscal Update* (HYEFU). Uncertainty is even greater beyond the forecast period.

Higher revenue creates options for increasing allowances that would still be consistent with our fiscal strategy, so we are increasing the capital allowance for Budget 2008 now...

The higher revenue forecasts provide us with options for increasing allowances while still maintaining consistency with our fiscal strategy. Although this additional fiscal headroom is subject to considerable uncertainty, it seems likely that at least some additional revenue represents an ongoing increase.

We are currently faced with a number of pressing infrastructure pressures that could make a substantial contribution to New Zealand’s social and economic development. For this reason we are doubling the capital allowance to \$1.8 billion, spread across the forecast period as indicated below:

Figure 5 – Budget 2008 capital allowance at *HYEFU 2007*

| \$ million | 2007/08 | 2008/09 | 2009/10 | 2010/11 | 2011/12 | Total |
|-------------------------------|---------|---------|---------|---------|---------|-------|
| Budget 2008 capital allowance | 48 | 992 | 330 | 200 | 230 | 1,800 |

Source: The Treasury

Although this is a considerable increase in the previously signalled capital allowance for Budget 2008, we are conscious of macroeconomic pressures. In considering the impact of the increase in the capital allowance on the economy, one cannot simply look to the size of the change in the allowance alone. In particular, part of the increase in the allowance will go to initiatives which will not immediately impact on demand. As a result, the headline allowance overstates the possible impact on demand and inflation.

Fiscally, we feel confident about a one-off increase to the capital allowance because more certainty exists around extra revenue in the current year.

...but, given current uncertainty, we are not increasing allowances at this stage by the full amount indicated in current forecasts.

The economic and fiscal uncertainties described above, together with potential differences between the Treasury’s HYEFU 2007 and Budget 2008 forecasts, complicate fiscal decision-making. The Government needs to take fiscal decisions that are robust to plausible fluctuations. This is especially important if the final outturns prove to be below our current forecasts – were we to move ahead with our full agenda on the basis of present forecasts, and then find ourselves stretched beyond available fiscal headroom, we would face a difficult process of uprooting policy development.

For these reasons we are not formally increasing the operating allowance for Budget 2008. Instead, we are holding \$1.5 billion per annum as a revenue reduction contingency for changes to personal tax. By its very nature, this contingency is still uncertain – that is, we are still working through options around the size and shape of any personal tax reform package, and will make a final decision closer to Budget 2008 in light of the revised forecast information we receive at that stage.

The Treasury’s forecasts build in the revenue reduction contingency of \$1.5 billion. These forecasts show us running cash deficits across the medium term consistent with our fiscal strategy. This means that we anticipate meeting some of our capital spending commitments from borrowing. So, while we are still working through our personal tax cut package, its final size and shape will be consistent with our fiscal strategy.

In its forecasts, the Treasury has assumed that the contingency is used for tax initiatives from April 2009. This is a modelling assumption only – the exact timing of any revenue reductions is yet to be determined.

Any decision taken at Budget 2008 on further increases to allowances will be based upon the medium-term benefits of prospective initiatives. Notwithstanding this focus, the Government will remain conscious of current pressures on inflation. A common way to measure the Government's impact on demand in the economy, and consequently inflation, is through the change in the fiscal balance, ie, the fiscal impulse. Given the increase in revenue forecasts, the Government can increase future budget allowances and not run a lower fiscal balance than that signalled at Budget 2007. For 2007/08 in particular, we are confident that we will have a stronger fiscal balance than previously signalled.

Conclusion

In summary, the HYEPU released today incorporates a Budget 2008 capital allowance of \$1.8 billion. The operating allowance for Budget 2008 remains at \$3.1 billion per annum, which includes the Business Tax Reform – but we have also created a revenue reduction contingency of \$1.5 billion per annum, which we will target toward changes to personal taxes.

We are looking forward to setting out our long-term programme for personal tax reform in Budget 2008 to share the dividends of economic growth fairly. This will be the next step in building a sustainable New Zealand underpinned by strengthened families, a transformed economy, and a unique national identity – all achieved in a fiscally responsible way.



Hon Dr Michael Cullen
Minister of Finance

5 December 2007

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

The Government's long-term fiscal objectives are unchanged from the 2007 FSR.

Table A1 – Long-term fiscal objectives

| Long-term fiscal objectives | To achieve the objectives, the Government's high-level focus is on: |
|--|---|
| <p>Operating balance Operating surplus on average over the economic cycle sufficient to meet the requirements for contributions to the NZS Fund and ensure consistency with the debt objective.</p> | <ul style="list-style-type: none"> • Operating surpluses during the build-up phase of the NZS Fund. Our focus is on maintaining the OBEGAL excluding NZS Fund revenue at a level sufficient, on average, to meet the requirements for contributions to the NZS Fund. • Our focus in meeting this objective is on core Crown revenues and expenses, maintaining tax to GDP and core Crown expenses to GDP around current levels. • Consistent with our revenue strategy, we will ensure tax policy decisions are consistent with the overall fiscal strategy including the Government's long-term revenue objective. • SOEs and Crown entities contributing to surpluses, consistent with their legislation and Government policy. |
| <p>Revenue Ensure sufficient revenue to meet the operating balance objective.</p> | |
| <p>Expenses Ensure expenses are consistent with the operating balance objective.</p> | |
| <p>Debt Manage total debt at prudent levels. Gross sovereign-issued debt broadly stable at around 20% of GDP over the next 10 years.</p> | <ul style="list-style-type: none"> • Gross sovereign-issued debt to GDP will be broadly stable over the period ahead of the major demographic changes associated with population ageing. • The Government is effectively targeting a level of gross sovereign-issued debt excluding the increase in debt on the Reserve Bank balance sheet as a result of the change in the liquidity management regime. • Core Crown net debt, with NZS Fund assets, is expected to fall towards -20% of GDP by 2018 (ie, a net financial asset position). • SOEs will have debt structures that reflect best commercial practice. Changes in the level of debt will reflect specific circumstances. |
| <p>Net worth Increase net worth consistent with the operating balance objective.</p> | <ul style="list-style-type: none"> • Increasing net worth consistent with the operating balance objective will see core Crown net worth at almost 40% of GDP by 2018. • The NZS Fund is expected to be above 22% of GDP by 2018. • Consistent with the net worth objective, there will also be a focus on quality investment. |

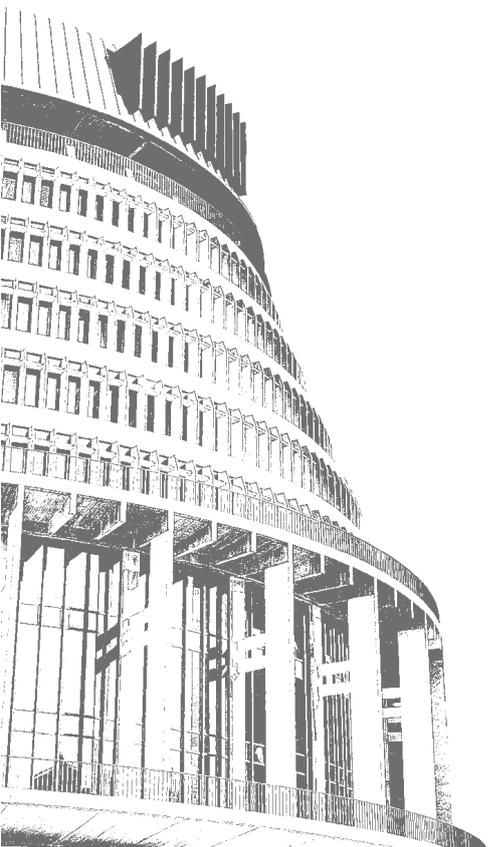
The Government's fiscal intentions are consistent with the progress towards meeting the long-term objectives and principles of responsible fiscal management, as specified by the Public Finance Act (1989). The fiscal forecasts in the HYEPU are consistent with the Government's short-term intentions. Differences between short-term intentions set out in the 2008 BPS and those in the 2007 FSR reflect changes in the economic and fiscal forecasts, together with policy changes. These changes are discussed in more detail in the HYEPU.

Table A2 – Short-term fiscal intentions

| 2008 Budget Policy Statement | 2007 Fiscal Strategy Report |
|---|--|
| <p>Operating balance</p> <p>Based on operating amounts for the 2008 Budget, and indicative amounts for the 2009 and 2010 Budgets, the 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. This remains consistent with the long-term objective for the operating balance.</p> | <p>Operating balance</p> <p>Based on operating amounts for the 2007 Budget, and indicative amounts for the 2008 and 2009 Budgets, the OBEGAL excluding NZS Fund revenue is forecast to be 3.1% of GDP in 2007/08, decreasing to 1.4% of GDP by 2010/11. This remains consistent with the long-term objective for the operating balance.</p> |
| <p>Debt</p> <p>Total debt (including Reserve Bank settlement cash) is forecast to be 24.7% of GDP in 2011/12.</p> <p>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.</p> <p>The Government will set forecast new operating and capital spending amounts over the next three years that are consistent with the long-term objective for debt.</p> | <p>Debt</p> <p>Total debt (including Reserve Bank settlement cash) is forecast to be 25.3% of GDP in 2010/11.</p> <p>Gross sovereign-issued debt including net settlement cash is forecast to be 21.8% of GDP in 2010/11. Excluding net settlement cash, gross sovereign-issued debt is forecast to be 18.8% of GDP in 2010/11.</p> <p>The Government will set forecast new operating and capital spending amounts over the next three years that are consistent with the long-term objective for debt.</p> |
| <p>Expenses</p> <p>Total Crown expenses are forecast to be 41.8% of GDP in 2011/12.</p> <p>Core Crown expenses are forecast to average 32.5% over the forecast period and be 33.0% of GDP in 2011/12.</p> <p>This assumes new operating expense amounts of \$2.0 billion for the 2008 Budget, \$2.0 billion for the 2009 Budget, and \$2.1 billion for the 2010 Budget (GST exclusive).</p> | <p>Expenses</p> <p>Total Crown expenses are forecast to be 42.5% of GDP in 2010/11.</p> <p>Core Crown expenses are forecast to average 32.7% over the forecast period and be 33.1% of GDP in 2010/11.</p> <p>This assumes new operating expense amounts of \$1.97 billion for the 2007 Budget, \$2.0 billion for the 2008 Budget, and \$2.0 billion for the 2009 Budget (GST exclusive).</p> |
| <p>Revenues</p> <p>Total Crown revenues are forecast to be 43.6% of GDP in 2011/12. Within this, core Crown revenues are forecast to be 34.3% of GDP in 2011/12.</p> <p>This assumes new revenue initiatives in the 2008 Budget resulting in a \$1.5 billion reduction in revenue per annum from April 2009, plus the previously announced Business Tax Reform resulting in a \$1.13 billion reduction in revenue from 2008/09.</p> <p>The Government will set revenue plans over the next three years that ensure progress is made towards the long-term revenue objective.</p> | <p>Revenues</p> <p>Total Crown revenues are forecast to be 44.3% of GDP in 2010/11. Within this, core Crown revenues are forecast to be 34.1% of GDP in 2010/11.</p> <p>This assumes new revenue initiatives in the 2008 Budget resulting in a \$1.13 billion reduction in revenue from 2008/09.</p> <p>The Government will set revenue plans over the next three years that ensure progress is made towards the long-term revenue objective.</p> |
| <p>Net worth</p> <p>Total Crown net worth is forecast to be 58.5% of GDP in 2007/08, rising to 60.6% of GDP in 2011/12.</p> <p>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.</p> | <p>Net worth</p> <p>Total Crown net worth is forecast to be 54.4% of GDP in 2006/07, rising to 57.3% of GDP in 2010/11.</p> <p>Excluding NZS Fund assets, total Crown net worth is forecast to be 43.8% of GDP in 2010/11. Core Crown net worth is forecast to be 33% of GDP in 2010/11.</p> |



Hon Dr Michael Cullen
MINISTER OF FINANCE



Half Year Economic & Fiscal UPDATE 2007

18 December 2007

Statement of Responsibility

On the basis of the economic and fiscal information available to it, the Treasury has used its best professional judgement in supplying the Minister of Finance with this Economic and Fiscal Update. The Update incorporates the fiscal and economic implications both of Government decisions and circumstances as at 5 December 2007 that were communicated to me, and of other economic and fiscal information available to the Treasury in accordance with the provisions of the Public Finance Act 1989.



John Whitehead
Secretary to the Treasury

5 December 2007

This Economic and Fiscal Update has been prepared in accordance with the Public Finance Act 1989. I accept overall responsibility for the integrity of the disclosures contained in this Update, and the consistency and completeness of the Update information in accordance with the requirements of the Public Finance Act 1989.

To enable the Treasury to prepare this Update, I have ensured that the Secretary to the Treasury has been advised of all Government decisions and other circumstances as at 5 December 2007 of which I was aware and that had material economic or fiscal implications.



Hon Dr Michael Cullen
Minister of Finance

5 December 2007

Executive Summary

The short-term economic and fiscal outlook for New Zealand has strengthened since the *Budget Update*. The New Zealand economy is expected to grow solidly over 2007/08. The fiscal position is forecast to strengthen further with the operating balance before gains and losses (OBEGAL) and excluding New Zealand Superannuation (NZS) Fund net revenue expected to come in at \$6.4 billion over 2007/08.

Economic growth is forecast to slow in 2008/09 before rebounding in later years to around its medium-term trend. Consumer price inflation is expected to be near the top of the 1% to 3% per annum target range through much of the forecast period. This economic outlook will see the fiscal position continue to strengthen, notwithstanding a forecast fall in the OBEGAL towards a level more consistent with the Government's long-term fiscal objectives. This fall reflects past and prospective Budget decisions, including the incorporation of a contingency for a reduction in tax revenue. The latter is assumed to be directed at personal income tax cuts and to take effect from 1 April 2009.

The economic and fiscal forecasts are subject to greater-than-usual uncertainty, with current turmoil in global financial markets and the future path of the terms of trade being the main sources of risk.

Economic Outlook

The economic expansion of the past nine years is forecast to continue with real Gross Domestic Product (GDP) growth of 2% to 3% per annum over the next five years. Real GDP growth is expected to rise to 3% in the March 2008 year, reflecting the recent upturn in domestic demand, before easing to around 2% a year later as high interest rates weaken domestic demand growth. Higher growth in exports relative to imports is forecast to lift real GDP growth back to almost 3% per annum from the March 2010 year.

Table 1 – Major economic parameters

| March years (annual average % change) | 2007/08 Estimate | 2008/09 Forecast | 2009/10 Forecast | 2010/11-2011/12 Forecast |
|---------------------------------------|------------------|------------------|------------------|--------------------------|
| Real GDP | 3 | 2 | 3 | 3 |
| Employment | 1½ | 1 | 1 | 1 |
| Wages | 4 | 4½ | 4½ | 4 |
| Consumer prices | 3 | 3 | 2½ | 2½ |

Note: Figures have been rounded to the nearest ½%; consumer price inflation is measured as an annual % change.

Source: The Treasury

High dairy prices mean the terms of trade are expected to be a lot stronger than previously forecast, providing a large boost to export receipts and activity in the next year and beyond. Solid global growth is expected to underpin the economic forecasts, but there are downside

risks to this outlook owing to renewed volatility in financial markets and signs of lower growth in the United States and some other regions of the world. A slowing of global growth would have a negative impact on demand for New Zealand exports and the terms of trade.

High short-term interest rates, in response to ongoing inflation pressure, have contributed to slower domestic demand growth since mid-2007 and that is forecast to continue. Lower net migration, high fuel prices and lower house price growth are also likely to have a dampening effect. Partially offsetting these forces are high farm incomes, a tight labour market that sees ongoing income growth, and an assumption of personal tax cuts from 1 April 2009.

Throughout the forecast period, the economy is expected to be operating at, or above, capacity. As a result, price pressures and the current account deficit that have built up over recent years are expected to persist and unwind only gradually. The exchange rate is forecast to fall from mid-2008 back towards its long-run equilibrium late in the forecast period.

Nominal GDP is forecast to be much higher than in the *Budget Update* throughout the forecast period. The key drivers of this stronger outlook are the higher terms of trade, driven by high world dairy prices, and a higher inflation outlook.

Fiscal Outlook

The OBEGAL excluding NZS Fund net revenue is forecast to rise to \$6.4 billion (3.6% of GDP) in the current June 2008 year before declining to \$4.1 billion next year and \$3.8 billion the year after. After making allowance for capital expenditure, a small cash surplus is forecast for 2007/08 with small deficits thereafter. Accumulated cash deficits are \$2.6 billion in the forecast period, compared to \$5.7 billion forecast at the *Budget Update*.

Table 2 – Summary of fiscal aggregates

| June years | 2007/08 Forecast | 2008/09 Forecast | 2009/10 Forecast | 2010/11 Forecast | 2011/12 Forecast |
|--|---------------------|---------------------|---------------------|---------------------|---------------------|
| OBEGAL (\$b) ^a | 6.4 | 4.1 | 3.8 | 3.7 | 3.5 |
| % of GDP | 3.6 | 2.2 | 2.0 | 1.8 | 1.7 |
| Residual cash | 0.8 | (0.8) | (0.8) | (0.9) | (0.9) |
| % of GDP | 0.4 | (0.4) | (0.4) | (0.4) | (0.4) |
| GSID (% of GDP) ^b | 18.7 | 17.7 | 16.3 | 17.0 | 15.6 |
| Net core Crown debt (% of GDP) ^c | (7.4) | (8.7) | (10.0) | (11.3) | (12.4) |

Note: a) excludes NZS Fund net revenue; b) excludes Reserve Bank Settlement Cash; c) includes NZS Fund

Source: The Treasury

Core Crown revenue is forecast to fall from 35.0% of GDP in the June 2008 year to 34.3% in the June 2012 year, which reflects the Business Tax Reform announced in Budget 2007 and an assumed revenue reduction contingency. This contingency is assumed to be around \$1.5 billion per annum from 1 April 2009.

Core Crown expenses are forecast to increase by around 1% of GDP between the June 2008 year and the June 2012 year. The increase in expenses largely arises from recent initiatives such as the enhancements to KiwiSaver announced in Budget 2007. Gross sovereign-issued debt (GSID) excluding Reserve Bank Settlement Cash falls from 18.7% to 15.6% of GDP by the end of the forecast period.

Economic and fiscal forecasts – Finalisation dates and key assumptions

| Finalisation dates | |
|--|-------------|
| Economic data | 2 November |
| Economic forecasts (refer <i>Chapter 1</i>) | 8 November |
| Tax revenue forecasts | 14 November |
| Fiscal forecasts (refer <i>Chapter 2</i>), including: | 5 December |
| – Government decisions and circumstances | 5 December |
| – Actual asset revaluations | 31 October |
| – Foreign exchange rates | 31 October |
| Specific fiscal risks (refer <i>Chapter 4</i>) | 5 December |
| Contingent liabilities and commitments (refer <i>Chapter 4</i>) | 31 October |

Key assumptions

Global economic activity – forecasts for global economic growth, inflation and interest rates were taken from the October 2007 *Consensus Forecasts*. Economic growth for our top 20 trading partners is expected to decline from an estimated 4.0% in 2007 to 3.5% in 2011, compared with stable growth of 3.6% throughout the period in the *Budget Update*. There are considerable risks associated with this outlook which are discussed in the *Economic and Tax Outlook* and *Risks and Scenarios* chapters.

Global inflation and interest rates – as a result of the recent robust growth for most of our major trading partners, inflation is also expected to be higher than at the time of the *Budget Update*. The outlook for interest rates is mixed, with lower rates expected in the United States; rates are expected to stay low for longer in Japan in the light of low inflation outturns, but the outlook is for higher rates in the near term in the euro area and Australia.

Oil prices – we have assumed that the price of West Texas Intermediate (WTI) crude oil will decline from an estimated US\$90 per barrel in the fourth quarter of 2007 and level off just below US\$75 per barrel in the fourth quarter of 2010. These projections, which are based on the average futures prices recorded in the month before finalisation of the forecast, range from one-third higher than in the *Budget Update* in the near term to around 12% higher later in the period. This projection of oil prices is a risk, as discussed in the *Risks and Scenarios* chapter.

Terms of trade – higher export prices, especially for dairy products, are expected to lift the goods terms of trade (measured on a System of National Accounts basis) throughout the forecast period by an average of 8% compared with the *Budget Update*. The terms of trade peak in the final quarter of 2008 and decline 5% by the end of the forecast period.

Monetary conditions – it is assumed that the New Zealand dollar exchange rate will decline from 71 on the Trade Weighted Index (TWI) in the final quarter of 2007 to 57 at the end of the forecast period. Ninety-day interest rates are assumed to average 8.5% from the first quarter of 2008 until the third quarter of 2009, after which they will start to decline, reaching 7.3% at the end of the period.

Net migration – the net inflow of permanent and long-term migrants is expected to decline from 8,300 in the year to September 2007 to 6,200 in the year to March 2008, before recovering to 7,400 in the following March year and returning to its average over the past decade of 10,000 per annum in subsequent years.

Revenue reduction contingency – the forecast incorporates a contingency for a reduction in tax revenue of \$1.5 billion per annum from April 2009, rising to \$1.7 billion in the year to June 2012 largely owing to income growth. The impact of this reduction, which we have assumed will be applied to personal taxes, is discussed in the *Economic and Tax Outlook* chapter.

Emissions Trading Scheme (ETS) – the economic forecast does not include any provision for the ETS which is being introduced by the Government to encourage efforts to reduce greenhouse gas emissions and to help meet New Zealand's obligations under the Kyoto Protocol. Final decisions on the scheme had not been taken when the forecasts were finalised in early November 2007. At an aggregate level, the scheme is considered unlikely to lead to any significant reduction in output, but there will be different effects on different sectors of the economy and it will result in higher prices for carbon-sourced energy. The economic impacts of the scheme will be incorporated in the 2008 *Budget Update*. For details of its fiscal implications, see the *Fiscal Outlook* chapter.

Climate – agricultural growing conditions and the level of hydro electricity storage lakes are assumed to be normal over the forecast period.

Fiscal forecasts – the fiscal forecasts have been prepared in accordance with the Public Finance Act 1989. They are based on the Crown's accounting policies and assumptions. The financial statements presented in the *Half Year Update 2007* have been prepared in accordance with New Zealand equivalents to International Financial Reporting Standards. A summary of the key economic assumptions that are particularly relevant to the fiscal forecasts is provided below (Table 3). These figures are on a June-year-end basis to align with the Crown's balance date of 30 June. The figures in Table 1 above and in the *Economic and Tax Outlook* chapter are for the year to 31 March.

Table 3 – Key economic assumptions for fiscal forecasts

| June years | 2007/08 | | 2008/09 | 2009/10 | 2010/11 | 2011/12 |
|--|---------|---------|---------|---------|---------|---------|
| | BEFU | HYEFU | HYEFU | HYEFU | HYEFU | HYEFU |
| Real GDP (ann avg % chg) | 2.3 | 2.7 | 2.3 | 2.8 | 2.7 | 2.9 |
| Nominal GDP (\$m) | 173,187 | 178,199 | 186,956 | 194,528 | 202,865 | 212,364 |
| CPI (ann avg % change) | 2.4 | 2.7 | 2.9 | 2.7 | 2.6 | 2.5 |
| Govt 10-year bonds (ann avg %) | 6.1 | 6.4 | 6.5 | 6.6 | 6.6 | 6.4 |
| 90-day bill rate (ann avg %) | 7.9 | 8.6 | 8.5 | 8.3 | 8.0 | 7.5 |
| Unemployment rate (ann avg %) | 3.9 | 3.8 | 3.9 | 3.9 | 4.1 | 4.1 |
| Full-time equivalent employment (ann avg % change) | 1.3 | 1.3 | 0.9 | 1.1 | 0.9 | 0.9 |
| Current account (% of GDP) | -7.2 | -6.9 | -6.4 | -7.2 | -6.8 | -6.3 |

Source: The Treasury

Economic and Tax Outlook

Introduction

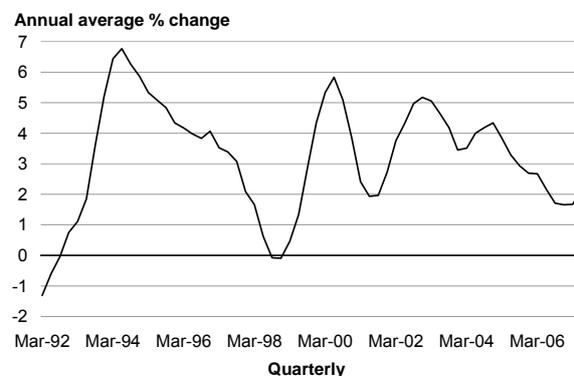
This chapter summarises the recent course of the New Zealand economy and the most likely path for its future development. Economic growth has slowed recently following a sustained expansion, but it is expected to continue, although at a slower pace. Higher dairy prices will boost returns to the agricultural sector, but global financial turmoil poses risks for the world economy. Domestically, the assumed reduction in tax revenue and continuing momentum in the labour market will be partially offset by tight monetary conditions, high oil prices, lower net migration inflows and high household debt. Tax revenue is forecast to be higher, even with the assumed reduction in tax revenue.

Growth slows after a long expansion

The New Zealand economy has experienced a period of sustained growth ...

The New Zealand economy has expanded on an annual basis for nearly nine years and the expansion looks likely to continue, albeit at a slower pace. Real Gross Domestic Product (GDP) has increased 34% since the trough of the previous recession in 1998 which was marked by the Asian financial crisis, two successive droughts and monetary tightening (Figure 1.1). A number of factors, some related to the international economic environment and some arising from specifically New Zealand origins, have sustained the recent period of growth.

Figure 1.1 – Real GDP



Source: Statistics New Zealand

... thanks to a number of international and domestic factors

- Growth in the world economy has been robust since the late 1990s, apart from a brief dip in 2001 following the bursting of the “tech boom” in the United States.
- This sustained expansion, combined with reductions in supply for some commodities, took the terms of trade to a 30-year high in 2007.
- The greater participation of China in world trade helped suppress global inflation as its low labour costs reduced the price of manufactured products.
- A surplus of savings and low investment rates in Asia, in conjunction with increased oil revenues being available for investment, increased global liquidity.

- Low inflation and a ready supply of capital led to low long-term interest rates becoming embedded in the major economies and provided a cheap source of debt.
- Financial market innovation and a greater willingness to borrow led New Zealand households to increase their debt levels.
- Net permanent and long-term (PLT) migration inflows averaged 20,000 per annum in the six years to 2006, twice their average in the past decade.
- Labour income increased by nearly 7% per annum in current dollar terms in the six years to 2006 as both employment and wages expanded rapidly.
- House prices more than doubled between 1998 and 2007, boosting wealth for homeowners and providing additional collateral for borrowing.
- The economy is more flexible and resilient, which has made it better able to respond to changes in the global economy and sustain growth.

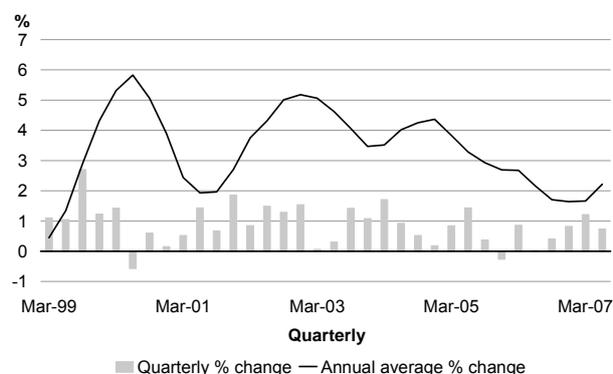
The combined effect of these developments has been a period of sustained growth in the New Zealand economy, especially in nominal GDP thanks to the higher terms of trade. The value of nominal GDP has increased by 64% since mid-1998 and tax revenue increased by 70% over the same period.

Economic growth dipped in late 2005-early 2006 ...

The rate of expansion began to slow on a quarterly basis in the second half of 2005 as some of the drivers of growth weakened (Figure 1.2). Net PLT migrant inflows fell to 6,000 in the year to October 2005 (from 17,000 the year before) as a result of lower student arrivals and a continuing increase in departures, especially to Australia. The Reserve Bank increased the Official Cash Rate by 50 basis points to 7.25% in late 2005 to counter increasing inflationary pressures. As a result, the housing market began to cool in late 2005-early 2006 and residential investment declined.

Increases in oil prices in the second half of 2005 reduced disposable income and detracted from household consumption growth. In addition, the appreciation of the exchange rate through this period curtailed growth in exports, particularly of services. Growth in production GDP fell to 1.7% in the year to September 2006 and remained at that rate for three quarters, its lowest rate since the late 1990s.

Figure 1.2 – Real GDP



Source: Statistics New Zealand

... but picked up again in late 2006-early 2007

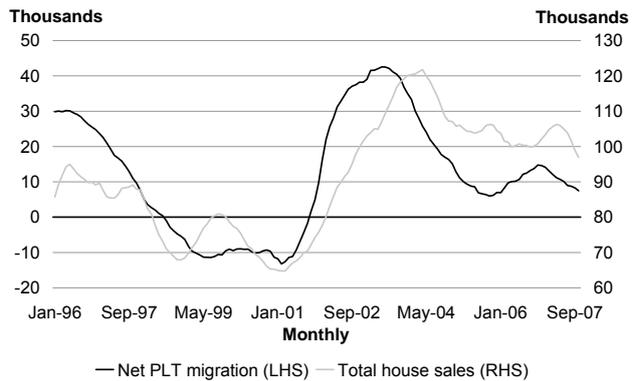
The slowdown in the economy was relatively short-lived as some of the same factors recovered towards the end of 2006 and brought a rebound in growth in late 2006 and early 2007. Net migration inflows increased from their low point in late 2005 to peak just below 15,000 in late 2006 as departures fell and arrivals increased. The faster population growth contributed to a recovery in the housing market, with house sales nearly one-fifth higher in the 2006/07 summer than a year before and a recovery in annual house price growth to just below 14% in June 2007.

Dwelling consents picked up in the first half of 2007 and residential investment increased in mid-2007 following the recovery in the housing market in late 2006. A fall in retail fuel prices in the December 2006 quarter boosted household disposable income and retail sales recovered in the second half of the year and the first quarter of 2007. The anticipation of higher dairy prices and the increase in the exchange rate in mid-2007 may have also played a role in higher consumption growth. Quarterly growth in real GDP accelerated from no change in the second quarter of 2006 to a 1.2% increase in the first quarter of 2007, boosted by consumption growth of 2.1% in the quarter.

Nevertheless, the economy was slowing from mid-2007

After the pick-up in the economy in late 2006-early 2007, there are signs that growth started to ease in mid-2007. Growth in real GDP declined to 0.7% in the second quarter of 2007 from 1.2% in the first quarter. Fuel prices have increased throughout 2007 as a result of higher international oil prices, the Reserve Bank increased the Official Cash Rate a further percentage point to 8.25% between early March and late July, net PLT migration inflows tracked down to 7,500 in the year to October, house prices were practically unchanged in the six months to September and annual house sales have fallen nearly 10% in the past six months (Figure 1.3). As a result of these developments, growth in retail sales and building consents has slowed, pointing to lower growth in private consumption and residential investment.

Figure 1.3 – Annual net migration and house sales



Sources: Statistics New Zealand, REINZ

But some negative factors have had less impact than expected ...

The New Zealand dollar exchange rate has strengthened again, after falling in the immediate aftermath of the global financial turmoil in July-August. Despite the high exchange rate, export volumes were still robust in mid-2007 and manufacturers' outlook for exports remained positive in September. Local finance company collapses, while significant for those directly affected, are not considered likely to have much impact at the aggregate level. They may have some impact on consumer confidence, however.

... and there are still some positives

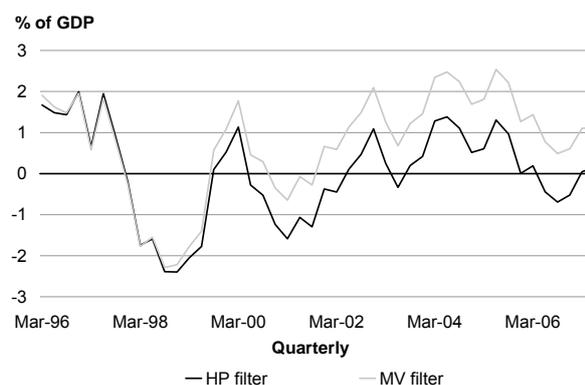
There are also some factors which have supported growth in the second half of 2007. Higher dairy prices (discussed in the next section) have started to flow through,

unemployment remains low and wage growth high, consumer confidence is moderately positive, and businesses' outlook for their own activity – although easing – is also still positive, pointing to ongoing growth next year. We expect growth in real GDP of around ½% in each of the September and December quarters of 2007. Combined with high growth over the first half of the year, this will lift growth to 3.0% on an annual average basis in March 2008.

The economy continues to operate at or above potential

Even with the slower growth from late 2005, the economy remains at or above its potential level of output. Capacity utilisation is just below its recent peaks and businesses are experiencing increasing difficulty finding staff. Wage pressures are high, input costs – especially for non-tradable items – are increasing steadily and firms' pricing intentions point to continuing inflationary pressure. The output gap (a measure of how far above potential the economy is) is estimated to be positive on two main indicators (Figure 1.4).

Figure 1.4 – Measures of the output gap

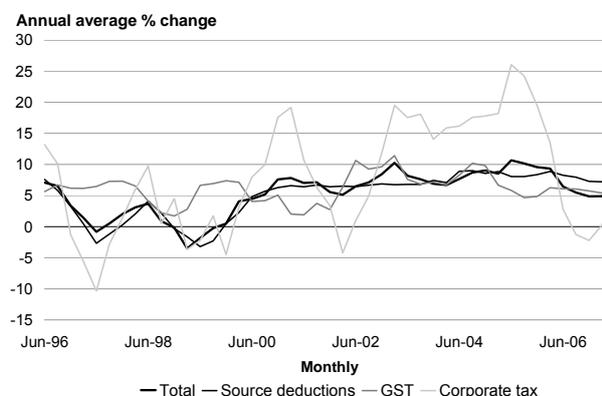


Source: The Treasury

Tax revenues continue to grow

Higher growth in nominal GDP led to faster growth in tax revenues in the recent period, especially in the June quarter 2007 (Figure 1.5). Corporate tax growth was flat to slightly negative through much of 2006 and then accelerated through the first half of 2007. The pick-up in corporate tax appears to be related more to investment returns than what would usually be thought of as business profits.

Figure 1.5 – Tax component growth



Source: The Treasury

GST growth also increased markedly towards the end of the June 2007 year, with the level of GST 10% higher in the 2007 June quarter compared with the 2006 June quarter, after hovering around the 5% mark through the previous three quarters. The unusually high growth in the June quarter may be related to the recovery in domestic consumption and increased residential investment through the first half of 2007.

With unemployment remaining low and wage growth high, source deductions (the largest single tax type) maintained steady growth through the June 2007 year. Although growth was down on the previous year, source deductions still grew by 7.5% in the year to June 2007. Overall, growth in total tax revenue declined through the end of 2006, but recovered again through the first half of 2007 on the back of the acceleration of GST and corporate tax.

Table 1.1 – Economic forecast¹

| Annual average % change, year to 31 March | 2007 Actual | 2008 Estimate | 2009 Forecast | 2010 Forecast | 2011 Forecast | 2012 Forecast |
|--|------------------------|--------------------------|--------------------------|--------------------------|--------------------------|--------------------------|
| Private consumption | 2.4 | 3.8 | 2.2 | 2.6 | 1.5 | 1.1 |
| Public consumption ² | 4.1 | 2.8 | 3.6 | 4.2 | 4.0 | 3.8 |
| Total consumption | 2.8 | 3.6 | 2.5 | 2.9 | 2.1 | 1.8 |
| Residential investment | -2.1 | 5.7 | -3.9 | -5.0 | -1.6 | 1.0 |
| Central government investment | 1.2 | -8.6 | 16.5 | 2.5 | 2.0 | 2.0 |
| Other investment | -3.3 | 5.6 | 4.9 | 1.1 | 2.0 | 3.5 |
| Total investment | -3.1 | 4.9 | 3.8 | 0.0 | 1.3 | 3.0 |
| Stock change ³ | -0.7 | 0.8 | -0.1 | 0.4 | 0.0 | 0.0 |
| Gross national expenditure | 0.7 | 4.7 | 2.7 | 2.6 | 1.8 | 2.0 |
| Exports | 3.0 | 1.6 | 2.6 | 3.4 | 3.7 | 4.0 |
| Imports | -1.4 | 6.1 | 4.0 | 2.7 | 1.3 | 1.4 |
| GDP (production measure) | 1.7 | 3.0 | 2.1 | 2.8 | 2.7 | 2.9 |
| - <i>annual % change</i> | 2.5 | 2.3 | 2.3 | 2.8 | 2.7 | 3.0 |
| Real GDP per capita | 0.5 | 2.0 | 1.1 | 1.8 | 1.7 | 2.0 |
| Nominal GDP (expenditure basis) | 4.7 | 7.3 | 5.4 | 4.1 | 4.2 | 4.6 |
| GDP deflator | 2.5 | 4.0 | 3.3 | 1.3 | 1.5 | 1.7 |
| Employment ⁴ | 2.0 | 1.4 | 0.8 | 1.1 | 0.9 | 0.9 |
| Unemployment ⁵ | 3.7 | 3.8 | 3.8 | 3.9 | 4.1 | 4.1 |
| Wages ⁶ | 4.8 | 4.2 | 4.4 | 4.4 | 4.2 | 3.9 |
| CPI inflation ⁷ | 2.5 | 3.1 | 2.8 | 2.7 | 2.6 | 2.5 |
| Export prices ⁸ | 9.1 | 3.1 | 11.1 | 4.1 | 4.7 | 3.3 |
| Import prices ⁸ | 7.2 | -4.4 | 2.5 | 6.0 | 6.5 | 4.6 |
| Current account balance | | | | | | |
| - \$million | -13522 | -12963 | -11851 | -13804 | -14109 | -13552 |
| - % of GDP | -8.3 | -7.4 | -6.4 | -7.2 | -7.0 | -6.5 |
| TWI ⁹ | 68.8 | 70.0 | 67.0 | 62.2 | 58.9 | 57.1 |
| 90-day bank bill rate ⁹ | 7.8 | 8.5 | 8.5 | 8.3 | 8.0 | 7.4 |
| 10-year bond rate ⁹ | 5.9 | 6.4 | 6.5 | 6.7 | 6.6 | 6.4 |

- Notes: 1 Forecast finalised 8 November 2007 incorporating data up until 2 November 2007.
 2 The forecast profile for public consumption is influenced by government defence spending.
 3 Contribution to GDP growth.
 4 Household Labour Force Survey, full-time equivalent employment.
 5 Household Labour Force Survey, percentage of the labour force, March quarter, seasonally adjusted.
 6 Quarterly Employment Survey, average ordinary time hourly earnings.
 7 Annual percentage change.
 8 Overseas Trade Index basis, annual average percentage change.
 9 Average for the March quarter.

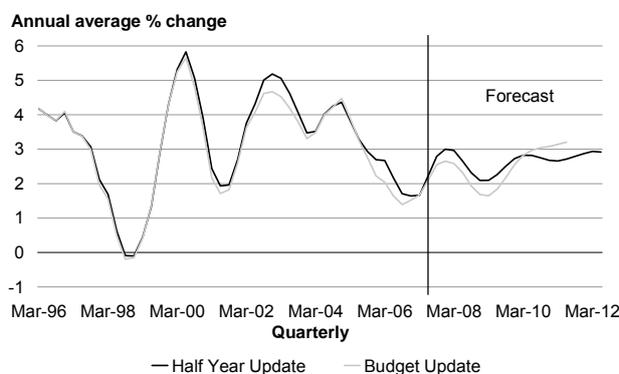
Sources: Statistics New Zealand, Reserve Bank of New Zealand, The Treasury

Outlook is for continuing but easing growth

The most likely path for the economy is continuing but easing growth

The most likely path for the economy is continuing but slowing growth until late 2008, when the rate of expansion will start to return towards its trend rate of around 3%. The robust growth in late 2006-early 2007 will boost the annual average rate of growth to 3.0% in the year to March 2008, but it will decline to 2.1% in the year to March 2009 before increasing again to 2.9% in the year to March 2012 (Figure 1.6). The key international and domestic influences determining the development of the economy are discussed in the following two sections. Considerable uncertainties surround this view and they are discussed in the *Risks and Scenarios* chapter.

Figure 1.6 – Real GDP



Sources: Statistics New Zealand, The Treasury

Weaker world growth, but higher terms of trade

Slowdown in the United States led to a reappraisal of the near-term outlook

The prospect of slower economic growth in the United States, largely as a result of heightened concerns about the fallout from the financial turmoil arising from the sub-prime mortgage market and the deepening downturn in the housing market, has led to a reappraisal of the prospects for United States and world growth since the *Budget Update*. Our forecasts of the international economy are based on the October 2007 *Consensus Forecasts*, a monthly survey of more than 240 forecasters worldwide. Compared with those underlying the *Budget Update*, they contain downward revisions for the United States, Japan and the euro area in the near term, partly offset by upward revisions for Australia and non-Japan Asia. Economic growth for our top 20 trading partners is now expected to decline from an estimated 4.0% in 2007 to 3.5% in 2011, compared with stable growth of 3.6% throughout the period in the *Budget Update*.

The latest views of major international forecasting agencies are consistent with the downward revision of the outlook for the world economy. In October the International Monetary Fund revised down its forecasts for global growth in 2008 from 5.2% to 4.8%, with lower growth expected in the United States and in most other economies. Since our forecasts were finalised, the OECD has commented that “more recent economic news points towards a more protracted adjustment” in the United States and the world economy.¹ In its December 2007 *Economic Outlook*, the OECD commented that the probability distribution around its baseline scenario (which incorporated downward revisions to growth from their mid-year *Outlook*) is skewed to the downside, with the main negative risks being greater cooling in housing markets, additional turbulence in financial markets and further upward pressure on commodity prices.

¹ Financial Market Trends No. 93, OECD 2007.

Risks to the outlook for the world economy

Our forecast for the world economy is based on the most common view which is that a recession is unlikely. However, the risks of such an event have increased since we finalised the forecast.

We have taken the outlook for our main trading partners from the October *Consensus Forecasts*, the latest available when we finalised the forecast and in line with our standard practice. Since that survey of other forecasters was released in mid-October, the outlook for the world economy has changed as fresh concerns have emerged regarding the effects of the financial turmoil and the United States housing market has weakened further.

Interest rate spreads between commercial and government securities in the United States and elsewhere have increased again close to their levels in August when the financial turmoil first developed. This is occurring as more losses by commercial banks and finance companies become apparent and the full implications of the sub-prime mortgage crisis unfold. The need to consolidate balance sheets prior to the end of the financial year may also be bringing some of these problems to light.

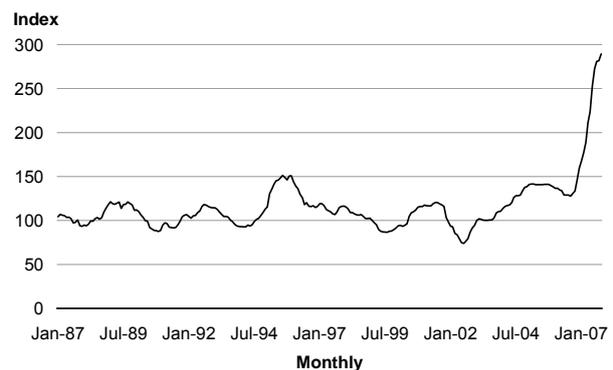
Although official forecasters are not picking a major downturn in the United States or world economy at present, the risks of such an event have increased recently. The most common view is still that the United States will not experience a recession, although most commentators consider that growth will be lower than previously forecast. The fresh concerns about the extent of the financial turmoil mean that the risks of a major downturn in the United States are greater than previously thought and these concerns have increased since we finalised our forecasts. This situation is developing rapidly and presents a major risk to the outlook presented in this forecast.

If there is a major downturn in the United States economy and it spreads to other parts of the world, there would be reduced demand for New Zealand exports. This would manifest itself primarily through lower terms of trade and lower real income. The *Risks and Scenarios* chapter explores the impact that lower terms of trade would have on key economic and fiscal aggregates.

Higher prices in world dairy markets ...

An important development for the New Zealand economy since the *Budget Update* is the continued increase in world dairy prices. In the six months from September 2006 to March 2007, spot prices for dairy products in international markets increased 45%; in the six months since then they increased by a further 49% as a result of a combination of supply and demand factors (Figure 1.7).

Figure 1.7 – World dairy prices



Source: ANZ National Bank

Changes to the Common Agricultural Policy (CAP) have brought lower subsidies for European farmers and less incentive for increased production. In

addition, the virtual elimination of butter stocks in Europe has removed downward pressure on prices, and milk production quotas and reduced export subsidies effectively place a ceiling on European Union dairy exports. In Australia, the effects of the drought have lingered and delayed recovery in dairy production. Persistent drought has cut the availability of irrigation water, reduced pasture growth and driven fodder costs higher. In the United

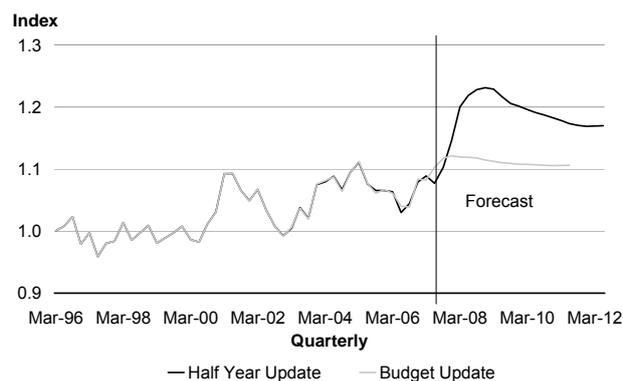
States, the expansion of ethanol production has limited the supply of feed corn and driven up its price, pushing up dairy prices at the same time.

Income growth in developing countries, along with changing consumer preferences towards more Western-style foods, has increased the demand for dairy products. High oil prices have also led to increased demand from oil-exporting nations as incomes have increased.

... will flow through to New Zealand exporters and the terms of trade

The increase in spot prices for dairy products in world markets in the past year has so far had little impact on dairy export prices, but we expect the majority of the increase to appear between the third quarter of 2007 and the first quarter of 2008. The full extent of the increase in spot prices will not be transmitted to local prices because the use of supply contracts by exporters smooths the peaks and delays the flow-through. We have assumed that annual growth in the world dairy prices received by New Zealand producers peaks at 64% in the March quarter 2008 and that they will level off in mid-2008, before declining gradually from the December quarter of 2008. By that time we expect increased production from other exporters (such as South America and the United States) as well as increased domestic production in China, and that higher prices for consumer products will have started to reduce demand. Higher dairy prices will lead to significantly higher terms of trade than previously forecast (Figure 1.8).

Figure 1.8 – Goods terms of trade (SNA basis)



Sources: Statistics New Zealand, The Treasury

We expect dairy prices to remain above their pre-boom level at the end of the forecast period, reflecting higher costs of production (as a result of the factors outlined above) and increased global demand. However, further price declines are likely beyond the forecast period as world supply expands further. There is considerable uncertainty related to these projections for dairy prices and alternative scenarios are presented in the *Risks and Scenarios* chapter, including their implications for the economy and fiscal indicators.

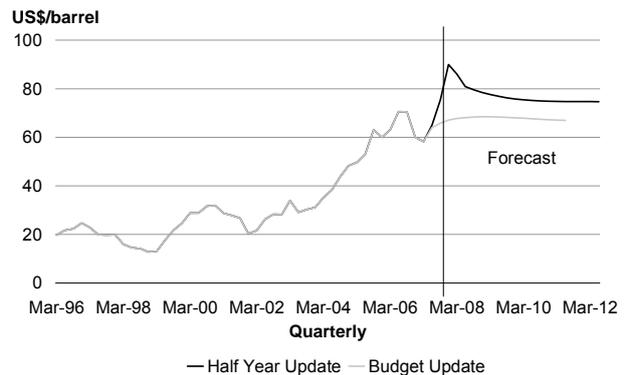
Meat prices are expected to increase as well

Meat prices are expected to increase modestly in the early part of the forecast period for similar reasons to dairy prices, namely lower production in Australia as a result of the drought, the removal of lamb production incentives in the CAP and expanding ethanol production in the United States leading to increased feed costs for beef farmers. This is expected to limit United States beef production, increase prices to final consumers and offset the effects of the re-opening of key north Asian markets to United States beef exports. Increased demand from developing countries for meat is also expected to lead to higher prices.

Oil prices are expected to remain high throughout the period

Prices for West Texas Intermediate (WTI) crude oil have increased in US dollar terms throughout most of 2007. The increase partly reflects the weakness of the US dollar, but also increased demand and concerns about supply. In accordance with our usual practice, we have assumed that the average futures prices recorded in the month prior to finalising the forecast will apply over the forecast period. The resulting projection declines from an assumed US\$90 per barrel in the fourth quarter of 2007 to just below US\$75 per barrel in the fourth quarter of 2010 (Figure 1.9). Oil prices

Figure 1.9 – WTI oil prices



Sources: Datastream, The Treasury

are forecast to be approximately one-third higher than in the *Budget Update* in the December 2007 quarter, gradually declining to 12% higher in 2011. These higher prices will offset some of the increase in dairy and meat prices on the terms of trade.

Higher terms of trade will benefit the wider economy ...

The direct impact of the increase in dairy prices will be concentrated in the agricultural sector, but with some flow-on to supporting service sectors and the rest of the economy. Higher export prices will lead to higher incomes and so increased consumption and investment. The indirect benefit from the higher terms of trade will accrue to the wider economy via the exchange rate which we now expect to remain higher than in the *Budget Update*. This will make imports cheaper and raise real incomes for households, boosting consumption.

... and bring a reduction in the current account deficit

Despite the higher consumption, the higher terms of trade are expected to bring a rapid reduction in the current account deficit from 8.3% of GDP in the year to March 2007 to 7.4% of GDP in the following year and to 6.4% in the year to March 2009. However, as the terms of trade begin to decline from their peak in the final quarter of 2008, the current account deficit is expected to increase again briefly to 7.2% of GDP in the year to March 2010. It then resumes its gradual decline as export volume growth, especially for services exports, outstrips import volume growth and the continuing decline in the terms of trade.

Export production is expected to increase in response to the higher terms of trade

We expect that there will be an increase in dairy production as farmers increase herd sizes through stock retentions and boost output in the short term through productivity-enhancing measures, and as dairy conversions increase. Meat production is expected to remain practically unchanged in the forecast period, but forestry export volumes are forecast to increase by 4% per annum from 2009 with supportive New Zealand dollar prices (as the exchange rate depreciates) and as the volume of wood available for harvest increases.

In the March 2008 year, export volumes will be boosted by production from the Tui oilfield. Exports began in the September quarter 2007 and were expected to peak in the December quarter 2007. Since the forecast was finalised, the reserves in the Tui oilfield have been revised up by some 30%, so production is now considered likely to remain high for longer. Non-commodity export volumes are forecast to continue to increase as manufacturers target production to their markets and as the assumed fall in the exchange rate supports the profitability of exporting. The fall in the exchange rate is also expected to lead to an increase in the volume of services exports from 2009 as New Zealand becomes a more competitive tourist destination. Total export volume growth is forecast to increase steadily from 2.6% in the year to March 2009 to 4.0% in the year to March 2012 as producers respond to higher returns.

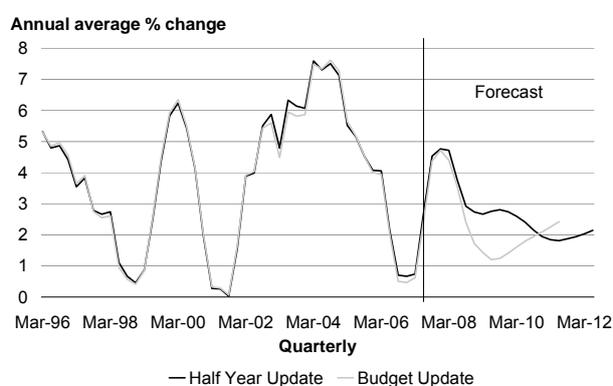
Domestic stimulus and momentum offset by some constraints

Positive and negative factors balanced in the domestic setting

Some key developments in the domestic economy will also be important in determining the path of the economy over the forecast period. The main supportive factors are an assumed reduction in personal income taxes and continuing momentum in the labour market, both of which will support private consumption, and continuing capacity constraints for firms which will encourage them to invest. These positive factors will be offset to some degree by continuing restrictive monetary conditions (combined with high debt levels for households), slower population growth as a result of lower net migration inflows, continuing high fuel costs and moderating house price growth.

Growth in real Gross National Expenditure (GNE) is estimated to be relatively high at 4.7% in the year to March 2008 as a result of the resurgence in consumption and residential investment in the first half of 2007 and higher market investment in the second half of 2007. In the 2009 and 2010 March years, growth in GNE is forecast to ease to 2.7% and 2.6% respectively, and then to ease further to 1.8% in the following year as the negative influences predominate, picking up slightly to 2.0% in the final year of the forecasts (Figure 1.10).

Figure 1.10 – Real GNE



Sources: Statistics New Zealand, The Treasury

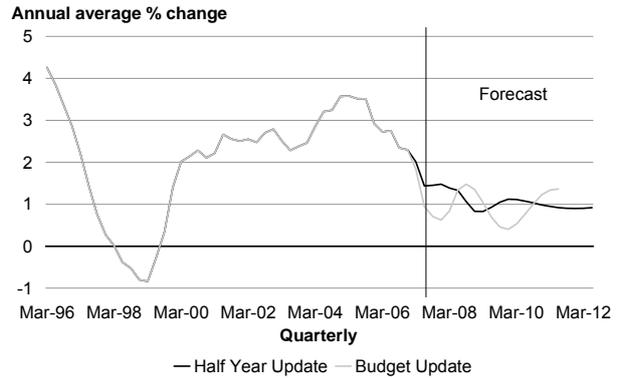
Assumed reduction in personal taxes stimulates private consumption

The forecast incorporates the implications of a reduction in tax revenue of around \$1.5 billion per annum from April 2009, which is discussed in the *Budget Policy Statement* and the *Fiscal Outlook* chapter. It has been assumed that the revenue reduction will be applied to personal income taxes, thus supporting private consumption with some flow-through to higher imports, especially in the year to March 2010. The higher level of consumption will continue in subsequent years as net incomes will be higher than they would otherwise be. No assumptions have been made about the nature of the tax revenue reduction, apart from its aggregate value, and no response has been assumed in labour supply.

Continuing momentum in labour market ...

Labour income growth was slightly higher in the first half of 2007 than our *Budget Update* forecasts, with higher employment growth offsetting lower wage growth. This increased momentum in the labour market is expected to continue in the forecast period as capacity constraints and high employment intentions point to continued robust employment growth. We expect full-time equivalent employment growth of 1.4% in the year to March 2008, but averaging just below 1% per annum over the following four years (Figure 1.11).

Figure 1.11 – Full-time equivalent employment



Sources: Statistics New Zealand, The Treasury

With a lower starting point for the unemployment rate than assumed in the *Budget Update* and slower labour force growth (as a result of lower net migration inflows), the unemployment rate is forecast to be lower than in the *Budget Update* throughout the forecast period, especially in the March 2009 and 2010 years. It is forecast to remain below 4% until the March quarter 2010 and then to rise only slowly to 4.1% by the end of the forecast period as growth in employment falls below growth in the labour force.

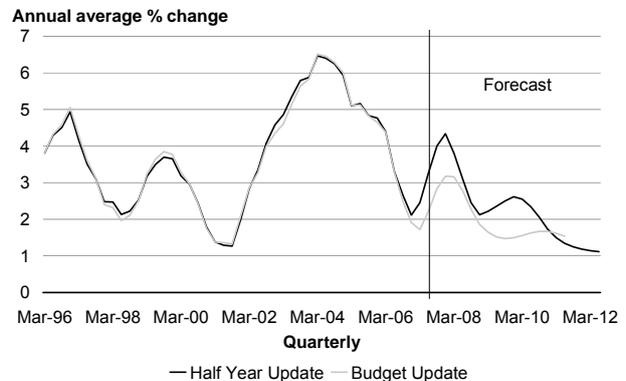
... will support earnings growth

With lower unemployment and continuing difficulties for firms in recruiting staff, as well as higher inflation, nominal wage growth is expected to be higher than in the *Budget Update*. Average ordinary time hourly earnings are forecast to increase by more than 4% on an annual average basis until the last year of the forecast period. Moderate but easing wage growth, combined with steady employment growth, is expected to lead to labour income growth continuing to decline from its recent peak of 7.5% annual average growth in mid-2006 to 6.1% in the year to March 2008, but remain at or above 5% until the end of 2011.

Consumption growth maintained in the short term

Continuing, although easing, momentum in the labour market is expected to support private consumption growth. The boost to private consumption in late 2006 and early 2007 keeps annual average growth high in the second half of 2007 and first quarter of 2008 (Figure 1.12). Other positive factors supporting consumption growth throughout this period are the higher dairy payout and associated higher exchange rate in the early part of the forecast period, making imports of goods and services cheaper. Growth in private consumption, which accounts for more than 60% of GDP, is expected to slow over calendar 2008 to a low of 2.1%, but the assumed reduction in personal taxes from April 2009 boosts annual

Figure 1.12 – Real private consumption



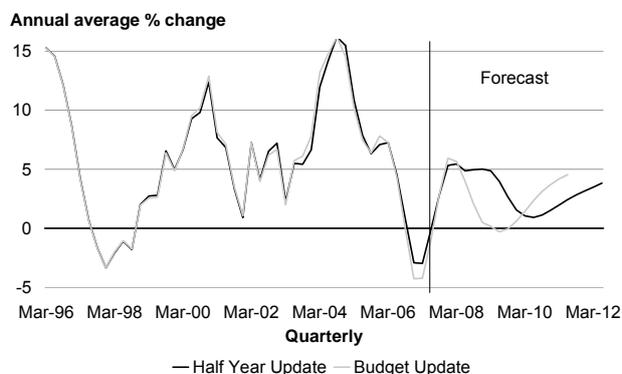
Sources: Statistics New Zealand, The Treasury

average growth in the following year to 2.6%, before growth slows over the remainder of the forecast period.

Capacity constraints encourage businesses to continue to invest ...

Capacity constraints and labour shortages will continue to support market investment in the short term as firms seek to expand output and supplement or complement labour input. The increase in the terms of trade and resultant higher profits (not only for the dairy industry), plus the associated higher exchange rate, are also expected to support market investment in the near term. However, as the economy slows and the exchange rate declines, growth in market investment is expected to ease from a peak of 5.6% in the March 2008 year (boosted by high quarterly growth in late 2006 and early 2007), to a trough of less than 1% in the year to June 2010 as a result of continuing high interest rates (Figure 1.13). It subsequently recovers somewhat in the final two years of the forecast.

Figure 1.13 – Real market investment



Sources: Statistics New Zealand, The Treasury

... and labour productivity growth is expected to increase

The reversal of some cyclical factors, along with the increased market investment, is expected to lead to a further recovery in labour productivity growth in the forecast period. Growth in labour productivity slowed in 2005 and 2006, possibly as firms held onto staff because of the difficulty of replacing them. As growth strengthened again without a commensurate increase in labour input, labour productivity growth began to increase and we expect this trend to continue. In addition, many new workers in the recent period may have been less productive than more experienced workers; as they learn by doing, labour productivity will also increase. Growth in labour productivity is expected to average 1.8% per annum in the forecast period, higher than its average of 1.2% in the past seven years.

Non-market investment and public consumption also expected to increase

Non-market investment (ie, central government and Crown entities) is forecast to grow at a high rate in the short term (partly reflecting a bounce-back from a sharp drop in mid-2007), boosting growth in the year to March 2009. Thereafter, non-market investment is forecast to grow at around 2% per annum as the Government continues to expand infrastructure for public services. The Government's current expenditure is also forecast to increase throughout the forecast period, averaging growth of nearly 4.0% per annum, up from 2.8% growth in the year to March 2008.

Inflation is expected to remain higher for longer ...

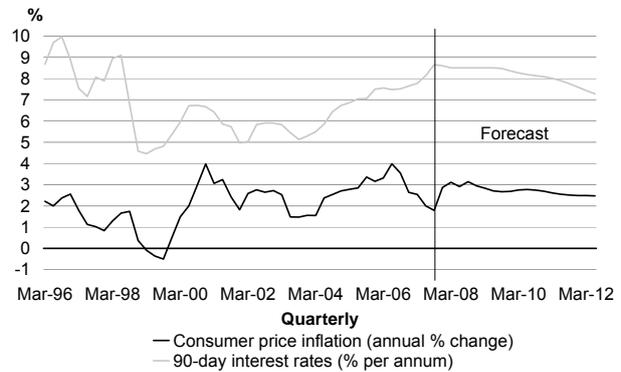
Continuing growth in domestic demand, as a result of the reduction in tax revenue incorporated from April 2009 and the ongoing momentum in the labour market, is expected to lead to greater pressure on resources and increased inflationary pressure. Consumer price inflation is forecast to peak at 3.1% in March 2008 and average 3.0% for calendar year 2008. Non-tradables inflation will remain high as a result of the additional growth in private consumption

and tradables inflation will be boosted by higher oil prices and the assumed fall in the value of the New Zealand dollar (discussed below). Higher international food prices will also push up tradables inflation. This forecast does not include the impact of the proposed emissions trading scheme which will result in higher prices for carbon-sourced energy.

... and high interest rates ...

As a result of higher inflation than in the *Budget Update*, 90-day interest rates are expected to remain at or above 8.5% until the final quarter of 2009, when they will start to ease. Consumer price inflation is expected to decline gradually from 3.1% in September 2008 to 2.5% by the end of the forecast period (Figure 1.14). This is above the mid-point of the Reserve Bank’s target band as the time required to bring inflation back to that rate is longer than the forecast period. As a result, short-term interest rates, at 7.3%, are still restrictive at the end of the period.

Figure 1.14 – Inflation and interest rates

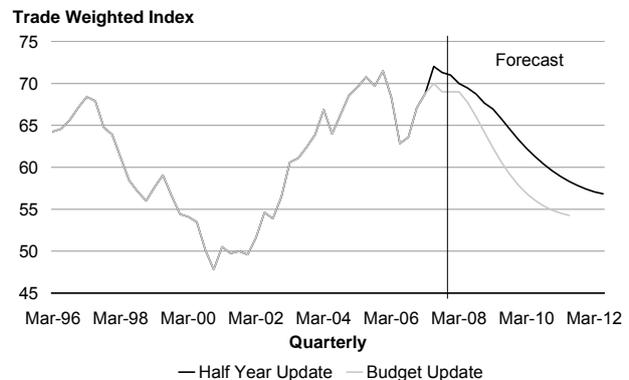


Sources: Statistics New Zealand, RBNZ, The Treasury

... will help keep the exchange rate up in the near term ...

Higher interest rates will help keep the New Zealand dollar at an elevated level for longer than previously assumed. The Trade Weighted Index (TWI) is now expected to remain at around 70 until mid-2008 (Figure 1.15). The factors which will keep the dollar high in the near term are the higher terms of trade, the increased interest rate differential, especially against the US dollar for which policy rates have been eased recently (and may be eased further), and continuing robust growth in domestic demand.

Figure 1.15 – NZ dollar exchange rate



Sources: Reserve Bank of New Zealand, The Treasury

... but it will begin to ease in the second half of 2008

However, as domestic demand begins to slow in the second half of 2008, the exchange rate is expected to begin to decline gradually to 56.8 on the TWI by the end of the forecast. The decline in the terms of trade from the start of 2009 and the increase in the current account deficit are also expected to contribute to the gradual fall in the exchange rate.

The fall in the exchange rate helps bring about an adjustment in household debt to more sustainable levels by discouraging consumption and encouraging savings (by making imports more expensive). Higher interest rates will also support increased saving. The household saving rate is forecast to recover from -13.7% of disposable income in the year to March 2007 to -8.2% in March 2012. Further adjustment is needed in order to achieve a sustainable debt level and this occurs beyond the forecast period.

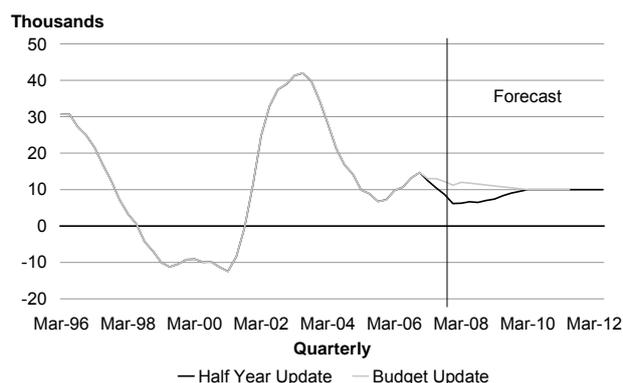
Lower net migration gains ...

Annual net gains from permanent and long-term migration slowed over 2007 from a peak of 14,800 in November 2006 to 7,500 in October 2007. The net gain has declined as departures increased from 68,100 in the 2006 calendar year to 75,100 in the year to October 2007; higher departures to Australia accounted for most of this increase. Arrivals increased slightly in the past year, but not sufficiently to offset the increase in departures.

... are expected to continue

These trends are expected to continue in the short term, with net PLT migration inflows declining to 6,200 in the year to March 2008. Net migration gains are assumed to stabilise at around that rate through 2008, and then rise gradually back towards their average for the past decade of 10,000 per annum as arrivals increase slightly and departures fall (Figure 1.16). Immigration approvals, for both permanent residency and work permits, have been running at a high level recently, pointing to steady permanent and long-term arrivals. Departures to Australia are expected to ease from their recent high level as growth slows there and picks up here with the assumed tax revenue reduction beginning in April 2009.

Figure 1.16 – Annual net PLT migration



Sources: Statistics New Zealand, The Treasury

High oil prices will limit growth in consumption

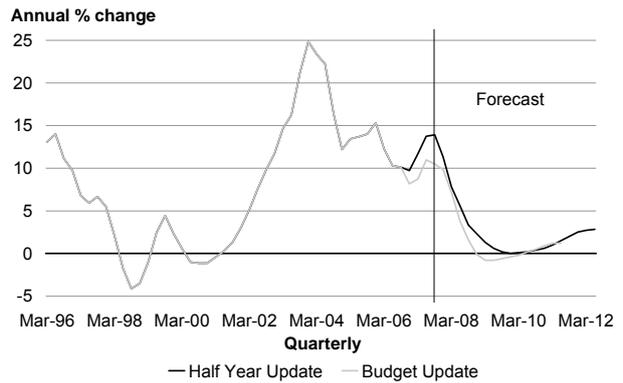
Some other factors will also serve to constrain growth in domestic demand later in the forecast period. As discussed above, oil prices are assumed to remain relatively high throughout the forecast period. The assumed decline in the New Zealand dollar from mid-2008 means that fuel prices will remain fairly steady in local currency terms for the following year, but will then begin to increase by around 1% per quarter as the fall in the New Zealand dollar outweighs the fall in the oil price. Recent increases in fuel prices will constrain growth in private consumption in the near term as they limit the expansion of disposable income and subsequently increasing fuel prices will suppress consumption growth slightly. Growth in private consumption falls to 1.1% in the final year of the forecast.

Housing market expected to slow ...

The market for existing houses slowed considerably in the middle of 2007. The median sale price was steady for the six months from March to September, annual house sales have fallen nearly 10% in the past six months and houses remained on the market longer before they sold. We expect these trends to continue as a result of the lower net migration inflows and the flow-through of high interest rates to homeowners as mortgage rates are re-set, offset to some degree by continuing, but easing, growth in labour incomes.

Past increases in house prices have been accompanied by rapid growth in residential investment (as increases in house prices show increased demand for housing which can be met only by further investment), but have also supported complementary consumption of consumer durables such as furnishings and appliances. The “wealth effect” of higher house values has also supported consumption, as have the increased collateral for borrowing and direct withdrawal of equity from housing. These effects will dissipate as house price growth slows in the forecast period (Figure 1.17).

Figure 1.17 – House prices

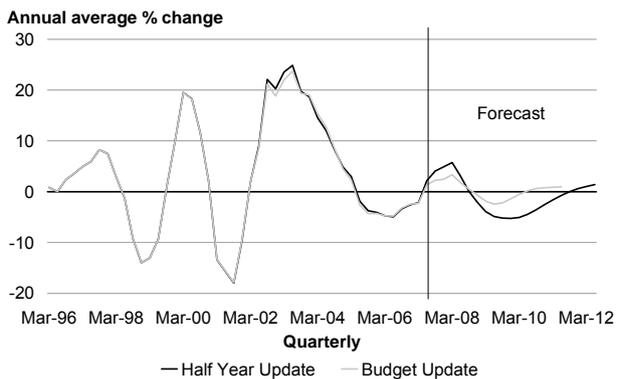


Sources: Quotable Value NZ, The Treasury

... with flow-on to residential investment

We expect house price growth to decline through 2008 and that prices will be flat in nominal terms through 2009, before beginning to increase again in 2010. This low rate of growth in house prices will lead to lower consumption growth, and residential investment is forecast to decline on a quarterly basis from late 2007 until later in the forecast period when some recovery is expected to occur. Continuing high interest rates will be the major factor constraining residential investment up until late 2010, along with lower net migration inflows in the preceding period. Lower interest rates will flow through to retail mortgage interest rates with a lag, and growth in residential investment is expected to recover by the end of the forecast period (Figure 1.18).

Figure 1.18 – Real residential investment



Sources: Statistics New Zealand, The Treasury

Growth in real GDP higher in the near term ...

Private consumption expenditure is forecast to grow more rapidly through most of the forecast period than in our *Budget Update* forecasts and residential investment is expected to grow faster in the near term. These two components are chiefly responsible for faster growth in real GDP in the near term which is now forecast to be 3.0% in the year to March 2008, higher than the 2.6% growth expected in the *Budget Update*.

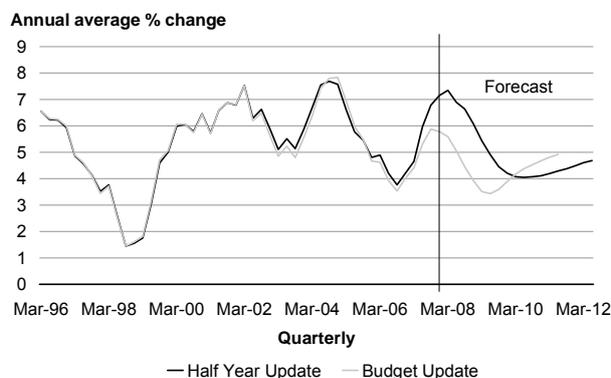
In the same way, higher private consumption growth in the March 2009 year, combined with higher non-residential investment, removes the trough of 1.6% growth projected in the *Budget Update*. Real GDP growth is now forecast to slip to only 2.1% in the March 2009 year, before strengthening again over the final three years of the forecast period towards its trend rate.

Higher domestic demand in the March 2008 and 2009 years leads to growth in the volume of imports of 6.1% and 4.0% respectively in those two years. Growth in imports tails off after that with the easing in growth in private consumption.

... and growth in nominal GDP ...

Higher inflation and terms of trade lead to faster growth in nominal GDP than previously forecast. The higher terms of trade also result in higher real GDP as higher export prices lead to higher incomes and increased expenditure. Growth in nominal GDP is forecast to accelerate to 7.3% in the year to March 2008. This period of growth coincides with a peak in inflation of 3.1% and the peak in the terms of trade as past increases in spot dairy prices flow through to export prices. Thereafter, growth in nominal GDP is expected to ease as inflation and the terms of trade decline. Growth in nominal GDP is forecast to decline to 5.4% in the year to March 2009 and 4.1% in the following year, partly as a result of the fall in the terms of trade. As that fall moderates in subsequent years and consumer price inflation remains relatively high, growth in nominal GDP picks up again to 4.2% in March 2011 and 4.6% in March 2012 (Figure 1.19).

Figure 1.19 – Nominal GDP



Sources: Statistics New Zealand, The Treasury

... and tax revenue will also be higher

With higher growth in nominal GDP, tax revenue is also forecast to be higher. Total tax forecasts are higher than in the *Budget Update* by as much as \$2 billion (around 4% of total tax) in some years, excluding the tax revenue reduction contingency. The terms of trade effect flows directly through to the income taxes, particularly other persons tax but also, to some extent, corporate taxes. Source deductions forecasts are up by an average of \$400 million each year compared to the *Budget Update* owing to higher forecasts for employment and wages. Further discussion of the tax forecasts can be found in the *Fiscal Outlook* chapter.

Fiscal Outlook

Introduction

The fiscal position is forecast to continue to strengthen over the forecast period.

Based on strong nominal Gross Domestic Product growth forecast over the next few years and its subsequent impact on tax revenue forecasts, the fiscal outlook is stronger than what was expected at the *Budget Update*. This is notwithstanding the inclusion of a revenue reduction contingency of \$1.5 billion effective 1 April 2009, rising to \$1.7 billion by 2011/12.

This strengthening is reflected in most indicators. For example:

- The operating balance before gains and losses (OBEGAL), while forecast to fall from \$6.6 billion in 2007/08 to \$3.9 billion in 2011/12, is higher in all years than forecast at the time of the *Budget Update*.
- Cash deficits of \$2.6 billion over the forecast period, are less than the \$5.7 billion forecast at the *Budget Update*.
- Gross sovereign-issued debt excluding settlement cash is forecast to increase by around \$2.3 billion over the forecast period in nominal terms, but continues to fall as a percentage of GDP from 18.5% to 15.6%.

This chapter outlines the trends of the key indicators over the forecast period, before discussing the main drivers of these trends in more detail. The forecasts are then compared to those provided in the *Budget Update*.

The chapter also includes a description of how the fiscal indicators are derived, how they are used and a historical series.

Table 2.1 – Summary fiscal indicators²

| \$million | Year ended 30 June | | | | | |
|--|--------------------|------------------|------------------|------------------|------------------|------------------|
| | 2007 Actual | 2008 Forecast | 2009 Forecast | 2010 Forecast | 2011 Forecast | 2012 Forecast |
| Core Crown revenue excluding NZS Fund revenue | 58,473 | 62,130 | 63,147 | 65,412 | 68,965 | 72,168 |
| Core Crown revenue | 58,174 | 62,409 | 63,496 | 65,832 | 69,458 | 72,740 |
| Core Crown expenses | 53,977 | 57,137 | 60,537 | 63,106 | 66,632 | 70,034 |
| OBEGAL | 5,339 | 6,574 | 4,327 | 4,062 | 3,984 | 3,850 |
| OBEGAL ³ excluding NZS Fund net revenue | 5,757 | 6,405 | 4,116 | 3,809 | 3,688 | 3,507 |
| Operating balance | 7,999 | 7,388 | 6,053 | 5,924 | 6,094 | 6,228 |
| Core Crown residual cash | 2,653 | 759 | (763) | (779) | (851) | (937) |
| Gross sovereign-issued debt (excl Settlement Cash) | 30,890 | 33,303 | 33,034 | 31,779 | 34,566 | 33,172 |
| Net core Crown debt | 4,411 | 1,983 | 1,756 | 1,705 | 1,792 | 2,105 |
| Net core Crown debt (incl NZS Fund) | (8,112) | (13,102) | (16,224) | (19,545) | (22,990) | (26,414) |
| % of GDP | | | | | | |
| Core Crown revenue excluding NZS Fund revenue | 35.1 | 34.9 | 33.8 | 33.6 | 34.0 | 34.0 |
| Core Crown revenue | 34.9 | 35.0 | 34.0 | 33.8 | 34.2 | 34.3 |
| Core Crown expenses | 32.4 | 32.1 | 32.4 | 32.4 | 32.8 | 33.0 |
| OBEGAL | 3.2 | 3.7 | 2.3 | 2.1 | 2.0 | 1.8 |
| OBEGAL excluding NZS Fund net revenue | 3.5 | 3.6 | 2.2 | 2.0 | 1.8 | 1.7 |
| Operating balance | 4.8 | 4.1 | 3.2 | 3.0 | 3.0 | 2.9 |
| Core Crown residual cash | 1.6 | 0.4 | (0.4) | (0.4) | (0.4) | (0.4) |
| Gross sovereign-issued debt (excl Settlement Cash) | 18.5 | 18.7 | 17.7 | 16.3 | 17.0 | 15.6 |
| Net core Crown debt | 2.6 | 1.1 | 0.9 | 0.9 | 0.9 | 1.0 |
| Net core Crown debt (incl NZS Fund) | (4.9) | (7.4) | (8.7) | (10.0) | (11.3) | (12.4) |

Source: The Treasury

New Zealand International Financial Reporting Standard (NZ IFRS) - “New GAAP”

The financial statements presented in the 2007 HYEPU have been prepared in accordance with New Zealand equivalents to International Financial Reporting Standards (NZ IFRS). All comparatives including the 30 June 2007 are also produced on an NZ IFRS basis, which means they will differ to what was published in the *Financial Statements of the Government of New Zealand for the year ended 30 June 2007* released 10 October 2007. The 30 June 2007 comparatives are provisional and have not yet been subject to audit.

With the adoption of NZ IFRS there is a series break in the graphs and tables presented in the fiscal chapter. For some indicators there is no comparable trend series.

² Detailed tables of the key indicators for the *Half Year Economic and Fiscal Update and Budget Economic and Fiscal Update* (BEFU) are located on pages 57 and 58.

³ The operating balance before gains and losses (OBEGAL) less NZS Fund revenue represents the residual of operating revenue and expenses minus the portion of net revenue earned by the NZS Fund. The indicator does not take into account any gains and losses which are now reported in a separate section of the *Statement of Financial Performance* (refer page 115).

Key Trends

This section looks at the trends of the key indicators presented in the fiscal forecasts. It follows the fiscal strategy framework (refer page 4) and focuses primarily on core Crown indicators.

Table 2.2 – Reconciliation of residual core Crown cash

| \$million | Year ended 30 June | | | | | |
|---|--------------------|------------------|------------------|------------------|------------------|------------------|
| | 2007 Actual | 2008 Forecast | 2009 Forecast | 2010 Forecast | 2011 Forecast | 2012 Forecast |
| Core Crown revenue | 58,174 | 62,409 | 63,496 | 65,832 | 69,458 | 72,740 |
| Less Core Crown expenses | 53,978 | 57,137 | 60,537 | 63,106 | 66,632 | 70,034 |
| Plus Core Crown gains/(losses) and other items | 2,392 | 934 | 1,209 | 1,362 | 1,569 | 1,784 |
| Plus Net surpluses/(deficits) of SOEs and CEs | 1,491 | 1,182 | 1,885 | 1,836 | 1,699 | 1,738 |
| Equals Operating balance | 8,079 | 7,388 | 6,053 | 5,924 | 6,094 | 6,228 |
| Less Net gains/(losses) and other items | 2,740 | 814 | 1,726 | 1,862 | 2,110 | 2,378 |
| Equals Operating balance before gains and losses (OBEGAL) | 5,339 | 6,574 | 4,327 | 4,062 | 3,984 | 3,850 |
| Less NZS Fund net revenue after-tax ⁴ | (418) | 169 | 211 | 253 | 296 | 343 |
| Equals OBEGAL less NZS Fund net revenue | 5,757 | 6,405 | 4,116 | 3,809 | 3,688 | 3,507 |
| Less Net retained surpluses of SOEs and CEs | 1,143 | 1,305 | 1,371 | 1,337 | 1,161 | 1,147 |
| Less Non-cash items and working capital movements | 3,956 | 1,396 | (2,184) | (1,895) | (1,701) | (1,674) |
| Equals Net core Crown cashflow from operations | 8,570 | 6,496 | 4,929 | 4,367 | 4,228 | 4,034 |
| Less Contribution to NZS Fund | 2,049 | 2,103 | 2,376 | 2,321 | 2,316 | 2,281 |
| Equals Net core Crown cashflow from operations after contributions to NZS Fund | 6,521 | 4,393 | 2,553 | 2,046 | 1,912 | 1,753 |
| Less Purchase of physical assets | 1,760 | 1,773 | 1,097 | 1,170 | 949 | 886 |
| Less Advances and capital injections | 2,109 | 1,861 | 1,216 | 882 | 890 | 694 |
| Less Forecast for future new capital spending | - | - | 1,003 | 773 | 924 | 1,110 |
| Equals Core Crown residual cash | 2,652 | 759 | (763) | (779) | (851) | (937) |

Source: The Treasury

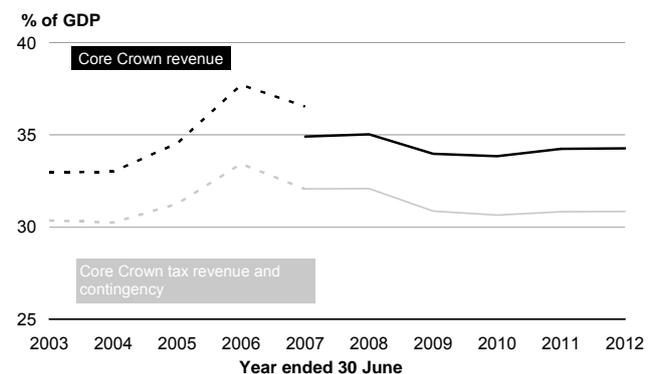
Core Crown revenue falls, then grows broadly in line with the economy ...

Core Crown revenue is forecast to decline from 35% of GDP in 2007/08 to 34% of GDP in 2008/09, and to remain relatively stable thereafter.

Tax revenue follows a similar trend, stabilising at around 31% of GDP. The main influences on the tax revenue trend are:

- underlying growth in the economy flowing into source deductions, corporate taxes and other persons taxes

Figure 2.1 – Core Crown revenue and core Crown tax revenue as a % of GDP⁵



Source: The Treasury

⁴ NZS Fund net revenue is the sum of its revenue (ie, interest and dividends) less expenses. The figure is also adjusted to add back tax revenue received by Inland Revenue from the NZS Fund.

⁵ One of the main presentation changes with the adoption of NZ IFRS is that gains and losses are now recorded in a separate section in the Statement of Financial Performance rather than within revenue and expenses. This has resulted in a downward shift in revenue and expenses.

- the Business Tax Reform announced in Budget 2007, reducing tax revenue by around \$1 billion in each year from 2008/09, and
- a revenue reduction contingency, which is outlined in the box below.

The tax forecasts are subject to potentially greater than usual risks flowing through from the uncertainty in the economic forecasts.

To a lesser extent core Crown revenue is also influenced by additional revenue forecast to be generated from the recently introduced Emissions Trading Scheme of around \$0.1 billion in 2008/09 rising to \$0.9 billion by 2011/12 (refer page 44).

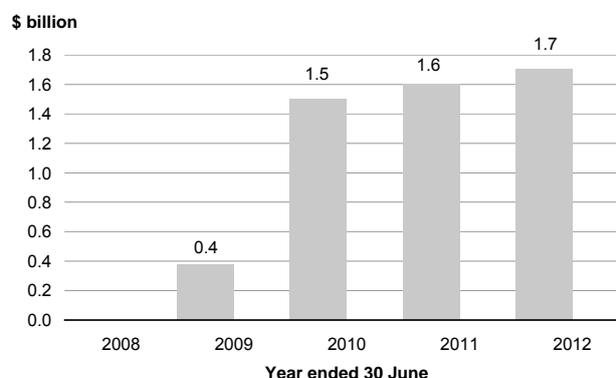
Revenue reduction contingency

The fiscal forecasts include a revenue reduction contingency for changes to personal tax. The forecasts assume that the contingency of \$1.5 billion is effective from 1 April 2009 – the exact shape and timing of any revenue reductions have yet to be determined. The contingency has a rising profile to reflect income growth. The contingency is disclosed separately in the forecast financial statements (refer page 115).

The fiscal forecasts also incorporate likely flow-on effects from reducing personal income tax. Increased economic activity resulting from increases in disposable income is expected to generate extra PAYE and GST tax revenue. In addition tax paid on benefits will be lower meaning there will be a reduction in gross benefit payments.

These impacts are built into the tax and benefit forecasts incorporated in the fiscal forecasts.

Figure 2.2 – Profile of revenue reduction contingency



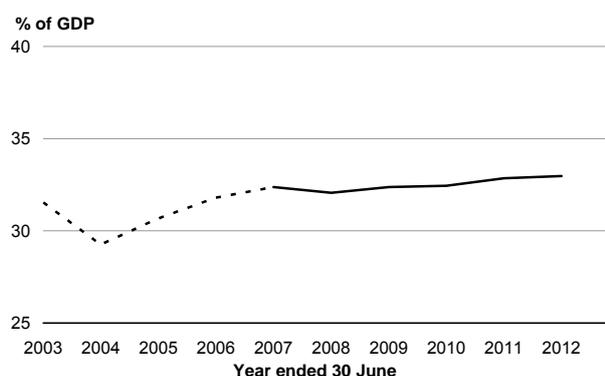
Source: The Treasury

... and core Crown expenses grow faster ...

Core Crown expenses are forecast to increase by around 1% of GDP between 2007/08 and 2011/12.

The forecast growth in expenses largely arises from expense initiatives introduced in recent Budgets. A number of policy decisions made in previous Budgets have rising spending profiles to allow sufficient time for full implementation. The enhancement to the KiwiSaver initiative announced in Budget 2007 is one of the main drivers of this rising profile,

Figure 2.3 – Core Crown expenses as a % of GDP



Source: The Treasury

at around \$0.8 billion in 2007/08 rising to around \$1.4 billion by 2011/12, which has been revised since the *Budget Update* based on forecast uptake.

In addition, the recently introduced Emissions Trading Scheme results in an increase in the expense base.

... as a result the OBEGAL declines ...

The OBEGAL is forecast to be \$6.6 billion (3.7% of GDP) in 2007/08. As the impact of the tax initiatives and recent spending decisions takes effect, the OBEGAL declines over the rest of the forecast period to \$3.9 billion (1.8% of GDP) in 2011/12.

Not all components of the OBEGAL expected over the forecast period are drawn upon by the Government to help fund its operations. For example, entities retain their surpluses for the purpose of achieving their long-term objectives, such as ACC building up financial assets to help meet its outstanding claims liability and SOEs investing in their capital base.

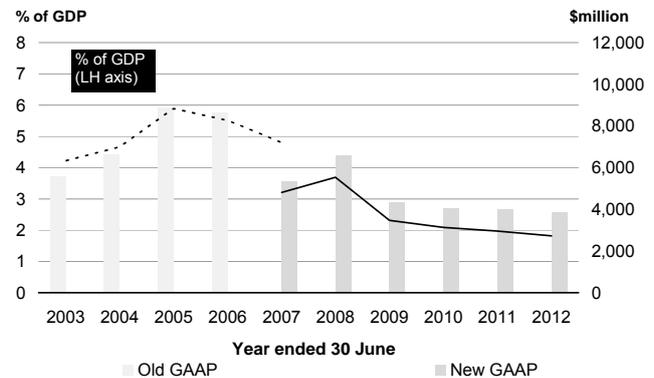
This leaves around two-thirds of the accumulated OBEGAL available to finance the Government’s investment activities, such as contributions to the NZS Fund and its general capital programme.

... and cash surpluses become deficits ...

The portion of the OBEGAL that is available to the Government translates into about \$24.1 billion of cash over the forecast period.

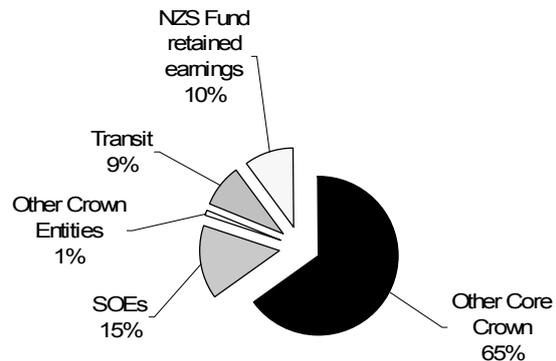
This is sufficient to meet the Government’s required contributions to the NZS Fund of \$11.4 billion. With the purchase of physical assets of \$9.7 billion (for example, schools and defence equipment), advances of \$4.4 billion (mainly student loans and refinancing debt of the health and housing sectors), injections into Crown entities for hospitals and housing of \$1.1 billion, there is a residual financing requirement over the forecast period of around \$2.6 billion.

Figure 2.4 – Operating balance before gains and losses (OBEGAL)



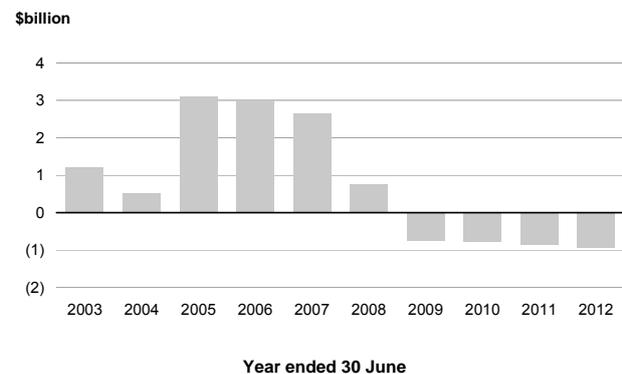
Source: The Treasury

Figure 2.5 – Accumulated OBEGAL breakdown for the period 2007/08 to 2011/12



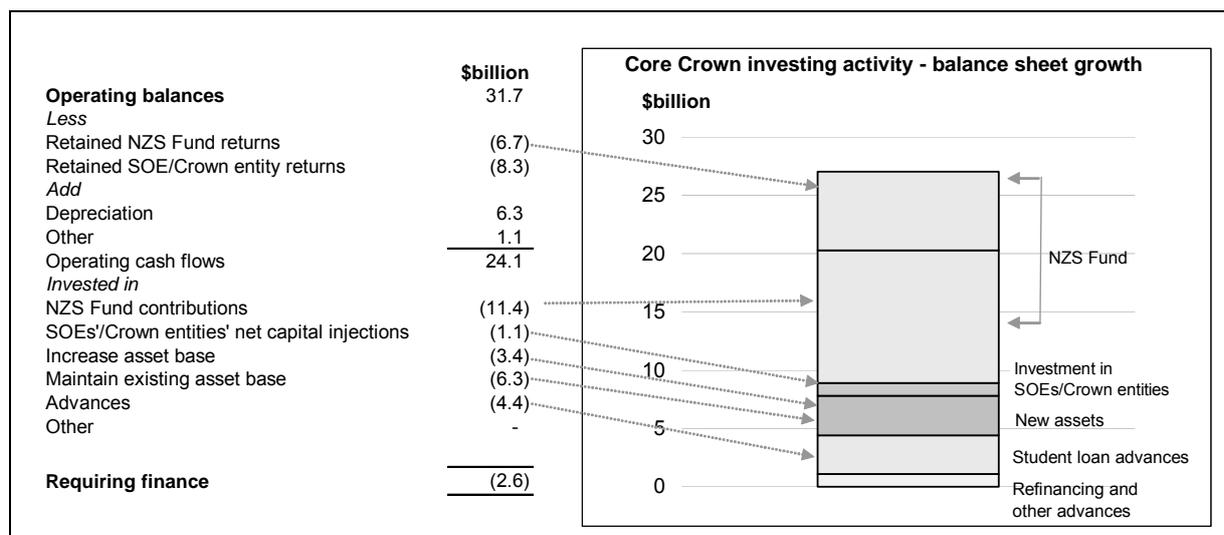
Source: The Treasury

Figure 2.6 – Core Crown residual cash on a year-by-year basis



Source: The Treasury

Table 2.3 – Impact of Crown operating surpluses on the Statement of Financial Position from 2007/08 to 2011/12 inclusive

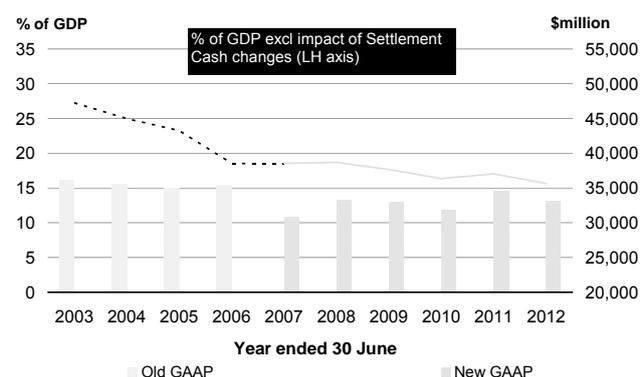


Source: The Treasury

... which are met by borrowings ...

Gross sovereign issued debt (GSID) (excluding Settlement Cash) is forecast to increase by around \$2.3 billion from 2006/07 to 2011/12, primarily to finance the forecast cash shortfall of \$2.6 billion. As a percentage of GDP, GSID (excluding Settlement Cash) is expected to fall from 18.5% to 15.6% over the same period.

Figure 2.7 – GSID (excluding Settlement Cash)



Source: The Treasury

The Government's bond programme is forecast to be around \$2.5 billion per annum, amounting to \$12.5 billion of new borrowings over the forecast period. After meeting the cash shortfall the residual new borrowing replaces maturing debt.

By increasing borrowings to meet the cash shortfall, financial assets (around \$6.5 billion) built up over recent years from strong cash outturns are left intact over the forecast period. These financial assets can be used to meet forecast cash shortfalls beyond 2012.

Why Settlement Cash is excluded from gross sovereign-issued debt

Settlement Cash is the amount of money deposited with the Reserve Bank by banks. It is a liquidity mechanism used to settle wholesale obligations between banks and provides the basis for settling most of the retail banking transactions that occur every working day between corporates and individuals.

Settlement Cash is technically a form of borrowing by the Reserve Bank, which is part of the core Crown. Unlike other core Crown borrowing, however, Settlement Cash represents a liability that is matched by a corresponding increase in financial assets.

Since early 2006, Settlement Cash has increased from \$20 million to around \$8 billion. This increase was a result of a review of the liquidity management arrangements available to banks. Given the increase in Settlement Cash is net debt neutral and the increase in borrowings does not arise out of any change in cash requirements of the Government, it is appropriate that fiscal policy “looks through” this increase.

The 2007 *Fiscal Strategy Report* (page 52) states that “the Government is effectively targeting a level of Gross Sovereign-Issued Debt (GSID) excluding the increase in debt on the Reserve Bank balance sheet as a result of the change in the liquidity management regime”. As the Reserve Bank decided to fund \$1.6 billion of the previously announced increase in its reserves from Settlement Cash rather than borrow from the NZ Debt Management Office, the amount to be excluded from GSID should be adjusted by this amount.

For these forecasts, the GSID excluding Reserve Bank Settlement Cash is:

| \$billion | Year ended 30 June | | | | | |
|---|--------------------|------------------|------------------|------------------|------------------|------------------|
| | 2007 Actual | 2008 Forecast | 2009 Forecast | 2010 Forecast | 2011 Forecast | 2012 Forecast |
| GSID (includes Settlement Cash) | 36.8 | 39.6 | 39.3 | 38.1 | 40.9 | 39.5 |
| Reserve Bank Settlement Cash | 7.5 | 7.9 | 7.9 | 7.9 | 7.9 | 7.9 |
| Reduced NZ DMO borrowing due to Settlement Cash | 1.6 | 1.6 | 1.6 | 1.6 | 1.6 | 1.6 |
| GSID excluding Settlement Cash | 30.9 | 33.3 | 33.0 | 31.8 | 34.6 | 33.2 |
| As a % of GDP | 18.5 | 18.7 | 17.7 | 16.3 | 17.0 | 15.6 |

For forecast purposes the amount of Settlement Cash is held constant. In practice, Settlement Cash does fluctuate through time so the actual amount deducted from GSID will vary when actual results are reported.

... while financial assets increase ...

Financial assets (including NZS Fund) are forecast to increase by around \$20.2 billion over the forecast period.

There are two main drivers of this increase:

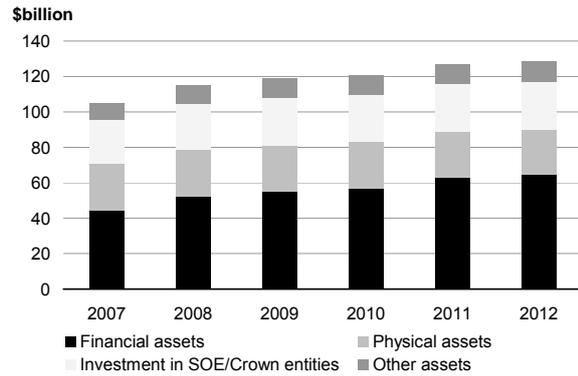
- Investment in the NZS Fund. In line with the fiscal strategy, a portion of the cash generated from the Government's operations is set aside to make contributions to the NZS Fund. In addition, the NZS Fund financial assets by the reinvestment of its retained grow surpluses.
- More advances are being made, primarily in the form of student loans. Student loans are not readily convertible into cash.

... and the Government continues to strengthen its net financial asset position

Including the financial assets held by the NZS Fund, the Government is forecast to move from an \$8.1 billion (or 4.9% of GDP) net financial asset position in 2006/07 to \$26.4 billion (or 12.4% of GDP) by 2011/12.

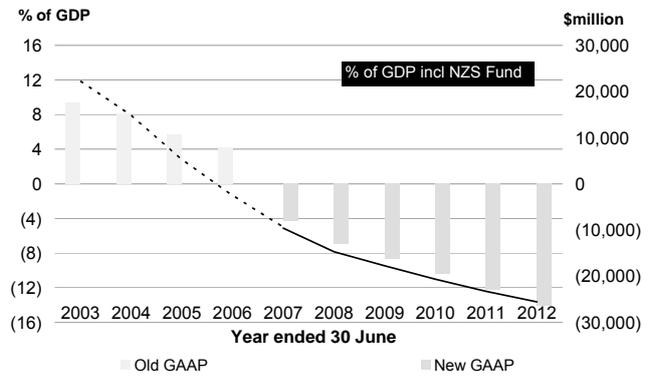
Without the NZS Fund, net debt remains relatively stable at around 1% of GDP over the forecast period. This trend reflects the fact that some increases in GSID (excluding Settlement Cash) are being invested in financial assets (eg, student loans) and are net debt neutral.

Figure 2.8 – Core Crown asset growth



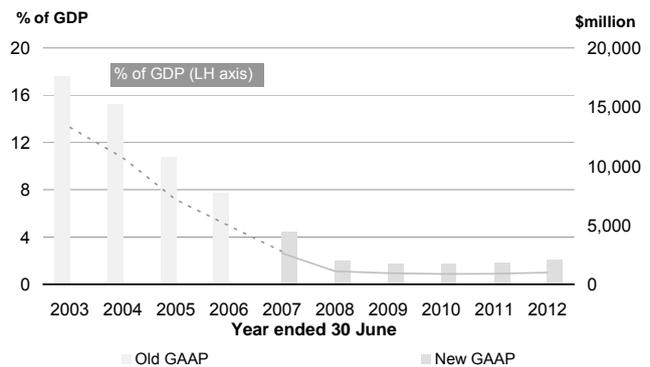
Source: The Treasury

Figure 2.9 – Net debt (% of GDP and \$million) including financial assets of NZS Fund



Source: The Treasury

Figure 2.10 – Net debt (% of GDP and \$million)



Source: The Treasury

The New Zealand Superannuation Fund

The NZS Fund is an important component of the Government's fiscal strategy. The NZS Fund's assets provide the means for the Government to partially pre-fund future fiscal pressures, particularly those pressures arising from an ageing population.

The NZS Fund's assets are to be built up through a combination of investment returns earned on the Fund's portfolio and Government contributions. The Government's contributions to the NZS Fund are calculated over a 40-year rolling horizon on the basis of funding superannuation payments over the next 40 years with a constant contribution rate over that period. The Government is forecast to make the required minimum annual contribution for 2007/08 and 2008/09 as calculated by the formula set out in the NZS Act.

| \$billion (June year end) | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|----------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Required contribution | 2.337 | 2.049 | 2.103 | 2.376 | 2.321 | 2.316 | 2.281 |
| Actual/Budgeted contribution | 2.337 | 2.049 | 2.103 | 2.376 | 2.321 | 2.316 | 2.281 |

The underlying assumptions in calculating the contributions for 2008 are the nominal GDP series to 2048, the New Zealand Superannuation expense series to 2048 and the expected long-term, net after-tax annual return of the NZS Fund (6.1%) (6.1% *Budget Update*). The forecast rate of return is based on the Treasury's assumptions for the rate of return on financial portfolios of Crown financial institutions. The Treasury website contains further information on the NZS Fund, as well as a copy of the NZS Fund model.

The Fund's assets are forecast to grow over the forecast period to \$31.1 billion, an increase of \$18.1 billion. Over \$6.7 billion of this increase is expected to come from the NZS Fund's investment performance, with the remaining increase from Government contributions.

| | Year ended 30 June | | | | | |
|-----------------------------------|---------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
| \$million | Actual | Forecast | Forecast | Forecast | Forecast | Forecast |
| Opening net worth | 9,855 | 12,973 | 15,993 | 19,488 | 23,140 | 27,016 |
| Gross contribution from the Crown | 2,049 | 2,103 | 2,376 | 2,321 | 2,316 | 2,281 |
| NZS Fund net revenue | 282 | 432 | 532 | 633 | 747 | 868 |
| NZS Fund gains and losses | 1,520 | 761 | 923 | 1,097 | 1,283 | 1,482 |
| Income tax | (733) | (276) | (336) | (399) | (470) | (545) |
| Closing net worth | 12,973 | 15,993 | 19,488 | 23,140 | 27,016 | 31,102 |

Introduction of an Emissions Trading Scheme

On 4 December 2007, the Government introduced legislation to establish an Emissions Trading Scheme (ETS) to encourage industries and businesses to reduce greenhouse gas emissions. Key features of the ETS from a forecasting perspective are:

- The ETS creates a limited number of tradable units (the NZ Unit), which the Government can allocate freely or sell to entities.
- Specified emitters (“points of obligation”) will be required to surrender NZ Units or International Units to the Crown based on the level of carbon dioxide equivalent they emit or that will be emitted downstream of their activities.
- The Government will exchange NZ Units for internationally tradable units if parties holding NZ Units wish to sell their units offshore.

Detail on the operation of the ETS is available at www.climatechange.govt.nz/

Reporting of the ETS

The economic impacts of the ETS are not included in these forecasts, as Cabinet’s decisions on the ETS were made after the HYEPU’s economic forecasts were finalised.

The fiscal forecasts do, however, capture the core policy decisions made by Cabinet (ie, transactions associated with the Government’s allocation of NZ Units to forestry and industrial process sectors and payment of units to the Crown by emitters). There is little guidance on how to report Emission Trading Schemes, with practices varying internationally. The following outlines the approach reflected in this *Half Year Update*. This approach is being discussed with the Office of the Auditor-General.

The allocation of NZ Units creates a liability (and an expense if allocated for free). The liability arises from the Crown being prepared to swap allocated units into International Units. This is similar to how currency issued by the Crown is reported. The liability is reduced, and revenue recognised, as NZ Units are paid back to the Crown by emitters. The forecast revenues and expenses are transacted in NZ Units (valued at the recent international carbon prices) – no cash is exchanged.

The ETS impact on the fiscal forecasts is:

| \$millions | Year ended 30 June | | | | |
|---|--------------------|------------------|------------------|------------------|------------------|
| | 2008 Forecast | 2009 Forecast | 2010 Forecast | 2011 Forecast | 2012 Forecast |
| Revenue - levies payable under ETS | - | 84 | 480 | 864 | 864 |
| Expense - free allocations of units | - | 597 | 477 | 477 | 477 |
| OBEGAL | - | (513) | 3 | 387 | 387 |
| Balance sheet - change in OBEGAL | | | | | |
| Liability - outstanding NZ Units | - | 513 | 510 | 123 | - |
| Asset - International Units | - | - | - | - | 264 |

Reporting of the Kyoto liability

The ETS is designed to encourage reductions in greenhouse gas emissions at least cost. Reductions in emissions will in turn reduce the Crown’s international Kyoto obligations. For the *Half Year Update*, the Kyoto liability has been updated for exchange rates and international carbon prices only, bringing the carbon price in New Zealand dollars to \$21.01 (\$15.48 at 30 June 2007). The price change increased the liability to \$956 million (up \$252 million since 30 June 2007).

Revenue and Expenses

This section discusses the trends in the three main OBEGAL components: core Crown revenue, core Crown expenses and SOEs'/CEs' OBEGAL. The trend in total Crown is primarily driven by the core Crown segment activity so is the focus of this section.

Table 2.4 – Revenue and expenses comparison with *Budget Update*

| % of GDP | Year ended 30 June | | | | | |
|---------------------------------|--------------------|------------------|------------------|------------------|------------------|------------------|
| | 2007 Actual | 2008 Forecast | 2009 Forecast | 2010 Forecast | 2011 Forecast | 2012 Forecast |
| Total revenue | | | | | | |
| <i>Half Year Update</i> | 44.6 | 44.7 | 43.5 | 43.4 | 43.7 | 43.6 |
| <i>Budget Update</i> | | 44.4 | 44.4 | 44.5 | 44.3 | |
| Total expenses | | | | | | |
| <i>Half Year Update</i> | 41.4 | 41.0 | 41.2 | 41.3 | 41.8 | 41.8 |
| <i>Budget Update</i> | | 41.5 | 42.2 | 42.6 | 42.5 | |
| Core Crown revenue | | | | | | |
| <i>Half Year Update</i> | 34.9 | 35.0 | 34.0 | 33.8 | 34.2 | 34.3 |
| <i>Budget Update</i> | | 34.3 | 34.1 | 34.1 | 34.1 | |
| Core Crown expenses | | | | | | |
| <i>Half Year Update</i> | 32.4 | 32.1 | 32.4 | 32.4 | 32.8 | 33.0 |
| <i>Budget Update</i> | | 32.4 | 32.8 | 33.0 | 33.1 | |
| SOE revenue | | | | | | |
| <i>Half Year Update</i> | 7.1 | 7.1 | 7.1 | 7.2 | 7.1 | 7.1 |
| <i>Budget Update</i> | | 7.5 | 7.6 | 7.5 | 7.2 | |
| SOE expenses | | | | | | |
| <i>Half Year Update</i> | 6.6 | 6.7 | 6.6 | 6.7 | 6.6 | 6.5 |
| <i>Budget Update</i> | | 6.9 | 6.9 | 6.9 | 6.7 | |
| Crown entities' revenue | | | | | | |
| <i>Half Year Update</i> | 15.7 | 15.4 | 14.7 | 14.2 | 13.8 | 13.3 |
| <i>Budget Update</i> | | 15.9 | 15.6 | 15.2 | 14.6 | |
| Crown entities' expenses | | | | | | |
| <i>Half Year Update</i> | 15.4 | 15.1 | 14.5 | 14.1 | 13.7 | 13.2 |
| <i>Budget Update</i> | | 15.5 | 15.3 | 14.9 | 14.4 | |

Source: The Treasury

Total revenue to GDP is forecast to fall over the forecast period from 44.7% in 2007/08 to 43.6% by 2011/12. Total expenses to GDP are forecast to increase from 41% to 41.8% over the same period.

The trend in total revenue and expenses over the forecast horizon is largely driven by activity in the core Crown segment of reported Government activity. The following section discusses the core Crown activity in more detail.

Core Crown – Revenue

Table 2.5 – Core Crown revenue

| | Year ended 30 June | | | | | |
|---|--------------------|------------------|------------------|------------------|------------------|------------------|
| | 2007 Actual | 2008 Forecast | 2009 Forecast | 2010 Forecast | 2011 Forecast | 2012 Forecast |
| \$ billion | | | | | | |
| Tax revenue and revenue reduction contingency | 53.4 | 57.2 | 57.7 | 59.6 | 62.5 | 65.5 |
| Investment revenue | 2.6 | 3.0 | 3.5 | 3.5 | 3.7 | 4.0 |
| Other core Crown revenue | 2.2 | 2.2 | 2.3 | 2.7 | 3.3 | 3.2 |
| Total core Crown revenue | 58.2 | 62.4 | 63.5 | 65.8 | 69.5 | 72.7 |
| % of GDP | | | | | | |
| Tax revenue and revenue reduction contingency | 32.0 | 32.1 | 30.9 | 30.6 | 30.8 | 30.8 |
| Investment revenue | 1.6 | 1.7 | 1.9 | 1.8 | 1.8 | 1.9 |
| Other core Crown revenue | 1.3 | 1.2 | 1.2 | 1.4 | 1.6 | 1.5 |
| Total core Crown revenue | 34.9 | 35.0 | 34.0 | 33.8 | 34.2 | 34.3 |

Source: The Treasury

Tax Revenue and Revenue Reduction Contingency

There are a number of factors that are influencing the trend in tax revenue over the forecast period. In summary the main drivers are:

- growth in the economy
- tax initiatives
- the revenue reduction contingency, and
- accounting disclosure changes.

Economic growth

Tax revenue is expected to grow by around 7% to the end of this year, which is broadly consistent with forecast growth in nominal GDP for the same period. In nominal terms, tax revenue is forecast to grow by about \$4 billion. The three largest components of this growth are:

- source deductions (\$1.5 billion), coming from growth in underlying salaries and wages of about 6%
- corporate taxes (\$0.8 billion), owing to forecast growth in profits, and
- other persons tax (\$0.6 billion), with much of this a result of the 50% increase in the 2008 dairy payout.

From 2009 onwards, the composition of forecast growth changes slightly. In particular tax types:

- Source deductions are still the main driver of tax growth. With aggregate salaries and wages forecast to grow at around 5% per annum, source deductions continue to grow by about \$1.5 billion each year, with fiscal drag contributing \$250 million to \$300 million of this.
- Corporate tax continues to grow, but only by about \$300 million each year, excluding the effects of the Business Tax Reform announced in the *Budget Update*.

- Other persons tax growth also slows, adding about \$200 million each year.
- GST makes a more prominent contribution in these later years, adding \$300 million to \$600 million each year.

Tax revenue forecasts have also incorporated some second round effects from the revenue reduction contingency. They assume that such a revenue reduction would increase disposable income and also spur some additional employment and wage growth. This would generate some extra PAYE and GST, as well as providing a small boost to some of the other income taxes. This additional revenue from second round effects is estimated to be as much as \$500 million by 2011/12.

Tax revenue initiatives

The Business Tax Reform has a significant effect in 2008/09 and beyond, reducing tax revenue by nearly \$1 billion each year. Without the business tax package, core Crown tax revenue would have a much flatter profile, hovering around 32% of GDP.

Revenue reduction contingency

The fiscal forecasts include a revenue reduction contingency of \$1.5 billion effective from 1 April 2009 and rising to \$1.7 billion by the end of the forecast period. As signalled in the *2008 Budget Policy Statement (BPS)*, the contingency reflects possible reduction to personal income tax.

Accounting disclosure changes

There has been a change in the disclosure of bad debt write-offs of tax receivables. Tax write-offs are now shown as an expense rather than netted off against revenue. The change in the write-off treatment has resulted in a \$450 million per annum increase in revenue and a corresponding increase in expenses. The main tax types affected are other persons, corporate tax and GST.

Other Revenue

Other core Crown revenue is forecast to increase slightly as a GDP over the forecast period. This is primarily due to the introduction of an ETS. The ETS will create tradable units (the NZ Unit) and will generate revenue when surrendered to the Government by emitters. Further information on the ETS can be found on page 44.

Inland Revenue's tax forecasts

In line with established practice, Inland Revenue has also prepared a set of tax forecasts, which, like the Treasury's tax forecast, is based on the Treasury's macroeconomic forecast. Inland Revenue's forecasts are shown here for comparative purposes. The Treasury's forecasts remain the Crown's official forecasts.

Table 2.6 – The Treasury and Inland Revenue core Crown tax revenue forecasts (excluding the revenue reduction contingency)

| \$billion | 2007/08 Forecast | 2008/09 Forecast | 2009/10 Forecast | 2010/11 Forecast | 2011/12 Forecast |
|-------------------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| Source deductions | | | | | |
| Treasury | 22.6 | 24.0 | 25.4 | 27.1 | 28.7 |
| Inland Revenue | 22.7 | 24.1 | 25.4 | 26.9 | 28.5 |
| Difference | (0.1) | (0.1) | - | 0.2 | 0.2 |
| Net other persons tax | | | | | |
| Treasury | 3.9 | 4.2 | 4.3 | 4.5 | 4.7 |
| Inland Revenue | 3.8 | 3.8 | 4.0 | 4.2 | 4.4 |
| Difference | 0.1 | 0.4 | 0.3 | 0.3 | 0.3 |
| Corporate taxes | | | | | |
| Treasury | 10.8 | 9.3 | 10.2 | 10.4 | 10.9 |
| Inland Revenue | 11.0 | 9.7 | 10.2 | 10.4 | 10.7 |
| Difference | (0.2) | (0.4) | - | - | 0.2 |
| Goods and services tax | | | | | |
| Treasury | 11.8 | 12.1 | 12.5 | 13.1 | 13.5 |
| Inland Revenue | 11.7 | 12.3 | 12.7 | 13.3 | 13.8 |
| Difference | 0.1 | (0.2) | (0.2) | (0.2) | (0.3) |
| Other taxes | | | | | |
| Treasury | 8.1 | 8.5 | 8.7 | 9.0 | 9.4 |
| Inland Revenue | 7.9 | 8.3 | 8.6 | 8.9 | 9.1 |
| Difference | 0.2 | 0.2 | 0.1 | 0.1 | 0.3 |
| Total tax | | | | | |
| Treasury | 57.2 | 58.1 | 61.1 | 64.1 | 67.2 |
| Inland Revenue | 57.1 | 58.2 | 60.9 | 63.7 | 66.5 |
| Difference | 0.1 | (0.1) | 0.2 | 0.4 | 0.7 |
| Total tax (% of GDP) | | | | | |
| Treasury | 32.1 | 31.1 | 31.4 | 31.6 | 31.6 |
| Inland Revenue | 32.0 | 31.1 | 31.3 | 31.4 | 31.3 |
| Difference | 0.1 | - | 0.1 | 0.2 | 0.3 |

Source: Inland Revenue, The Treasury

The main differences between the Treasury's and Inland Revenue's forecasts occur in:

- net other persons tax, where the two agencies have differing views on the amount of tax that will be payable on the additional dairy income
- corporate taxes, where Treasury's forecast is initially lower than Inland Revenue's, but is higher by 2012, owing to Treasury forecasting a higher average growth rate than Inland Revenue, and
- GST, where Inland Revenue's implicit GST rate on nominal private consumption is higher than the Treasury's from 2009 onwards.

Core Crown – Expenses

Table 2.7 – Expenses indicators

| Expenses \$billion | Year ended 30 June | | | | | |
|-----------------------|--------------------|------------------|------------------|------------------|------------------|------------------|
| | 2007 Actual | 2008 Forecast | 2009 Forecast | 2010 Forecast | 2011 Forecast | 2012 Forecast |
| Core Crown | 54.0 | 57.1 | 60.5 | 63.1 | 66.6 | 70.0 |
| Total Crown | 69.1 | 73.0 | 77.0 | 80.4 | 84.7 | 88.8 |
| % of GDP | | | | | | |
| Core Crown | 32.4 | 32.1 | 32.4 | 32.4 | 32.8 | 33.0 |
| Total Crown | 41.4 | 41.0 | 41.2 | 41.3 | 41.8 | 41.8 |

Source: The Treasury

Expense growth

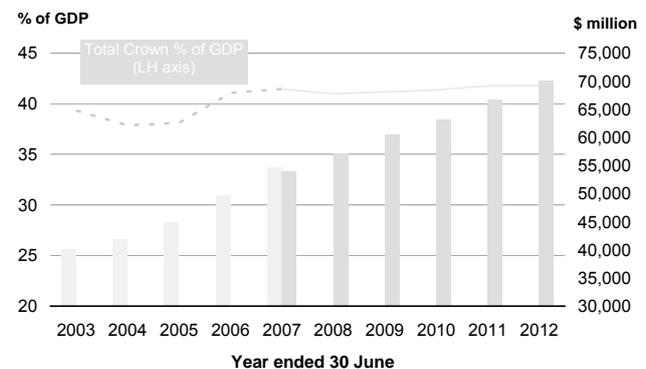
Core Crown expenses are forecast to increase by around 1% of GDP between 2007/08 and 2011/12. In nominal terms, expenses are forecast to increase by \$12.9 billion over the same period.

Budget initiatives

The forecast growth in expenses largely arises from expense initiatives introduced in recent Budgets. A number of policy decisions made in previous Budgets have rising spending profiles to allow sufficient time for full implementation. The enhancement to the KiwiSaver initiative announced in Budget 2007 is one of the main drivers of this rising profile (around \$0.8 billion in 2007/08 rising to around \$1.4 billion by 2011/12).

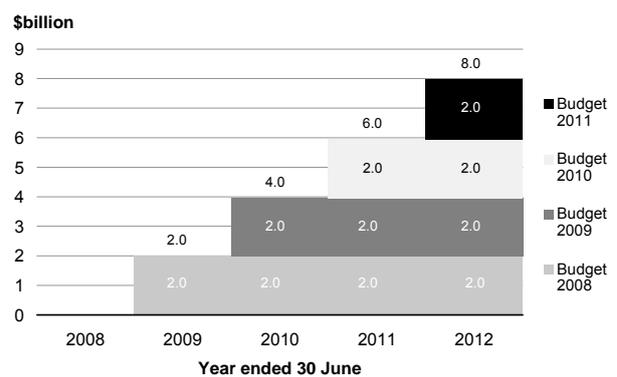
The fiscal forecasts also include indicative amounts for new operating initiatives for future Budgets. The allowances for each of the next four Budgets have been set at around \$2 billion, so are broadly consistent with the forecast growth in the economy. New operating spending initiatives add around \$8 billion to the expense base by the end of the forecast horizon.

Figure 2.11 – Core expenses (\$ and % of GDP)



Source: The Treasury

Figure 2.12 – Net amounts for new operating initiatives



Source: The Treasury

Emissions Trading Scheme

As part of the new ETS the Government has agreed to allocate NZ Units to emitters free of charge. This has resulted in an increase to expenses of \$0.6 billion in 2008/09 and \$0.5 billion in subsequent forecast years. Further information on the ETS can be found on page 44.

Benefit expenses

Social security and welfare expenses are forecast to broadly grow in line with the forecast growth in the economy. In nominal terms they are forecast to increase from \$17.9 billion in 2007/08 to \$20.4 billion in 2011/12. Around \$1.7 billion of this reflects cost of living adjustments for New Zealand Superannuation payments and welfare benefits, which reflect inflationary pressures. Most benefits are adjusted each April by the CPI movement over the previous calendar year.

Partly offsetting nominal growth in benefit expense forecasts are second round effects from the assumed revenue reduction contingency. They assume tax paid on benefits will be lower, resulting in reduced gross payment of benefits for the Government.

Top-down adjustment to spending

Forecasts are initially compiled from returns provided by individual entities. The need for a top-down adjustment to core Crown expense and capital expenditure forecasts arises from the extent to which departments use appropriations, which are an authority for the maximum that a department may spend, rather than a mid-point estimate for these forecasts. As appropriations apply to the core Crown only, no adjustment is required to SOE or Crown Entity forecasts.

The size of the adjustment reflects analysis of key departments, trend analysis of expense variances across all departments and a review of results to September 2007. This analysis includes identifying where appropriations have been used as proxy for forecasts, where appropriations and hence forecasts reflect contingencies that may have low probability of being realised in any one year, and past trends of variances between results and forecasts.

In this update the outyear forecasts also have a top-down adjustment in order that aggregate department forecasts better reflect mid-point estimates, rather than appropriation levels, for Government policies. The top-down adjustment is applied to both cash and accrual forecasts and is explicitly identified in the financial statements. The adjustment is:

| \$millions | Year ended 30 June | | | | |
|-----------------------|---------------------------|--------------------------|--------------------------|--------------------------|--------------------------|
| | 2008 Forecast | 2009 Forecast | 2010 Forecast | 2011 Forecast | 2012 Forecast |
| Operating expenditure | 750 | 275 | 250 | 200 | 150 |
| Capital expenditure | 250 | 100 | 100 | 100 | 100 |
| Total | 1,000 | 375 | 350 | 300 | 250 |

The adjustment for the 2007/08 financial year is higher than the outyears because it reflects the extent to which some expenses will be transferred from 2007/08 to subsequent outyears in Budget 2008. While we expect transfers to be made in the years beyond 2007/08, the amounts transferred into each of those years will be largely offset by the transfers out at the end of those same years.

State-owned Enterprises and Crown Entities – OBEGAL

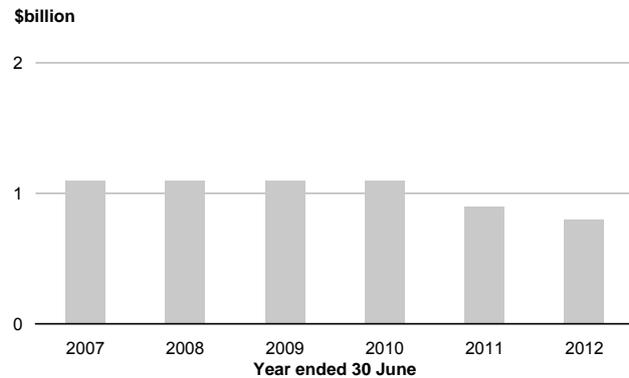
The OBEGAL of the SOEs and CEs are forecast to total \$8.5 billion over the forecast period. Around \$2.1 billion of the operating surpluses will be returned as dividends, and will be available to fund spending elsewhere in the Crown (ie, it forms a part of residual cash).

Over the forecast period SOE/CEs' OBEGAL after dividends are on average \$1 billion.

SOE/CEs' OBEGAL after payment of dividends total \$6.4 billion. This residual is maintained within the entities that have generated the net surpluses and so is not

available to fund spending elsewhere in the Crown. In broad terms, the majority of the accumulated net surpluses are forecast to build up financial and physical assets.

Figure 2.13 – SOE and Crown entities operating balance



Source: The Treasury

Physical Asset Purchases and Capital Spending

Table 2.8 – Net purchases of physical assets by segment⁶

| | Year ended 30 June | | | | | Total |
|--|--------------------|------------------|------------------|------------------|------------------|---------------|
| | 2008 Forecast | 2009 Forecast | 2010 Forecast | 2011 Forecast | 2012 Forecast | |
| \$million | | | | | | |
| Core Crown (after top-down adjustment) | 1,773 | 1,097 | 1,170 | 949 | 886 | 5,875 |
| Crown entities | 2,542 | 2,232 | 2,046 | 2,157 | 2,086 | 11,063 |
| State-owned enterprises | 2,234 | 2,423 | 3,039 | 3,158 | 2,872 | 13,727 |
| | 6,549 | 5,752 | 6,255 | 6,264 | 5,844 | 30,664 |

Source: The Treasury

Core Crown capital spending forecasts comprise net physical asset purchases met from existing baselines plus new capital allocated in Budgets.

As part of the Budget 2007, the Government allocated \$1.6 billion of new capital over the next four years. Amounts for the 2008, 2009 and 2010 Budgets have been set at \$0.9 billion phased in over four years, some of which falls outside the forecast horizon. On a year-by-year basis, capital spending is forecast to be on average \$2 billion per annum over the next five years.

⁶ Net purchases of physical assets are net of any sales of physical assets.

Table 2.9 – Core Crown capital spending

| | Year ended 30 June | | | | | Total |
|-------------------------------------|--------------------|------------------|------------------|------------------|------------------|--------------|
| | 2008 Forecast | 2009 Forecast | 2010 Forecast | 2011 Forecast | 2012 Forecast | |
| \$million | | | | | | |
| Net purchase of physical assets | 1,773 | 1,097 | 1,170 | 949 | 886 | 5,875 |
| Budget 2008 | 48 | 992 | 330 | 200 | 230 | 1,800 |
| Budget 2009 | - | 20 | 480 | 250 | 150 | 900 |
| Budget 2010 | - | - | 20 | 480 | 250 | 750 |
| Budget 2011 | - | - | - | 20 | 480 | 500 |
| Total Budget allocation for capital | 48 | 1,012 | 830 | 950 | 1,110 | 3,950 |
| Total capital spending | 1,821 | 2,109 | 2,000 | 1,899 | 1,996 | 9,825 |

Source: The Treasury

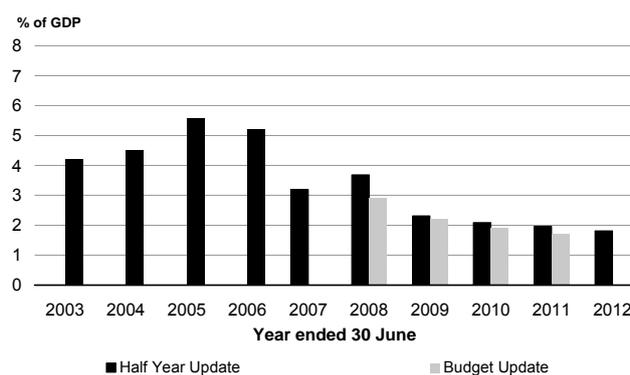
Comparison with *Budget Update*

This section compares the key indicators for the *Half Year Update* with the *Budget Update*.

OBEGAL

Compared to the *Budget Update* the OBEGAL is expected to be around \$1.6 billion higher than forecast for the 2007/08 year. Over the rest of the forecast period the OBEGAL is on average about \$0.5 billion higher than the *Budget Update*.

Both core Crown revenue and expenses have increased since the *Budget Update*. The key changes are outlined in Table 2.10 and discussed below.

Figure 2.14 – OBEGAL comparison

Source: The Treasury

Tax revenue

Tax revenue forecasts have been increased by about \$2 billion each year over the forecast period since the *Budget Update*.

Much stronger price growth and, to a lesser extent, a higher level of real economic activity contributes to the level of nominal GDP being significantly higher than in the *Budget Update* in each year of the forecast period. The economic forecasts take into account increased activity spurred by the revenue reduction contingency.

This increase in the nominal GDP forecast has the largest effect on income taxes, as follows:

- **Other persons tax** – Shortly after the 2007 Budget was released, Fonterra announced that the dairy payout for the year to May 2008 would be about 50% up on 2007. This large increase in dairy farm incomes has prompted the Treasury to significantly revise up its projections for unincorporated profits for 2008 and beyond. In turn, this has led to increases of as much as \$400 million in some years for other persons tax.
- **Corporate taxes** – As well as unincorporated profits, the Treasury has also increased its projections of corporate profits and hence corporate taxes. The biggest effect occurs in 2009/10 where the corporate tax forecast is more than \$600 million higher than in the *Budget Update*.
- **Source deductions** – Forecasts of aggregate salaries and wages have been increased by as much as \$3 billion in some years, prompting some large increases in the source deductions forecasts.
- **RWT on interest** – There have also been some significant increases made to the RWT forecasts. However, these increases are more the result of changes to the forecasting model than changes in the forecasts of any underlying economic parameter. RWT on interest has increased by an average of nearly 20% per annum for each of the past five years. With no sign of this growth abating, the Treasury has revised up the forecast growth rates for RWT in most years of the forecast.

With increased incomes, we might also expect to see an increase in the forecasts of domestic consumption and hence GST. Yet, despite increases in the consumption forecasts, the GST forecasts are little changed from the *Budget Update* owing to changes in judgements around the average effective rate of GST on consumption. Note that not all consumption is subject to GST, eg, residential rents, and there are things outside of the System of National Accounts measure of consumption that attract GST, eg, residential construction.

The change in the way bad debt write-offs of tax receivables are disclosed has resulted in a \$450 million per annum increase in tax revenue. As previously mentioned, tax write-offs are now shown as an expense rather than being netted off against revenue. The change in the write-off treatment also results in a corresponding increase in expenses compared to the *Budget Update*.

Table 2.10 – OBEGAL reconciliation (explains changes to the operating balance since the *Budget Update*)

| \$million | 2008 | 2009 | 2010 | 2011 |
|--|--------------|----------------|--------------|--------------|
| | Forecast | Forecast | Forecast | Forecast |
| OBEGAL 2007 Budget Update | 4,958 | 3,957 | 3,530 | 3,347 |
| Core Crown revenue changes | | | | |
| Tax revenue (forecasting) | 2,010 | 1,342 | 1,791 | 1,720 |
| Tax revenue (accounting policy change) | 450 | 450 | 450 | 450 |
| Revenue reduction contingency | - | (375) | (1,600) | (1,700) |
| Net Investment income | (156) | 131 | 77 | 222 |
| Kyoto - ETS levies | - | 84 | 480 | 864 |
| Impact of OBU | 149 | 130 | 135 | 167 |
| Other revenue | (4) | 21 | 26 | (40) |
| Total core Crown revenue changes | 2,449 | 1,783 | 1,359 | 1,683 |
| Core Crown expense changes | | | | |
| KiwiSaver uptake | (344) | (172) | (49) | 12 |
| Benefit forecast | (24) | (45) | 106 | 17 |
| Tax revenue (accounting policy change) | (450) | (450) | (450) | (450) |
| ETS expenses | - | (597) | (477) | (477) |
| Kyoto liability increase | (252) | - | - | - |
| Transport full hypothecation funding | - | - | (35) | (182) |
| Impact of OBU | (354) | (150) | (154) | (63) |
| Top-down expense adjustment | 750 | 275 | 250 | 200 |
| Other operating expenses | 187 | (4) | 26 | (13) |
| Total core Crown operating expense changes | (487) | (1,143) | (783) | (956) |
| Core Crown OBEGAL change | 1,962 | 640 | 576 | 727 |
| Net SOE/CE change (including impact of eliminations) | (346) | (270) | (44) | (90) |
| Total changes | 1,616 | 370 | 532 | 637 |
| OBEGAL 2007 Half Year Update | 6,574 | 4,327 | 4,062 | 3,984 |
| Core Crown OBEGAL change | 1,962 | 640 | 576 | 727 |
| Kyoto liability increase (no cash impact) | 252 | 513 | (3) | (387) |
| Top-down capital adjustment | 250 | 100 | 100 | 100 |
| Capital allocation | - | (503) | (23) | (24) |
| Capital transfers | (268) | - | - | - |
| NZS Fund | - | (157) | 12 | 156 |
| Advances | (236) | (157) | (83) | (141) |
| Other changes (eg, working capital, PPE) | (223) | 523 | 291 | 144 |
| Residual cash change | 1,735 | 924 | 870 | 575 |

Source: The Treasury

Revenue reduction contingency

The fiscal forecasts include a revenue reduction contingency of \$1.5 billion effective from 1 April 2009, rising to \$1.7 billion by the end of the forecast period. This is on top of the operating allowances signalled in the *2007 FSR*.

Net investment income

The stronger cash position compared to the *Budget Update* has meant the Government has built up more financial assets and in turn is forecast to generate more investment income (around \$100 million per annum) than previously expected at the time of the *Budget Update*.

KiwiSaver

Take-up for the KiwiSaver scheme over the first four months of its operation has proved to be higher than that forecast in the *Budget Update*. The *Half Year Update* revisions are based on an assumption that growth in applications will ease in the new year, and that the total number of applications will reach around 563,000 by June 2008 (this includes members of non-KiwiSaver superannuation schemes but who are eligible to access some KiwiSaver benefits).

Some uncertainty arises from the nature of the extra applications received to date. Some of the unanticipated take-up has come from children (nearly 16,000 applications for those aged under 15 years to date), and people nearing retirement (37,000 applications to date are for those aged 60-64). For these groups, the main fiscal impact is on the \$1,000 kick-start contribution. However, extra growth from people in employment affects all aspects of the scheme. There is even greater uncertainty over whether the strength in applications to date is simply a bring forward of applications (faster growth), or will lead to genuinely higher than assumed take-up in the long run.

Benefit forecasts

Benefit expense forecasts have not changed substantially from the *Budget Update*. However, there are two offsetting factors:

- New Zealand Superannuation payments are forecast to be higher owing to greater expected indexation growth since the *Budget Update* flowing from higher CPI inflation and wage growth; offset by
- the \$1.5 billion revenue reduction contingency will result in lower gross benefit payments for the Government as a result of lower tax payable.

Kyoto Protocol liability

The Kyoto Protocol liability has been revised up in the current year to reflect updated carbon prices. The carbon price used for the *Half Year Update* fiscal forecasts is \$21.01 (NZD), compared to \$13.52 (NZD) used in the *Budget Update*.

Top-down adjustments

The top-down adjustment is now being rolled out in each year of the fiscal forecasts. Applying the adjustment across the forecast horizon compensates for departments using appropriations as the basis for their forecasts. Appropriations will overstate actual expenditure as they set upper spending limits, not mid-point estimates, and in some instances they reflect contingencies.

Residual Cash

Similar to the OBEGAL, residual cash is forecast to be stronger compared to the *Budget Update*. The majority of the drivers that influenced the upwards revision in the OBEGAL are also present in residual cash. In addition:

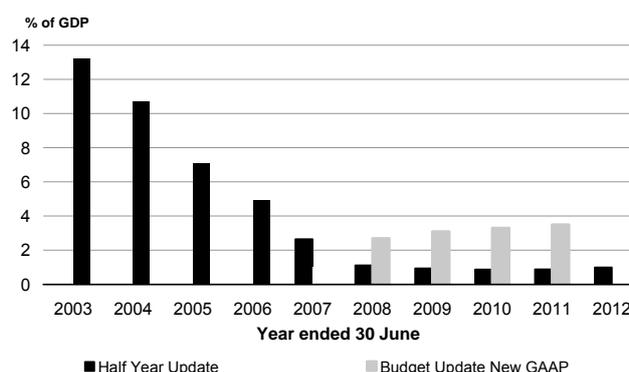
- The *Half Year Update* allows for a \$900 million higher capital allowance in Budget 2008 than that signalled in the *2007 FSR*. The majority of the increase in the capital allowance is forecast to occur in the 2008/09 fiscal year.
- The capital top-down adjustment has resulted in a reduction in capital payments compared to the *Budget Update* (\$250 million in 2007/08 and \$100 million in the other outyears).
- Repayments of advances are forecast to be lower than expected at the *Budget Update*, primarily due to student loans.

Debt Indicators

Net core Crown debt is forecast to be lower in each forecast year compared to the *Budget Update*. Net debt is forecast to be around 1% of GDP in 2010/11 compared to 3.5% in the *Budget Update*. In nominal terms, net core Crown debt is forecast to be around \$5 billion lower compared to the *Budget Update*. The main reason for the lower net core Crown position since the *Budget Update* is the flow-on impact of the increase in residual cash.

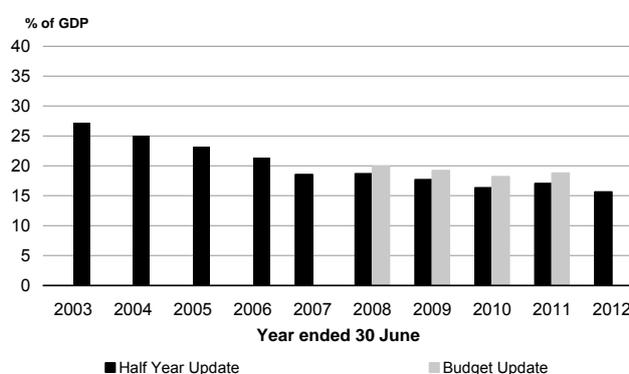
GSID (excluding Settlement Cash) is also forecast to be lower than forecast at the *Budget Update*, despite no change in forecast debt issuance. This is primarily owing to revisions to the forecast tenor of bond issuance, and consequentially increasing bond maturities within the forecast period.

Figure 2.15 – Net debt comparison



Source: The Treasury

Figure 2.16 – GSID (excl Settlement Cash) comparison



Source: The Treasury

Table 2.11 – 2007 Half Year Update fiscal indicators

| Fiscal indicators \$million | Year ended 30 June | | | | | |
|--|--------------------|------------------|------------------|------------------|------------------|------------------|
| | 2007 Actual | 2008 Forecast | 2009 Forecast | 2010 Forecast | 2011 Forecast | 2012 Forecast |
| Revenue | | | | | | |
| Total Crown revenue | 74,427 | 79,608 | 81,280 | 84,482 | 88,710 | 92,612 |
| Core Crown revenue | 58,174 | 62,409 | 63,496 | 65,832 | 69,458 | 72,740 |
| Core Crown tax revenue and contingency | 53,445 | 57,166 | 57,697 | 59,618 | 62,531 | 65,507 |
| Expenses | | | | | | |
| Total Crown expenses | 69,088 | 73,034 | 76,953 | 80,420 | 84,726 | 88,762 |
| Core Crown expenses | 53,976 | 57,137 | 60,537 | 63,106 | 66,632 | 70,034 |
| Operating balance - Core Crown | 6,498 | 6,206 | 4,166 | 4,089 | 4,395 | 4,489 |
| Operating balance - Crown entities | 1,006 | 580 | 1,135 | 968 | 938 | 901 |
| Operating balance - SOEs | 821 | 986 | 1,125 | 1,251 | 1,173 | 1,368 |
| Dividend elimination | (326) | (384) | (373) | (384) | (412) | (530) |
| Total operating balance | 7,999 | 7,388 | 6,053 | 5,924 | 6,094 | 6,228 |
| OBEHAL | 5,339 | 6,574 | 4,327 | 4,062 | 3,984 | 3,850 |
| OBEHAL excluding NZS Fund revenue | 5,757 | 6,019 | 3,642 | 3,243 | 3,021 | 2,733 |
| Cash available/(shortfall to be funded) | 2,653 | 759 | (763) | (779) | (851) | (937) |
| Debt indicators | | | | | | |
| GSID (excluding Settlement Cash) | 30,890 | 33,303 | 33,034 | 31,779 | 34,566 | 33,172 |
| Total gross Crown debt | 41,914 | 46,363 | 47,956 | 49,351 | 53,106 | 52,434 |
| Net core Crown debt | 4,411 | 1,983 | 1,756 | 1,705 | 1,792 | 2,105 |
| Net core Crown debt with NZS Fund assets | (8,112) | (13,102) | (16,224) | (19,545) | (22,990) | (26,414) |
| Net worth | 96,704 | 104,315 | 110,372 | 116,313 | 122,417 | 128,652 |
| Domestic bond programme | 2,294 | 2,453 | 2,459 | 2,487 | 2,507 | 2,497 |
| Nominal GDP | 166,714 | 178,199 | 186,956 | 194,528 | 202,865 | 212,364 |
| Fiscal indicators as a % of GDP | | | | | | |
| Revenue | | | | | | |
| Total Crown revenue | 44.6 | 44.7 | 43.5 | 43.4 | 43.7 | 43.6 |
| Core Crown revenue | 34.9 | 35.0 | 34.0 | 33.8 | 34.2 | 34.3 |
| Core Crown tax revenue and contingency | 32.1 | 32.1 | 30.9 | 30.6 | 30.8 | 30.8 |
| Expenses | | | | | | |
| Total Crown expenses | 41.4 | 41.0 | 41.2 | 41.3 | 41.8 | 41.8 |
| Core Crown expenses | 32.4 | 32.1 | 32.4 | 32.4 | 32.8 | 33.0 |
| Operating balance | 4.8 | 4.1 | 3.2 | 3.0 | 3.0 | 2.9 |
| OBEHAL | 3.2 | 3.7 | 2.3 | 2.1 | 2.0 | 1.8 |
| OBEHAL excluding NZS Fund revenue | 3.5 | 3.4 | 1.9 | 1.7 | 1.5 | 1.3 |
| Debt indicators | | | | | | |
| GSID (excluding Settlement Cash) | 18.5 | 18.7 | 17.7 | 16.3 | 17.0 | 15.6 |
| Total gross Crown debt | 25.1 | 26.0 | 25.7 | 25.4 | 26.2 | 24.7 |
| Net core Crown debt | 2.6 | 1.1 | 0.9 | 0.9 | 0.9 | 1.0 |
| Net core Crown debt with NZS Fund assets | (4.9) | (7.4) | (8.7) | (10.0) | (11.3) | (12.4) |
| Net worth | 58.0 | 58.5 | 59.0 | 59.8 | 60.3 | 60.6 |
| New Zealand Superannuation Fund | | | | | | |
| Fund asset returns (after tax) | 1,069 | 917 | 1,119 | 1,331 | 1,560 | 1,805 |
| Fund contributions | 2,049 | 2,103 | 2,376 | 2,321 | 2,316 | 2,281 |
| Fund assets (year end) | 12,973 | 15,993 | 19,488 | 23,140 | 27,016 | 31,102 |
| % of GDP | 7.8 | 9.0 | 10.4 | 11.9 | 13.3 | 14.6 |

Source: The Treasury

Table 2.12 – 2007 Budget Update fiscal indicators

| Fiscal indicators \$ million | Year ended 30 June | | | | |
|---|--------------------|------------------|------------------|------------------|------------------|
| | 2007 Actual | 2008 Forecast | 2009 Forecast | 2010 Forecast | 2011 Forecast |
| Revenue | | | | | |
| Total Crown revenue | 74,427 | 76,872 | 79,576 | 83,178 | 86,819 |
| Core Crown revenue | 58,174 | 59,402 | 61,172 | 63,825 | 66,993 |
| Core Crown tax revenue | 53,445 | 54,707 | 56,280 | 58,877 | 61,960 |
| Expenses | | | | | |
| Total Crown expenses | 69,088 | 71,914 | 75,619 | 79,648 | 83,472 |
| Core Crown expenses | 53,976 | 56,096 | 58,819 | 61,677 | 64,898 |
| Operating balance - Core Crown | 6,498 | 4,463 | 3,667 | 3,630 | 3,781 |
| Operating balance - Crown entities | 1,006 | 1,241 | 1,169 | 974 | 960 |
| Operating balance - SOEs | 821 | 1,068 | 1,141 | 1,155 | 1,065 |
| Dividend elimination | (326) | (341) | (408) | (449) | (440) |
| Operating balance | 7,999 | 6,431 | 5,569 | 5,310 | 5,366 |
| OBEHAL | 5,339 | 4,958 | 3,957 | 3,530 | 3,347 |
| OBEHAL (excluding NZS Fund revenue) | 5,757 | 4,860 | 3,862 | 3,438 | 3,260 |
| Cash available/(shortfall to be funded) | 2,653 | (976) | (1,687) | (1,649) | (1,426) |
| Debt indicators | | | | | |
| GSID (excluding Settlement Cash) | 30,890 | 34,477 | 34,308 | 33,971 | 36,814 |
| Total gross Crown debt | 41,914 | 46,364 | 47,050 | 46,522 | 49,691 |
| Net core Crown debt | 4,411 | 4,655 | 5,529 | 6,217 | 6,860 |
| Net core Crown debt with NZS Fund assets | (8,112) | (10,784) | (13,145) | (16,008) | (19,287) |
| Net worth | 96,704 | 96,061 | 101,645 | 107,024 | 112,421 |
| Domestic bond programme | 2,294 | 2,520 | 2,500 | 2,483 | 2,515 |
| Nominal GDP | 166,714 | 173,187 | 179,132 | 186,985 | 196,177 |
| Fiscal indicators as a % of GDP | | | | | |
| Revenue | | | | | |
| Total Crown revenue | 44.6 | 44.4 | 44.4 | 44.5 | 44.3 |
| Core Crown revenue | 34.9 | 34.3 | 34.1 | 34.1 | 34.1 |
| Core Crown tax revenue | 32.1 | 31.6 | 31.4 | 31.5 | 31.6 |
| Expenses | | | | | |
| Total Crown expenses | 41.4 | 41.5 | 42.2 | 42.6 | 42.5 |
| Core Crown expenses | 32.4 | 32.4 | 32.8 | 33.0 | 33.1 |
| Operating balance | 4.8 | 3.7 | 3.1 | 2.8 | 2.7 |
| OBERAC | 3.2 | 2.9 | 2.2 | 1.9 | 1.7 |
| OBERAC (excluding net NZS Fund asset returns) | 3.5 | 2.8 | 2.2 | 1.8 | 1.7 |
| Debt indicators | | | | | |
| GSID (excluding Settlement Cash) | 18.5 | 19.9 | 19.2 | 18.2 | 18.8 |
| Total gross Crown debt | 25.1 | 26.8 | 26.3 | 24.9 | 25.3 |
| Net core Crown debt | 2.6 | 2.7 | 3.1 | 3.3 | 3.5 |
| Net core Crown debt with NZS Fund assets | (5.1) | (6.5) | (7.7) | (9.0) | (10.3) |
| Net worth | 58.0 | 55.5 | 56.7 | 57.2 | 57.3 |
| New Zealand Superannuation Fund | | | | | |
| Fund asset returns (after tax) | 1,069 | 965 | 1,150 | 1,351 | 1,573 |
| Fund contributions | 2,049 | 2,103 | 2,194 | 2,312 | 2,458 |
| Fund assets (year end) | 12,973 | 15,977 | 19,321 | 22,984 | 27,015 |
| % of GDP | 7.8 | 9.2 | 10.8 | 12.3 | 13.8 |

Source: The Treasury

Risks to fiscal forecasts

The fiscal forecasts were finalised on 5 December 2007 in accordance with the forecast accounting policies. There are certain risks associated with the forecast results. To assist in evaluating such risks, the following chapters should be read in conjunction with the fiscal forecasts:

- *Risks and Scenarios* (Chapter 3) – The fiscal forecasts are based on the economic forecasts presented in Chapter 1 and any variation from the economic forecast will affect the fiscal forecasts in particular, tax revenue and benefit expenses. *The Risks and Scenarios* chapter discusses the effect on the forecasts under different circumstances.
- *Specific Fiscal Risks* (Chapter 4) – The fiscal forecasts incorporate Government decisions up to 5 December 2007. The *Specific Fiscal Risks* chapter covers specific policy decisions that are under active consideration by the Government at the time of the finalisation of the forecasts.

In addition to the specific fiscal risks and the link to the economic forecasts, there are a number of forecasting issues explained below that may arise in future.

Tax forecasting risks

The tax forecasts prepared for this *Half Year Update* are based on current tax policy and on the macroeconomic central forecast. Sensitivities of tax revenue to changes in economic conditions are also presented in the *Risks and Scenarios* chapter on page 69.

KiwiSaver risks

IRD baselines incorporate an assumed take-up profile for the KiwiSaver regime. Actual take-up could be higher or lower than assumed, or faster or slower than assumed, representing an unquantified risk to the operating balance. This could impact on the operating balance.

SOEs' and CEs' forecasts

The forecasts for large SOEs and CEs were provided on 30 September 2007 based on their best assessments at that time.

Revaluation of property, plant and equipment

Crown accounting policy is to revalue certain classes of property, plant and equipment on a regular basis. In certain circumstances the valuation will be affected by foreign exchange rates, so any appreciation in the NZ dollar (from 30 June 2008) will adversely affect the current physical asset values included in the fiscal forecasts.

Discount rates

The GSF and ACC liabilities included in these forecasts have been valued as at 31 October and 30 September respectively. The liabilities will next be valued for the 2008 Budget. Any change in discount rates will affect the present fiscal forecast. For example, if the discount rate rises, the value of the liabilities will decrease.

Tertiary education institutes' accounting treatment

The forecast information presented in the 2007 *Half Year Update* combined Tertiary Education Institutes (TEIs) on an equity accounting basis. This treatment has been under consideration by accounting standard setters. The Financial Reporting Standards Board has recently advised that the question of whether to consolidate autonomous and independent entities will be considered by delivering its deliberations of the International Accounting Standards Board (IASB) project on consolidation.

The combination method adopted in these forecasts is to equity account for the TEIs' net surpluses and net investment (ie, TEI revenues, expenses, assets and liabilities are not included on a line-by-line basis). This is consistent with the treatment adopted in the *2007 Financial Statements of the Government*.

The key indicators are unchanged as a result of the combination approach for TEIs (refer page 64 of the *30 June 2007 Financial Statements of the Government*).

Indicators of the Government's Fiscal Performance and Position

This section aims to help readers better understand the Government's fiscal performance and position.

Each indicator in this section gives valid insights into the Government's historical, current and forecast fiscal situation, but no one indicator gives a complete picture. Individual indicators do, however, come into greater or lesser focus as circumstances change.

When, for example, the New Zealand Government's net worth was low and gross and net debt-to-GDP ratios were high, much of the focus of Government and public commentary at that time was on eliminating annual operating deficits and on the need to attain, and later to maintain, annual operating surpluses.

However, as net worth has risen, and gross and net debt-to-GDP ratios have fallen, the Government in more recent years has increasingly focused on how to maintain debt ratios around current levels and, accordingly, has given more focus to the Government's annual cash balance.

Most of the indicators in this section may be useful regardless of the particular fiscal strategy being followed. In a few cases (such as the formulation of OBEGAL excluding NZS Fund net revenue), the indicator is used to throw light on the impact of a particular strategy (in this case the build-up of financial assets in the NZS Fund).

Accounting equations

Flow indicators (a worked example of how these flows interact is provided in this chapter, see Table 2.2 – Reconciliation of residual core Crown cash).

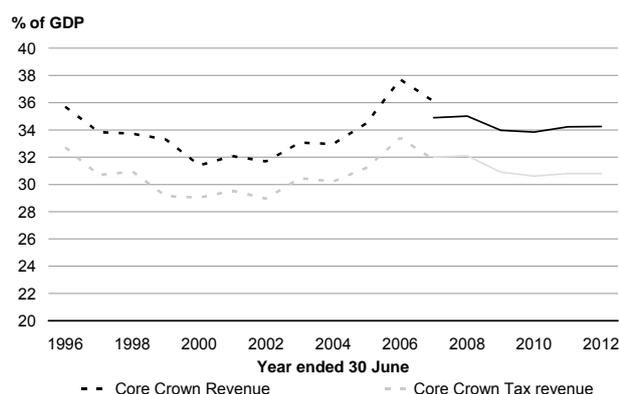
- Core Crown revenues – core Crown expenses net gains and losses + net surplus of SOEs (ie, after dividends) and Crown entities = **Operating balance**.
- Operating balance – net gains and losses = Operating balance before gains and losses (OBEGAL).
- OBEGAL – retained items (eg, net surplus of SOEs/CEs and NZS Fund net revenue) – non-cash items (eg, depreciation) = **Net core Crown cash flow from operations**.
- Net core Crown cash flow from operations – net investing activities (eg, contributions to NZS Fund, purchases of assets, loans to others) = **Residual cash**.

Stock indicators

- Gross sovereign-issued debt (GSID) = debt issued by the core Crown.
- **GSID (excluding Settlement Cash)** = GSID – Reserve Bank Settlement Cash.
- **Core Crown net debt** = GSID – core Crown's financial assets.
- **Net worth** = Crown's total assets – Crown's total liabilities. The operating balance in any year largely drives the change in net worth.

Ratio of core Crown revenue (excluding NZS Fund net revenue) to GDP

Ratio of core Crown revenue (excluding NZS Fund net revenue) to GDP = the amount of revenue the core Crown receives as a percentage of GDP. Core Crown revenue mostly consists of tax revenue collected by the Government, but also includes investment income, sales of goods and services and other receipts. Tax revenue is an accrual measure of taxation (ie, it is a measure of tax due, regardless of whether or not it has actually been paid).

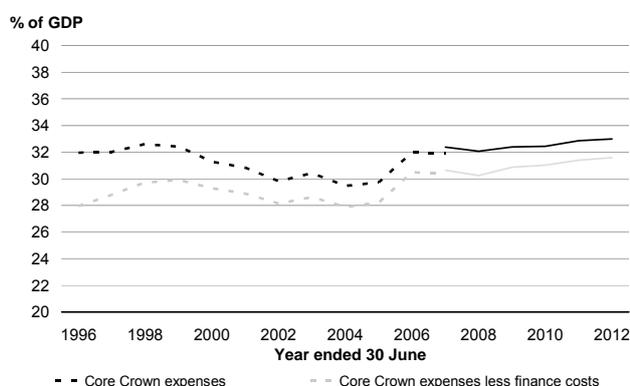


The revenue collected is used to meet the Government's spending needs. It is important to look at this alongside expenses, operating balance and gross debt indicators for insights into the sustainability of current policy settings.

Core Crown revenue (excluding NZS Fund net revenue) to GDP is expected to be broadly stable at around 34% over the forecast period, while core Crown tax to GDP is expected to fall then remain relatively flat over the forecast period.

Ratio of core Crown expenses to GDP

Ratio of core Crown expenses to GDP = the day-to-day spending (eg, salaries, welfare benefit payments, finance costs and maintaining national defence etc) that do not build physical assets for the Government. This is an accrual measure of expenses and includes items such as depreciation on physical assets.



The forecasts of operating expenses assume that the entire forecast operating allowance is allocated to spending.

By reducing gross debt, the Government has also reduced finance costs. However, in the years ahead, finance costs are likely to be fairly flat with gross debt forecast to be broadly stable.

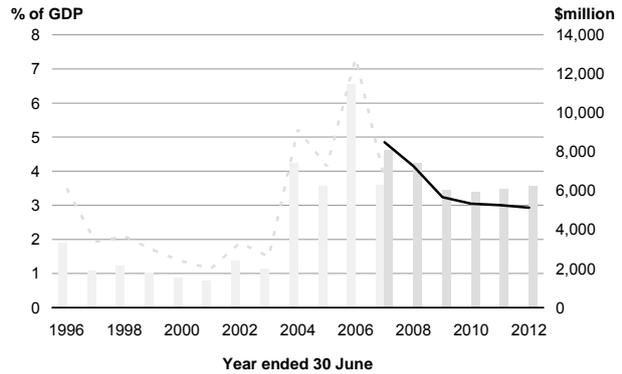
Core Crown expenses to GDP rise slightly over the forecast period.

Operating balance

Operating balance = revenues less expenses, plus net gains and losses.

The operating balance shows whether the government sector has generated enough revenues to cover its expenses in any given year.

This measure can be volatile from year to year owing to events outside of the Government’s direct control (such as changes in interest rates and revaluations etc); therefore, it is generally not used as a measure of the Government’s short-term fiscal stewardship.



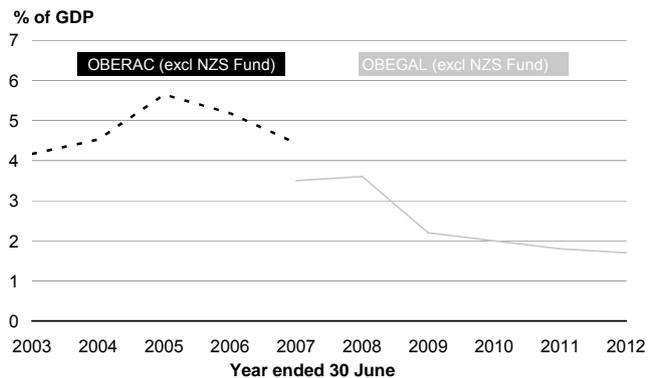
The Government has been running operating surpluses since the early 1990s. The operating balance was just under 5% of GDP in 2007 and is expected to decline to around 3% of GDP by the end of the forecast period.

OBEGAL

OBEGAL = the operating balance before net gains and losses.

OBEGAL excluding NZS Fund net revenue = a measure of the operating balance that recognises the role of the NZS Fund in accumulating assets and returns to meet future NZS cost.

By excluding net gains and losses the OBEGAL gives a more direct indication of the underlying stewardship of the Government.



The NZS Fund retains its after tax investment returns. These investment returns comprise mostly gains and losses. Because it excludes gains and losses the OBEGAL already recognises a large part of the Fund’s role. The final adjustment needed is to exclude from the OBEGAL the remaining NZS Fund net revenue.

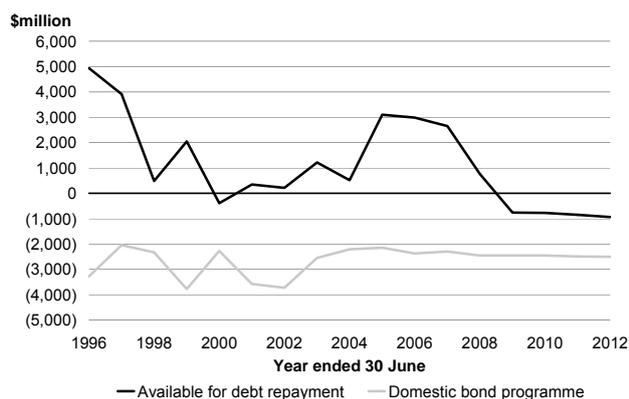
The OBEGAL excluding the NZS Fund net revenue is expected to decline over the forecast period to just under 2% of GDP.

Residual cash and domestic bond programme

Residual cash = the level of money the Government has available to repay debt or, alternatively, needs to borrow in any given year. Residual cash is alternatively termed “Cash available/(shortfall to be funded)”.

Domestic bond programme = the amount of new government stock expected to be issued over the financial year.

The cash available measure includes capital investment and NZS Fund contributions; therefore, it is the flow contributing to changes in debt. This balance cannot be looked at independently from GSID.



The domestic bond programme raises term debt for the Government, the proceeds of which contribute to funding operating and investing activity, and the repayment of maturing debt. The programme tends to be different from the cash available figure in any given year as financing activity, such as the repayment of debt, needs to be considered.

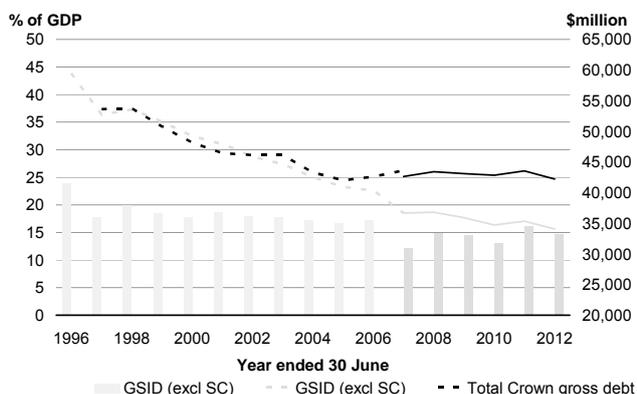
The Government is currently moving from a period of having cash available to repay debt, to a need, in subsequent years, to generate cash through borrowing and reductions in marketable securities.

Gross debt

Total Crown gross debt = the total borrowings (both sovereign-guaranteed and non-sovereign guaranteed) of the total Crown.

Gross sovereign-issued debt = debt issued by the sovereign (ie, core Crown) and includes Government stock held by the NZS Fund, GSF, ACC or EQC for example.

Total gross debt represents the complete picture of whole-of-government obligations to external parties. However, debt issued by SOEs and CEs is not explicitly guaranteed by the Crown.



The debt that is issued by the sovereign and guaranteed by the sovereign is in GSID. The Government has a long-term objective to maintain GSID broadly stable at around 20% of GDP. Since the Reserve Bank is part of the core Crown, settlement cash flows directly GSID. However, Settlement Cash activity is financed from commercial banks and not by Government funding, with the debt matched by a corresponding increase in financial assets.

The *2007 Fiscal Strategy Report* (page 52) states that "the Government is effectively targeting a level of gross sovereign-issued debt excluding the increase in debt on the Reserve Bank balance sheet as a result of the change in the liquidity management regime".

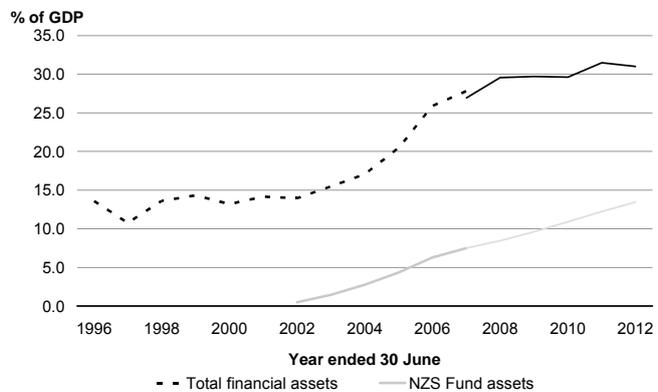
For forecast purposes the amount of Settlement Cash is held constant. In practice, Settlement Cash held by the Reserve Bank does fluctuate through time so the actual amount of Settlement Cash deducted from GSID will vary when actual results are reported.

Debt is often expressed as a percentage of GDP to put the level into perspective, in terms of a country’s ability to generate growth to repay the debt and/or income to service this debt. A high ratio of debt to GDP can have an adverse impact on credit ratings and perceived sustainability of current policy settings. So as a general rule, a relatively low ratio is considered to be prudent. A low ratio of debt to GDP can also provide the Government with more flexibility in their accounts to respond to adverse shocks through increasing debt.

The ratio of GSID (excluding Settlement Cash) to GDP has been steadily declining since the early 1990s but is expected to decline more gradually over the forecast period.

Core Crown financial assets

Core Crown financial assets = the financial assets of the core Crown. These are either cash, marketable securities or shares (equity) or a right to receive a financial instrument, which can be converted to cash. The assets of the NZS Fund are becoming the dominant feature of the Crown’s financial assets. The NZS Fund is the Government’s means of building up assets to partially pre-fund future NZS expenses. The Government’s contributions to the NZS Fund are calculated over a 40-year rolling horizon to ensure superannuation entitlements over the next 40 years can be met.



Established under the New Zealand Superannuation and Retirement Income Act 2001, the NZS Fund was created to partially provide for the future cost of NZS, which is expected to almost double in cost owing to population ageing.

The Government plans to allocate around \$2 billion a year to the NZS Fund over the next 20 years. The NZS Fund’s mandate is to invest money in a way that maximises its returns, without undue risks.

As the cost of providing NZS increases, future governments will draw on the NZS Fund to help smooth the impact of the cost of New Zealand Superannuation on their finances.

For the year ended June 2007, NZS Fund assets totalled \$13 billion or around 7.8% of GDP. The NZS Fund is expected to grow to around \$31 billion or 14.6% of GDP by the end of the forecast period.

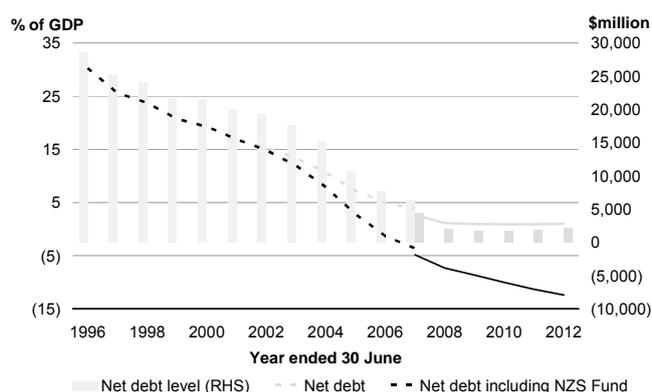
Core Crown net debt

Core Crown net debt = borrowings (financial liabilities) less cash and bank balances, marketable securities and deposits, and advances (financial assets). Net debt excludes the assets of the NZS Fund and GSF.

By including financial assets, net debt can provide additional information about the sustainability of the Government's accounts. Many international agencies believe the quantity of off-setting financial assets is important when determining the credit-worthiness of a country. That is, if a country has a high ratio of financial assets to GDP, it is better able to justify a high ratio of debt to GDP.

However, as some financial assets are not very liquefiable (or easily converted into cash), it is important to view net debt alongside GSID.

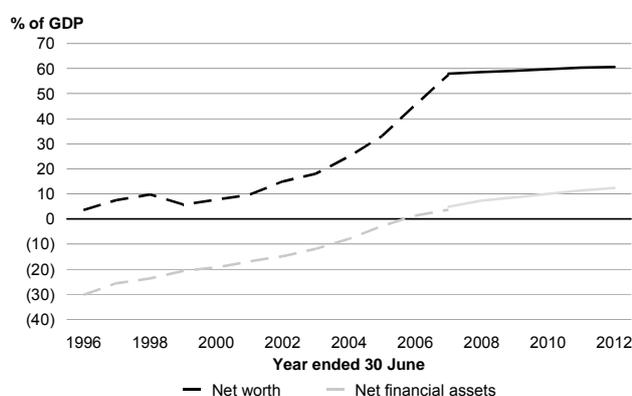
After declining steadily since the early 1990s, net debt is projected to consolidate in the years ahead at around 1% of GDP. If the assets of the NZS Fund are included, the Government's net debt position is in a net financial asset position.



Net worth

Net worth = assets less liabilities (also referred to as the Crown balance). The change in net worth in any given forecast year is largely driven by the operating balance.

Total Crown net worth is one indicator of the degree to which current government activities are sustainable. This indicator should be considered alongside the Crown's debt position, as relatively high debt-to-GDP ratios may still be considered sustainable if the Crown has relatively high ratios of saleable or commercial assets to GDP.



Building up net worth is also consistent with preparing for population ageing.

Net worth is projected to continue to rise, moving from around 58% in 2006 to around 60% at the end of the forecast period.

Historical trend series of key indicators

Key indicators as a percentage of GDP

| | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|----------|----------|----------|----------|----------|
| | Actual | Actual | Actual | Actual | Actual | Actual | Actual | Actual | Actual | Actual | Actual | Forecast | Forecast | Forecast | Forecast | Forecast |
| % of GDP | | | | | | | | | | | | | | | | |
| Revenue | | | | | | | | | | | | | | | | |
| Core Crown tax revenue | 30.7 | 31.0 | 29.1 | 29.0 | 29.6 | 29.0 | 30.3 | 30.1 | 31.2 | 33.3 | 32.1 | 32.1 | 30.9 | 30.6 | 30.8 | 30.8 |
| Core Crown | 33.9 | 33.7 | 33.3 | 31.4 | 32.1 | 31.7 | 32.9 | 32.9 | 34.5 | 37.6 | 34.9 | 35.0 | 34.0 | 33.8 | 34.2 | 34.3 |
| Total Crown | 40.2 | 40.5 | 40.1 | 37.4 | 38.4 | 39.7 | 43.0 | 42.3 | 44.4 | 48.7 | 44.6 | 44.7 | 43.5 | 43.4 | 43.7 | 43.6 |
| Expenses | | | | | | | | | | | | | | | | |
| Core Crown | 32.0 | 32.4 | 32.8 | 31.1 | 31.0 | 30.2 | 31.5 | 29.1 | 30.6 | 31.7 | 32.4 | 32.1 | 32.4 | 32.4 | 32.8 | 33.0 |
| Total Crown | 38.3 | 38.5 | 38.5 | 36.1 | 37.3 | 37.9 | 41.6 | 37.2 | 40.3 | 41.4 | 41.4 | 41.0 | 41.2 | 41.3 | 41.8 | 41.8 |
| OBEGAL | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | 3.2 | 3.7 | 2.3 | 2.1 | 2.0 | 1.8 |
| OBERAC | 1.9 | 2.2 | 0.2 | 0.8 | 1.8 | 2.2 | 4.2 | 4.6 | 5.9 | 5.5 | 4.4 | .. | .. | .. | .. | .. |
| Operating balance | 1.9 | 2.1 | 1.7 | 1.4 | 1.1 | 1.9 | 1.5 | 5.2 | 4.1 | 7.3 | 4.8 | 4.1 | 3.2 | 3.0 | 3.0 | 2.9 |
| Core Crown residual cash | 4.0 | 0.5 | 2.0 | -0.3 | 0.3 | 0.2 | 0.9 | 0.4 | 2.1 | 1.9 | 1.6 | 0.4 | -0.4 | -0.4 | -0.4 | -0.4 |
| Gross sovereign-issued debt (excl SC) | 36.3 | 37.3 | 35.1 | 32.4 | 31.0 | 28.8 | 27.2 | 24.9 | 23.2 | 21.3 | 18.5 | 18.7 | 17.7 | 16.3 | 17.0 | 15.6 |
| Net core Crown debt | 25.6 | 23.7 | 20.7 | 19.3 | 16.9 | 15.3 | 13.2 | 10.7 | 7.1 | 4.9 | 2.6 | 1.1 | 0.9 | 0.9 | 0.9 | 1.0 |
| Net core Crown debt (including NZS Fund) | 25.6 | 23.7 | 20.7 | 19.3 | 16.9 | 14.8 | 11.8 | 7.9 | 2.8 | -1.3 | -4.9 | -7.4 | -8.7 | -10.0 | -11.3 | -12.4 |
| NZS Fund balance | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.5 | 1.4 | 2.8 | 4.3 | 6.3 | 7.8 | 9.0 | 10.4 | 11.9 | 13.3 | 14.6 |
| Net worth | 7.5 | 9.8 | 5.8 | 7.7 | 9.7 | 15.0 | 17.9 | 24.8 | 33.1 | 45.4 | 58.0 | 58.5 | 59.0 | 59.8 | 60.3 | 60.6 |

Key indicators in nominal terms

| | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------|---------|----------|----------|----------|----------|----------|
|  | Actual | Actual | Actual | Actual | Actual | Actual | Actual | Actual | Actual | Actual | Actual | Forecast | Forecast | Forecast | Forecast | Forecast |
| \$million | | | | | | | | | | | | | | | | |
| Revenue | | | | | | | | | | | | | | | | |
| Core Crown tax revenue | 30,387 | 31,429 | 30,525 | 32,248 | 34,995 | 36,459 | 40,168 | 43,008 | 47,118 | 52,444 | 53,445 | 57,166 | 57,697 | 59,618 | 62,531 | 65,507 |
| Core Crown | 33,533 | 34,222 | 34,899 | 34,891 | 38,005 | 39,907 | 43,624 | 46,932 | 52,065 | 59,170 | 58,174 | 62,409 | 63,496 | 65,832 | 69,458 | 72,740 |
| Total Crown | 39,803 | 41,092 | 41,985 | 41,557 | 45,506 | 49,979 | 57,027 | 60,387 | 67,065 | 76,581 | 74,427 | 79,608 | 81,280 | 84,482 | 88,710 | 92,612 |
| Expenses | | | | | | | | | | | | | | | | |
| Core Crown | 31,708 | 32,852 | 34,367 | 34,536 | 36,699 | 37,970 | 41,749 | 41,608 | 46,234 | 49,900 | 53,977 | 57,137 | 60,537 | 63,106 | 66,632 | 70,034 |
| Total Crown | 37,940 | 39,044 | 40,280 | 40,128 | 44,213 | 47,653 | 55,224 | 53,057 | 60,910 | 65,084 | 69,088 | 73,034 | 76,953 | 80,420 | 84,726 | 88,762 |
| OBEGAL | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | 5,339 | 6,574 | 4,327 | 4,062 | 3,984 | 3,850 |
| OBERAC | 1,904 | 2,191 | 246 | 884 | 2,115 | 2,751 | 5,580 | 6,629 | 8,873 | 8,648 | 7,290 | .. | .. | .. | .. | .. |
| Operating balance | 1,908 | 2,127 | 1,763 | 1,503 | 1,358 | 2,391 | 1,966 | 7,424 | 6,247 | 11,473 | 8,079 | 7,388 | 6,053 | 5,924 | 6,094 | 6,228 |
| Core Crown residual cash | 3,913 | 484 | 2,048 | (386) | 349 | 216 | 1,217 | 520 | 3,104 | 2,985 | 2,653 | 759 | (763) | (779) | (851) | (937) |
| Gross sovereign-issued debt (excl SC) | 35,972 | 37,892 | 36,712 | 36,041 | 36,761 | 36,202 | 36,086 | 35,527 | 35,045 | 33,497 | 30,890 | 33,303 | 33,034 | 31,779 | 34,566 | 33,172 |
| Net core Crown debt | 25,324 | 24,069 | 21,701 | 21,396 | 19,971 | 19,250 | 17,577 | 15,204 | 10,771 | 7,745 | 4,411 | 1,983 | 1,756 | 1,705 | 1,792 | 2,105 |
| Net core Crown debt (including NZS Fund) | 25,324 | 24,069 | 21,701 | 21,396 | 19,971 | 18,635 | 15,693 | 11,248 | 4,216 | (2,116) | (8,112) | (13,102) | (16,224) | (19,545) | (22,990) | (26,414) |
| NZS Fund balance | .. | .. | .. | .. | .. | 615 | 1,884 | 3,956 | 6,555 | 9,861 | 12,973 | 15,993 | 19,488 | 23,140 | 27,016 | 31,102 |
| Net worth | 7,470 | 9,921 | 6,022 | 8,583 | 11,463 | 18,820 | 23,781 | 35,463 | 49,983 | 71,403 | 96,704 | 104,315 | 110,372 | 116,313 | 122,417 | 128,652 |

Risks and Scenarios

Introduction

The forecasts presented in the *Economic and Tax Outlook* chapter incorporate a number of judgements about how various forces affecting the economy will evolve. These judgements reflect the balancing of a number of positive and negative risks facing the economy to arrive at our best assessment of how it is likely to develop. Some of these judgements are related to the cyclical drivers of activity and some are related to the structural characteristics of the economy. The path taken by the economy will deviate from the *Half Year Update* forecast if events turn out differently from our assessment.

The first part of this chapter, Economic Risks, outlines the main risks to the economic outlook. Although we believe the forecast presented in the *Economic and Tax Outlook* chapter is the most likely outcome, two scenarios that illustrate different paths for the economy are presented in the second part of this chapter, Economic Scenarios. These two scenarios focus on different paths for the terms of trade, which are a key area of uncertainty. However, these scenarios are only two of a number of possible outcomes so do not show the full range of possibilities and should not be considered as upper or lower bounds.

The third part of this chapter, Fiscal Scenarios, considers the implications of the economic scenarios for the fiscal position, while the fourth part, Fiscal Sensitivities, examines how sensitive the fiscal position is to changes in specific variables.

Economic Risks

The chief uncertainty in these forecasts is the terms of trade ...

The terms of trade, the ratio of export prices to import prices, are at their highest level in over 30 years and are expected to increase further in coming quarters before easing back. However, there are key risks to the terms of trade on both the upside and downside. The terms of trade could stay elevated for longer than expected or could decline more sharply than expected, largely depending on commodity prices, particularly for dairy products.

Changes in international commodity markets can have a large impact on the New Zealand economy. A range of demand and supply factors have caused world spot prices for dairy products to more than double since mid-2006, and the resulting higher export receipts will boost domestic incomes, especially in the agricultural sector. However, predicting prices for dairy products involves uncertainties with regard to both world demand and supply.

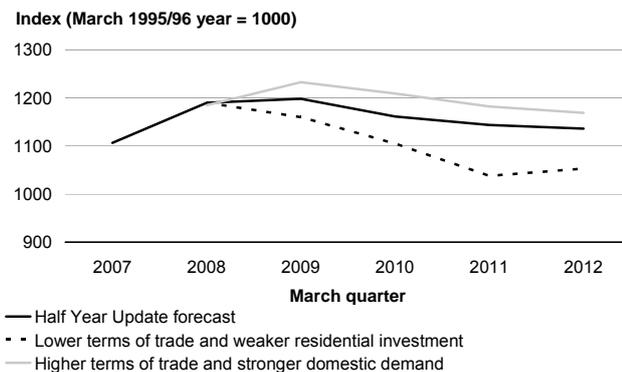
Demand for dairy products has been driven higher by rising incomes in developing nations (eg, China) coinciding with shifting preferences towards high-protein foods. However, there is uncertainty as to the extent demand will respond to the rise in prices, with less reaction likely for staples such as milk compared to other products such as cheese, yoghurt and ice-

cream. Prices for dairy products, and for other commodities, would also be negatively affected in the event of a marked slowing of world growth.

A range of factors has limited the supply of dairy products (eg, in Australia, Europe and the United States). How these factors evolve are key judgements, as is the ability of other parts of the world to raise production, including South America for exports and China for their own domestic consumption.

An additional uncertainty is that, while information is available on world spot dairy prices, much of New Zealand's dairy exports are pre-sold at agreed contract prices. As a result, judgements have to be made as to how a given change in spot dairy prices impacts on the price received by New Zealand exporters. It is also possible that New Zealand's other commodities could enjoy larger price rises in response to the factors lifting dairy prices.

Figure 3.1 – Total terms of trade index



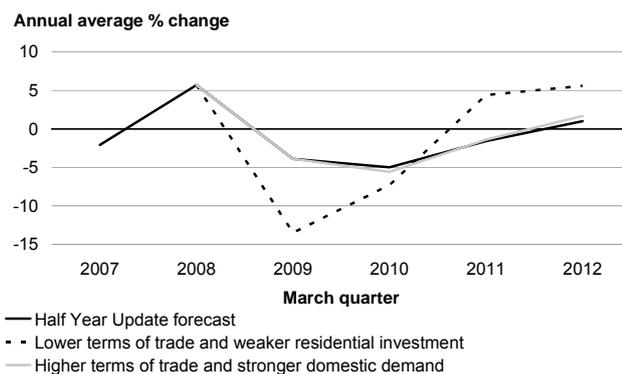
Given risks associated with the terms of trade on the upside and downside, two scenarios are developed below that focus on these risks (Figure 3.1). Alternative scenarios involving differences in the terms of trade show the consequences for the economy and implications for tax revenue and other fiscal indicators.

Sources: Statistics New Zealand, The Treasury

... and there are risks around the strength of domestic demand in the near term

Domestic demand experienced an upturn in late 2006 and early 2007, but a number of factors that contributed to this strength have turned: house price growth has slowed, fuel prices have risen and net migration has declined. In addition, 2007 has seen further increases in interest rates, including for mortgages, and finance company collapses. As a result of these factors, growth in domestic demand appears to have eased in the second half of 2007, but there is much uncertainty about the extent of this apparent easing and how long it will endure.

Figure 3.2 – Real residential investment



Sources: Statistics New Zealand, The Treasury

Residential investment is forecast to weaken and house price growth is expected to slow further from late 2007 (Figure 3.2). Based on leading indicators (eg, house sales), there is a risk of a sharper fall in residential investment and house price growth in the coming year, as has happened in the United States in the past year. Such a housing downturn has the potential to have a large impact on the labour market given the high employment growth in construction and property services since 2002.

Not all risks to domestic demand are on the downside. Although retail trade data point to a slowing in consumer spending since high growth in early 2007, data such as electronic card transactions and consumer confidence suggest there is still momentum left. Higher domestic demand could occur if more of the income boost expected from the higher terms of trade is spent, or if higher wage growth results from the tight labour market.

Consumers Price Index (CPI) inflation is forecast to rise to 3.1% in the year to March 2008 and stay near the top of the Reserve Bank target band (1% to 3% per annum) for much of the forecast period. Additional domestic demand strength would put further upward pressure on non-tradables inflation. Rising food and oil prices are other upside risks to inflation.

Risks to the global economy have heightened over the course of this year ...

The world economy has experienced a strong expansion during the past three years, with real Gross Domestic Product (GDP) growth among our trading partners averaging around 3.6% per annum. Trading partner growth is forecast to continue at a broadly similar rate, but risks to this outlook are concentrated on the downside.

Global financial markets have experienced a high degree of volatility in recent months. A downturn in the United States housing market led to concerns about sub-prime mortgages (riskier loans made to those with poor credit histories) and uncertainty among investors as to where associated losses would be felt. These events triggered financial market turmoil in August 2007 and a generalised rise in risk aversion. The situation stabilised in September and October, but there has been renewed uncertainty since the forecast was finalised.

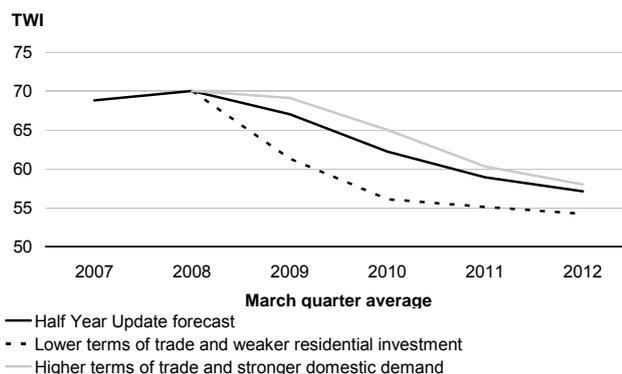
The *Half Year Update* forecast reflects a view that recent developments in global financial markets and the United States housing market will not cause a marked slowing of growth in the world economy. There is a risk that further fallout in the housing market weakens growth in the United States and slows world growth, which would make conditions more difficult for firms and households in New Zealand, particularly if it reduced the availability of credit.

... the exchange rate has been volatile in recent months ...

The exchange rate has been volatile in 2007. The Trade Weighted Index (TWI) of the New Zealand dollar rose to a post-float high of 77 in July, but turmoil in global financial markets resulted in widespread risk aversion that saw the TWI fall to 66 in September. A return of market confidence led to a rise back above 70, largely as a result of weakness in the United States dollar.

The *Half Year Update* forecast assumes the exchange rate remains around its current level until mid-2008, before falling in response to lower interest rates and commodity prices (Figure 3.3). However, the New Zealand dollar exchange rate is

Figure 3.3 – TWI exchange rate



Sources: Reserve Bank of New Zealand, The Treasury

always a major uncertainty in economic forecasts and recent volatility highlights how quickly sentiment can change. Recent events also illustrate the role of the exchange rate in buffering the New Zealand economy from shocks.

The exchange rate could fall sooner than assumed in our main forecast, especially if there is renewed risk aversion among financial market participants that results in an unwinding of the carry trade (ie, borrowing in nations with low interest rates such as Japan to invest in countries with higher rates such as New Zealand). Other factors that could lead to a sharper fall in the exchange rate are a large fall in commodity prices, a downturn in domestic demand, or concern over the size of the current account deficit. A sharp fall in the currency would raise tradables inflation, but the exact impact depends on the extent to which importers pass on higher costs or absorb them through lower margins.

Conversely, renewed appetite for risk among financial market participants, a resurgence in domestic demand or higher commodity prices could lift the exchange rate back to the post-float high reached in July 2007. An appreciation of the currency is most likely against the United States dollar given the greater risk of economic growth slowing in the United States. A rise in the New Zealand dollar would postpone a recovery in exports and would likely result in stronger domestic demand.

... and the world price for oil has increased to historic highs

Our oil price assumption is generally based on futures prices. The oil price track incorporates a West Texas Intermediate (WTI) price of US\$90/barrel in the December 2007 quarter. However, oil prices have been volatile; since the forecast was finalised, the WTI oil price peaked at almost US\$100/barrel on 21 November and fell back below US\$90/barrel in early December. There is a risk that oil prices may fall further or once again move higher.

Potential growth depends on growth in the labour supply and labour productivity

There are some risks specific to the labour market. The labour force participation rate rose to a record high in mid-2007 but has been volatile. This volatility continued after the forecast was finalised, with a large fall in the participation rate from 68.8% in the June 2007 quarter to 68.3% in the September 2007 quarter.

Other risks to the labour supply are a further fall in average working hours and a continued easing of net permanent and long-term migration owing to rising departures. Lower growth in the labour supply would imply a lower potential growth rate for the economy and thus greater inflation pressure for a given level of output.

Annual average growth in labour productivity (GDP per hour worked) rose to 1.5% at June 2007, partly reflecting the economic upturn since late 2006 (labour productivity growth tends to rise in upturns as inputs are used more intensively). Higher productivity growth may also reflect high levels of business investment in recent years. A key judgement in these forecasts is that labour productivity growth averages 1.5% to 2% per annum. If this assumption is incorrect and it falls back to average around 0.5% per annum, as in 2005 and 2006, the potential growth rate of the economy will be lower.

There is uncertainty as to the exact impact of policy changes and other events

The forecasts include an assumption of a \$1.5 billion revenue reduction contingency, but additional uncertainty arises because the exact impact on the real economy, inflation and interest rates will depend on the precise nature of the revenue reduction and not just the overall size.

As discussed in the *Economic and Tax Outlook* chapter, the forecasts do not incorporate impacts from a decision to proceed with an Emissions Trading Scheme (ETS). The exact impacts of such a scheme are uncertain, but it would likely result in higher inflation owing to higher costs faced by consumers of energy.

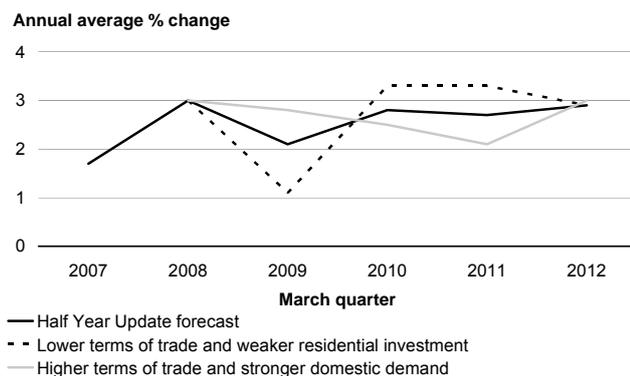
There are many non-economic risks that would have a large impact on the economy. For example, climatic events and agricultural diseases can affect agricultural production, both in New Zealand and in competing supplier countries, with beneficial or adverse effects on returns to New Zealand producers. Market perceptions arising from concerns about climate change may also affect the demand for New Zealand products.

Economic Scenarios

The following scenarios show how the growth path of the economy might evolve if some of the key judgements in the main forecast are altered (Table 3.1). The scenarios are two of a large number of possible examples, and do not represent upper or lower bounds for the main forecast, with more extreme paths possible. They represent what we assess to be the key risks to the *Half Year Update* forecast and illustrate the impact of relatively small changes in the assumptions on key variables, especially the fiscal aggregates. Although not the most likely outcome, we consider that there is a realistic prospect that these scenarios could occur.

The first scenario is entitled “Lower terms of trade and weaker residential investment”. In this scenario, there is a larger fall in the terms of trade and weaker domestic demand led by residential investment. This scenario leads to lower real GDP growth initially (Figure 3.4). Non-tradables inflation also falls, but total inflation is higher as a lower exchange rate drives up the price of imports and thus tradables inflation in the short term. Compared to the main forecast, interest rates are not cut as early because of high inflation and the current account deficit does not narrow as much because of the lower terms of trade.

Figure 3.4 – Real GDP



Sources: Statistics New Zealand, The Treasury

The second scenario, entitled “Higher terms of trade and stronger domestic demand”, incorporates stronger terms of trade owing to higher export prices throughout the forecast period. In this scenario, there is stronger growth in consumption and market investment relative to the main forecast, which raises real growth in GDP in the near term, but also increases inflationary pressures.

Table 3.1 – Alternative scenarios: summary

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|--|--------|----------|----------|----------|----------|----------|
| | Actual | Estimate | Forecast | Forecast | Forecast | Forecast |
| Real production GDP (annual average % change, year ending 31 March) | | | | | | |
| <i>Half Year Update</i> forecast | 1.7 | 3.0 | 2.1 | 2.8 | 2.7 | 2.9 |
| Lower terms of trade and weaker residential investment | 1.7 | 3.0 | 1.1 | 3.3 | 3.3 | 2.9 |
| Higher terms of trade and stronger domestic demand | 1.7 | 3.0 | 2.8 | 2.5 | 2.1 | 3.0 |
| Nominal expenditure GDP (annual average % change, year ending 31 March) | | | | | | |
| <i>Half Year Update</i> forecast | 4.7 | 7.3 | 5.4 | 4.1 | 4.2 | 4.6 |
| Lower terms of trade and weaker residential investment | 4.7 | 7.3 | 3.9 | 3.9 | 3.8 | 4.2 |
| Higher terms of trade and stronger domestic demand | 4.7 | 7.4 | 6.7 | 4.4 | 3.8 | 4.5 |
| OBEGAL (\$billion, year ending 30 June)¹ | | | | | | |
| <i>Half Year Update</i> forecast | 5.3 | 6.6 | 4.3 | 4.1 | 4.0 | 3.9 |
| Lower terms of trade and weaker residential investment | 5.3 | 6.4 | 3.1 | 3.0 | 2.3 | 2.0 |
| Higher terms of trade and stronger domestic demand | 5.3 | 6.6 | 5.2 | 5.0 | 4.6 | 4.6 |

Note: 1 Operating balance before gains and losses.

Sources: Statistics New Zealand, The Treasury

Lower terms of trade and weaker residential investment

The first scenario illustrates a situation in which the terms of trade fall sooner and by more than assumed in the main forecast and – in conjunction with an assumption of a greater impact on housing from recent increases in interest rates – there is weaker residential investment (Table 3.2).

Table 3.2 – Lower terms of trade and weaker residential investment

| Annual average % change, year ending 31 March | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|--|------------|------------|------------|------------|------------|------------|
| | Actual | Estimate | Forecast | Forecast | Forecast | Forecast |
| Private consumption | 2.4 | 3.8 | 1.1 | 1.6 | 1.8 | 1.3 |
| Residential investment | -2.1 | 5.7 | -13.5 | -7.3 | 4.4 | 5.6 |
| Market investment | -3.3 | 5.6 | 4.5 | -0.6 | 3.5 | 3.7 |
| Gross national expenditure | 0.7 | 4.7 | 1.4 | 1.7 | 2.6 | 2.2 |
| Exports of goods and services | 3.0 | 1.6 | 2.6 | 3.6 | 3.7 | 4.1 |
| Imports of goods and services | -1.4 | 6.1 | 3.1 | -1.0 | 1.8 | 2.3 |
| Real GDP (production measure) | 1.7 | 3.0 | 1.1 | 3.3 | 3.3 | 2.9 |
| Real GDP per capita | 0.5 | 2.0 | 0.2 | 2.3 | 2.3 | 1.9 |
| Employment growth | 1.9 | 1.9 | 0.6 | 0.9 | 1.0 | 0.3 |
| Unemployment rate ¹ | 3.7 | 3.8 | 4.1 | 4.0 | 4.3 | 4.6 |
| 90-day bank bill rate ² | 7.8 | 8.5 | 8.5 | 8.3 | 8.2 | 7.5 |
| TWI ² | 68.8 | 70.0 | 61.3 | 56.1 | 55.1 | 54.2 |
| CPI ³ | 2.5 | 3.1 | 3.0 | 3.1 | 2.6 | 2.6 |
| Current account balance (% GDP) | -8.3 | -7.3 | -7.0 | -8.0 | -8.4 | -8.6 |
| Nominal GDP (expenditure measure) | 4.7 | 7.3 | 3.9 | 3.9 | 3.8 | 4.2 |

- Notes: 1 Percentage of labour force, March quarter, seasonally adjusted.
 2 Average for March quarter.
 3 Annual percentage change, March quarter.

Sources: Statistics New Zealand, Reserve Bank of New Zealand, The Treasury

In this scenario, the terms of trade fall more sharply as export prices reverse much of their recent rise. This scenario envisages a sharp fall in world dairy prices to levels prevailing in 2005/06, prior to the current boom. Such a fall would likely involve some slowing of world growth, particularly in the United States, and a larger negative reaction to the recent increase in dairy prices, especially for products that are relatively price elastic (eg, yoghurt and ice-cream). A faster rise in dairy production, in response to previous increases in dairy prices, would likely be another important contributor to a fall in world dairy prices.

The exchange rate falls more quickly in this scenario because of lower prices for New Zealand exports. Over the first two years of the forecast period, the TWI is approximately 10% lower than in the main forecast at 61.3 in the March 2009 quarter and 56.1 a year later. The exchange rate then levels off but it is still slightly below the *Half Year Update* track towards the end of the forecast period because of the lower terms of trade.

Residential investment is much lower initially in this scenario, falling by 13.5% in the March 2009 year and 7.3% the next year. Although this is a large fall, it would not be unusual relative to previous downturns (eg, 2000/01) and the recent experience of the United States. The larger fall in residential investment in this scenario is caused by a greater reaction to recent increases in interest rates than is incorporated in the main forecast. Furthermore, interest rates are high for longer in this scenario because of the inflation pressure that results from a faster fall in the exchange rate. Relative to the main forecast, market investment is also lower as a result of the weakening in domestic demand, a lower New Zealand dollar raising the cost of imported capital, and higher interest rates.

Private consumption growth is around one percentage point lower than in the main forecast in the years to March 2009 and 2010 as a housing market downturn reduces perceptions of household wealth and reduces the ability of households to borrow against their home. Higher costs of imported consumption goods, owing to the weaker dollar, also act to weaken private consumption growth.

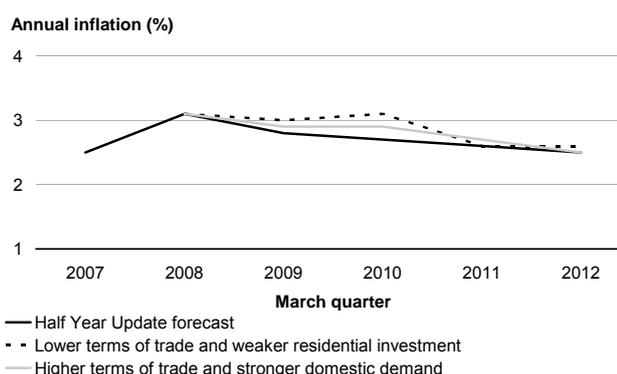
Weaker domestic demand results in slower growth in imports over the years to March 2009 and 2010, including a fall in import volumes over the March 2010 year. In the final two years of the forecasts, import growth is higher than in the main forecast as domestic demand strengthens again. Export volumes, particularly export services, grow by more in this scenario than in the *Half Year Update* forecast because of the lower exchange rate.

Growth in real GDP of 1.1% over the year to March 2009 is much lower than in the main forecast, but stronger export growth relative to import growth leads to higher growth in real GDP of 3.3% in each of the following two years.

Employment growth is lower through much of the forecast period as firms utilise a lower level of labour input in response to weaker demand. The unemployment rate is higher as a result, rising to 4.6% by March 2012. Wage growth is weaker throughout the period, compounding the weaker private consumption and residential investment growth.

Consumer price inflation is higher than the *Half Year Update* forecast because of the pass-through from the sharp fall in the exchange rate. Annual inflation rises to 3.1% at March 2008, as in the main forecast, but remains at or above 3% in the following two years (Figure 3.5). Monetary policy is loosened later than in the *Half Year Update* forecast, with 90-day rates staying above 8% until the final year of the forecasts.

Figure 3.5 – CPI inflation



The current account deficit narrows initially as growth in imports slows in response to weaker domestic demand. However, the current account deficit is larger throughout the period compared to the main forecast because of lower export prices.

Sources: Statistics New Zealand, The Treasury

Despite high consumer price inflation, the initial lower rate of growth in real GDP means the level of nominal GDP is lower throughout the forecast period by a cumulative total of approximately \$15 billion. This brings a reduction in tax revenues, as discussed in the Fiscal Scenarios section.

Higher terms of trade and stronger domestic demand

In this scenario, the terms of trade are assumed to be higher across the forecast period relative to the *Half Year Update* forecast (Table 3.3). It is also assumed there is greater confidence as a result of the higher terms of trade and more momentum in the economy than in the main scenario. This scenario is similar to one of the scenarios that was outlined in the *Budget Update 2007*.

Table 3.3 – Higher terms of trade and stronger domestic demand scenario

| Annual average % change, year ending 31 March | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|------------|------------|------------|------------|------------|------------|
| | Actual | Estimate | Forecast | Forecast | Forecast | Forecast |
| Private consumption | 2.4 | 3.9 | 3.2 | 2.5 | 1.1 | 1.0 |
| Residential investment | -2.1 | 5.7 | -3.9 | -5.6 | -1.4 | 1.7 |
| Market investment | -3.3 | 5.6 | 8.7 | 3.7 | -1.6 | 1.6 |
| Gross national expenditure | 0.7 | 4.8 | 3.9 | 3.1 | 1.0 | 1.7 |
| Exports of goods and services | 3.0 | 1.6 | 2.6 | 3.3 | 3.4 | 3.7 |
| Imports of goods and services | -1.4 | 6.1 | 5.7 | 4.7 | 0.2 | 0.2 |
| Real GDP (production measure) | 1.7 | 3.0 | 2.8 | 2.5 | 2.1 | 3.0 |
| Real GDP per capita | 0.5 | 2.0 | 1.8 | 1.6 | 1.1 | 2.0 |
| Employment growth | 1.9 | 1.9 | 1.1 | 1.5 | 0.9 | 0.7 |
| Unemployment rate ¹ | 3.7 | 3.8 | 3.6 | 3.7 | 3.9 | 4.0 |
| 90-day bank bill rate ² | 7.8 | 8.5 | 8.8 | 8.3 | 7.9 | 7.4 |
| TWI ² | 68.8 | 70.0 | 69.1 | 65.0 | 60.3 | 58.0 |
| CPI ³ | 2.5 | 3.1 | 2.9 | 2.9 | 2.7 | 2.5 |
| Current account balance (% GDP) | -8.3 | -7.3 | -6.2 | -7.1 | -6.8 | -6.1 |
| Nominal GDP (expenditure measure) | 4.7 | 7.4 | 6.7 | 4.4 | 3.8 | 4.5 |

Notes: 1 Percentage of labour force, March quarter, seasonally adjusted.
 2 Average for March quarter.
 3 Annual percentage change, March quarter.

Sources: Statistics New Zealand, Reserve Bank of New Zealand, The Treasury

This scenario assumes the terms of trade remain higher throughout the period relative to the main forecast. The terms of trade are still forecast to fall, but not as sharply as in the main forecast (they are assumed to fall back to the same long-run level after the end of the forecast period). The driver of the higher terms of trade could be stronger world demand, a more sustained increase in international dairy prices, a large rise in the price of other commodities, or a greater flow-through from the recent commodity price increases to the price received by New Zealand producers. Higher export prices are assumed to be offset slightly by higher oil prices (as oil would likely be influenced by some of the same factors keeping the price of food commodities high). As a result of higher export prices, the New Zealand dollar is assumed to be 3% higher than the main forecast in the March 2009 quarter and 5% higher a year later.

In this scenario, private consumption growth is assumed to be stronger in the March 2009 year than in the *Half Year Update* forecast, as households respond to their higher real incomes and increased confidence. With stronger demand from households and a higher exchange rate making imported capital cheaper, firms raise their investment relative to the main forecast in the March 2009 and 2010 years. Residential investment is similar over the forecast period compared to the main forecast as the impact of stronger incomes is offset by higher interest rates.

Employment growth is about a quarter of a percentage point higher in the March 2009 and 2010 years as a result of higher domestic demand. Stronger employment growth means the unemployment rate is relatively stable and around a quarter of a percentage point lower than the main forecast over the period. Wage growth is higher than in the main forecast and the greater strength in the labour market reinforces the stronger domestic demand.

Growth in non-commodity and services export volumes is expected to be inhibited by the effect of the higher exchange rate and thus overall export volume growth is lower in this scenario than in the *Half Year Update* forecast. Import volume growth responds to the increased private consumption and business investment to be higher in the March 2009 year and the March 2010 year.

Real GDP growth is higher in the year to March 2009 but lower over the following two years relative to the main forecast. Driving the slowing from the year to March 2010 in this scenario is a sharper weakening of domestic demand owing to higher interest rates and low export growth relative to import growth owing to the higher exchange rate.

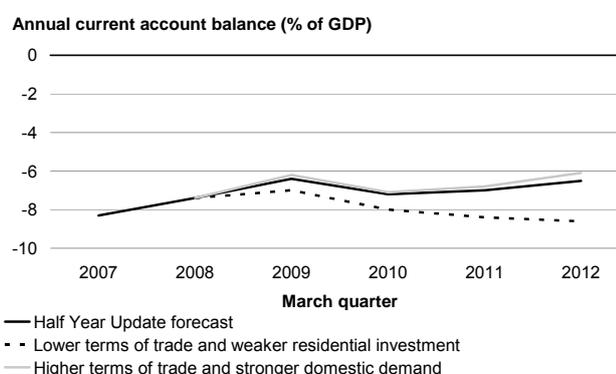
Stronger domestic demand leads to higher inflation pressure. Increased inflation pressure results in tighter monetary policy and 90-day interest rates are around a quarter of a percentage point higher in the March 2009 quarter. Even with this monetary tightening, inflation remains higher until the final year of the forecasts.

The monetary tightening, however, brings about a slowing in domestic demand. Private consumption and market investment grow more slowly in this scenario in the final two years of the forecast than in the main forecast. Import growth is also lower in this period, but so is real GDP growth.

The higher terms of trade lead to a slightly faster adjustment in the current account deficit. The current account deficit narrows in the March 2009 year, reaching 6.2% of nominal GDP. As in the main forecast, it increases in the following year but narrows again in the last two years of the forecast period (Figure 3.6).

Because of stronger growth in nominal GDP in the early part of the forecast period, the level of nominal GDP is higher throughout the whole forecast period. The cumulative increase over the period to March 2012 is around \$10 billion, with an increase in the final year of \$2.3 billion. This higher level of nominal GDP leads to higher tax revenues throughout the period.

Figure 3.6 – Current account



Sources: Statistics New Zealand, The Treasury

Fiscal Scenarios

The fiscal position is strongly influenced by the economy (Table 3.4). The major economic determinants, and how they impact on the fiscal position, are listed below. While each effect is expressed in terms of an increase in the determinant, the opposite impact applies for a decrease.

- Nominal GDP – higher GDP levels are reflected in higher tax revenue, which increases the operating balance and lowers the Government’s net debt.
- Interest rates – higher interest rates lead to increased debt-financing costs but also to higher interest-based revenue.
- The level of unemployment – higher levels of unemployment translate into an increase in spending because the number of unemployment beneficiaries rises. This decreases the operating balance and raises net debt levels.
- CPI inflation – as most benefits are indexed to CPI movements, higher inflation results in increased benefit costs. This reduces the operating balance and increases net debt.

Table 3.4 – Alternative scenarios: impact on OBEGAL and debt

| Year ending 30 June | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|--|--------|----------|----------|----------|----------|----------|
| | Actual | Estimate | Forecast | Forecast | Forecast | Forecast |
| OBEGAL (\$billion)¹ | | | | | | |
| <i>Half Year Update</i> forecast | 5.3 | 6.6 | 4.3 | 4.1 | 4.0 | 3.9 |
| Lower terms of trade | 5.3 | 6.4 | 3.1 | 3.0 | 2.3 | 2.0 |
| Higher terms of trade | 5.3 | 6.6 | 5.2 | 5.0 | 4.6 | 4.6 |
| Gross sovereign-issued debt (\$billion)² | | | | | | |
| <i>Half Year Update</i> forecast | 30.9 | 33.3 | 33.0 | 31.8 | 34.6 | 33.2 |
| Lower terms of trade | 30.9 | 33.5 | 34.5 | 34.3 | 38.8 | 39.3 |
| Higher terms of trade | 30.9 | 33.3 | 32.2 | 30.0 | 32.1 | 30.0 |
| OBEGAL (% GDP)¹ | | | | | | |
| <i>Half Year Update</i> forecast | 3.2 | 3.7 | 2.3 | 2.1 | 2.0 | 1.8 |
| Lower terms of trade | 3.2 | 3.6 | 1.7 | 1.6 | 1.2 | 0.9 |
| Higher terms of trade | 3.2 | 3.7 | 2.7 | 2.5 | 2.3 | 2.1 |
| Gross sovereign-issued debt (% GDP)² | | | | | | |
| <i>Half Year Update</i> forecast | 18.5 | 18.7 | 17.7 | 16.3 | 17.0 | 15.6 |
| Lower terms of trade | 18.5 | 18.8 | 18.8 | 17.9 | 19.6 | 18.9 |
| Higher terms of trade | 18.5 | 18.6 | 17.0 | 15.2 | 15.7 | 14.0 |
| Core Crown net debt (% GDP) | | | | | | |
| <i>Half Year Update</i> forecast | 2.7 | 1.1 | 0.9 | 0.9 | 0.9 | 1.0 |
| Lower terms of trade | 2.7 | 1.2 | 1.7 | 2.2 | 3.0 | 3.9 |
| Higher terms of trade | 2.7 | 1.1 | 0.5 | 0.0 | -0.3 | -0.5 |

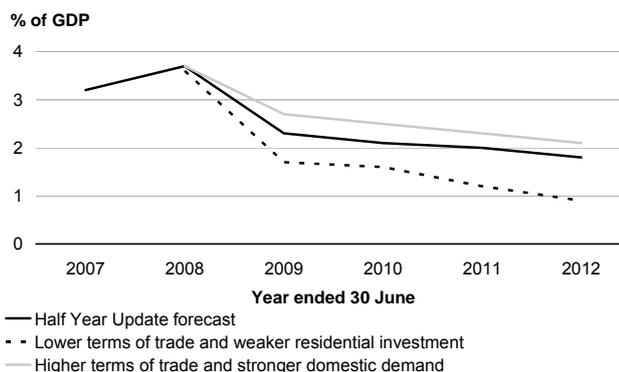
Notes: 1 Operating balance before gains and losses.
 2 Excluding Reserve Bank Settlement Cash.

Source: The Treasury

Lower terms of trade and weaker residential investment

The first scenario is driven by a combination of international and domestic factors. Easing world demand for dairy products and/or a strong global supply response to high dairy prices leads to a fall in the terms of trade and the exchange rate. In addition, residential investment slows sharply. As a result, nominal GDP growth is slower, particularly over 2008/09, and a fall in the exchange rate increases tradables inflation. Real economic growth in 2010 increases through a rebound in private consumption and higher export volumes owing to the lower exchange rate. Overall, nominal GDP is a cumulative \$15 billion lower by 2012 relative to the main forecast.

Figure 3.7 – OBEGAL



Source: The Treasury

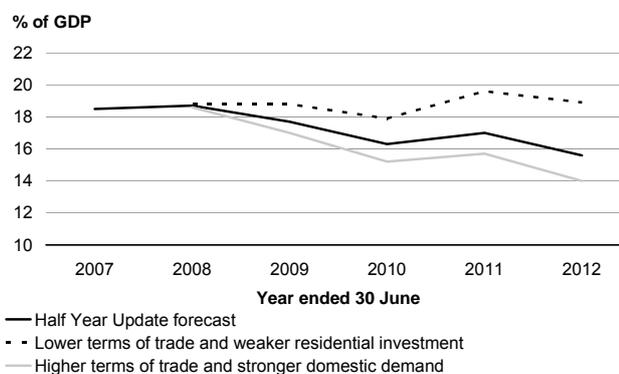
The weaker nominal GDP track reduces revenue by around \$5 billion across the forecast period. In addition, expenses are higher because of higher unemployment and the higher CPI increasing inflation-indexed benefit costs. As a result, the OBEGAL as a percentage of GDP is 0.9% lower in the last year of the forecast period compared to the main forecast (Figure 3.7). Gross Sovereign-issued debt (GSID) is around 3.3% of GDP higher.

Higher terms of trade and stronger domestic demand

Scenario two sees higher commodity prices driven by, for example, demand from China and constraints on the global supply response from drought in Australia and conversion of grain to biofuel in the United States. The effect on the terms of trade is offset somewhat by higher oil prices. Strength in the domestic economy is characterised by consumer spending and business investment that flows through to higher real GDP. The CPI is also higher than in the main forecast as a result of higher non-tradables inflation and oil prices. Eventually, high interest rates dampen demand pressures in the domestic economy, leading to a fall in the exchange rate and a rise in export volume growth.

Overall, nominal GDP is a cumulative \$10 billion higher across the forecast period, and revenues are a cumulative \$3.3 billion higher compared to the main forecast. Expenses are the same across the period as a reduction in finance costs and unemployment benefits is offset by higher inflation-indexed welfare payments. The OBEGAL as a percentage of GDP is around 0.3% higher compared to the main case in the final year of the forecast. GSID is around 1.6% of GDP lower (Figure 3.8).

Figure 3.8 – GSID



Source: The Treasury

Fiscal Sensitivities

The scenarios above indicate the sensitivity of fiscal aggregates to changes in economic conditions. Table 3.5 provides some “rules of thumb” on the sensitivities of the fiscal position to small changes in specific variables.

Table 3.5 – Fiscal sensitivity analysis

| (\$million) Year ending 30 June | 2008 | 2009 | 2010 | 2011 | 2012 |
|--|--------------|----------------|----------------|----------------|----------------|
| | Forecast | Forecast | Forecast | Forecast | Forecast |
| 1% lower nominal GDP growth per annum | | | | | |
| Revenue | (541) | (1,099) | (1,737) | (2,423) | (3,157) |
| Addition to financing costs | 17 | 69 | 164 | 306 | 484 |
| Impact on the operating balance | (559) | (1,168) | (1,901) | (2,729) | (3,641) |
| Revenue impact of a 1% decrease in the growth rates of: | | | | | |
| Wages and salaries | (245) | (520) | (830) | (1,175) | (1,550) |
| Taxable business profits | (125) | (265) | (425) | (585) | (770) |
| One percentage point lower interest rates | | | | | |
| Interest income | (88) | (114) | (98) | (123) | (111) |
| Expenses | (62) | (102) | (126) | (155) | (178) |
| Impact on the operating balance | (26) | (12) | 28 | 33 | 67 |

The forecasts of capital contributions to the New Zealand Superannuation (NZS) Fund are sensitive to the rate of return assumed on the Fund’s assets (Table 3.6).

Table 3.6 – NZS Fund contributions sensitivity analysis

| Variable | Marginal change (%age points) | Effect on net return after tax (%age points) | Effect on capital contribution (\$million) | | | |
|-------------------------------|----------------------------------|---|--|---------|---------|---------|
| | | | 2008/09 | 2009/10 | 2010/11 | 2011/12 |
| Expected gross rate of return | -1% | -0.76% | 237 | 252 | 268 | 287 |

Specific Fiscal Risks

Introduction

This chapter describes the specific fiscal risks to the Crown, including contingent liabilities. The Public Finance Act 1989 (PFA) requires disclosure of all Government decisions and other circumstances that may put pressure on the forecast spending amounts, and/or have a material effect on the fiscal and economic outlook.

Criteria for Disclosure of Specific Fiscal Risks

To ensure a practicable and consistent disclosure approach, fiscal risks are disclosed based on the following criteria, consistent with the principles of the PFA:

- *Reasonable certainty criterion* – risks have not been included in the fiscal forecasts because they reflect Government decisions or legislative commitments with uncertain fiscal consequences or timing.
- *Materiality criterion* – risks have an impact on the fiscal forecasts (operating balance, net worth or gross debt) of \$10 million or more in any one forecast year.
- *Active consideration criterion* – risks are being actively considered by the Minister of Finance and responsible Ministers (eg, are the subject of written reports) or are decisions that have been deferred until a later date.

Exclusions from Disclosure

The PFA requires that all specific fiscal risks be disclosed, except where it is determined by the Minister of Finance that disclosing a risk is likely to:

- prejudice the substantial economic interests of New Zealand
- prejudice the security or defence of New Zealand or international relations of the Government
- compromise the Crown in a material way in negotiation, litigation or commercial activity, or
- result in a material loss of value to the Crown.

Specific fiscal risks do not include:

- normal forecasting risks, such as uncertainty around welfare benefits, State-Owned Enterprise/Crown entity surpluses, the impact of regular revaluations of physical assets, finance costs or fluctuations in external markets

- possible changes to the interpretation of accounting policies, such as the changes to revenue recognition rules and recognition of liabilities, or
- discussion documents containing proposals that the Minister of Finance and responsible Ministers will not actively consider until the consultation process has been completed.

In addition, the Minister of Finance has to determine that there is no reasonable or prudent way the Government can avoid this prejudice, compromise or material loss by making a decision on the fiscal risk before the finalisation of the forecasts, or by disclosing the fiscal risk without reference to its fiscal implications.

Contingent liabilities are also included according to materiality. Contingent liabilities below \$10 million are included in the “other quantifiable contingent liabilities” total. Comparatives have been adjusted where appropriate to align with the disclosure of new “material” contingent liabilities. The total amount of prior years’ contingent liabilities remains unchanged.

Information Relating to All Disclosed Risks

- The risks disclosed may not eventuate into Government policy and the final cost or saving may differ from the amount disclosed if the policy is developed.
- All risks, should they eventuate, would impact on the Government’s forecast operating and/or capital spending amounts. There are new spending amounts already incorporated into the forecasts to accommodate policy initiatives on which decisions have yet to be made. Most risks outlined in this chapter, if they eventuate, would be covered by these amounts and therefore have no impact on the overall level of the forecasts. The risks have been disclosed to indicate the pressure the risks place upon the forecast spending amounts.
- If the total of all risks considered exceeds the forecast new operating spending amounts in the forecasts, this would impact on the operating balance.
- The impact of capital spending initiatives is described as increasing the Government’s gross debt position. This is correct but because the Government also holds some financial assets the actual impact could equivalently be described as reducing the Government’s assets.
- There are a number of other pressures on the fiscal position that have not been included as risks. These pressures comprise proposals largely generated within individual departments and not yet considered by the Minister of Finance and responsible Ministers. Such items are expected to be managed within forecast spending amounts noted above.

Charges against Future Budgets

As part of its Budget strategy, the Government has put in place some longer-term funding paths for particular sectors. This aids long-term planning and demonstrates the Government's commitment to specific policies.

Charges against future Budgets do not meet the definition of a 'risk' under the PFA, as these items are incorporated in the fiscal forecasts. This section is provided to increase transparency about the provisions for future Budgets.

Business Tax Reform

In Budget 2007 the Government announced the Business Tax Review, a package of reforms to business taxation. This included:

- reducing the company tax rate from 33% to 30%
- reducing the maximum tax rate that applies to widely-held savings vehicles and the top portfolio investment entity cap in line with the reduced company tax rate, and
- introducing a tax credit for research and development.

The package cost is being met from the Budget 2008 allowance.

| Charge against Budget 2008 (\$ million) | 2008/09 | 2009/10 | 2010/11 | 2011/12 and Outyears |
|--|----------------|----------------|----------------|---------------------------------|
| Operating | 1,056.3 | 1,135.4 | 1,129.5 | 1,129.5 |
| Capital | 3.2 | - | - | - |

Defence Funding Package

The Defence Funding Package (DFP) is designed to provide the New Zealand Defence Force (NZDF) with the funding required to address issues identified by the Defence Capability and Resourcing Review, including capability, and maintaining equipment and reserves. Budget 2007 included \$58 million per annum as the third tranche of the 10-year plan. The following table shows the additional tranches to be charged against future Budgets.

| Budget to be Charged (\$ million) | 2008/09 | 2009/10 | 2010/11 | 2011/12 | 2012/13 | 2013/14 | 2014/15 |
|--|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Budget 2008 | 69.1 | 69.1 | 69.1 | 69.1 | 69.1 | 69.1 | 69.1 |
| Budget 2009 | | 85.7 | 85.7 | 85.7 | 85.7 | 85.7 | 85.7 |
| Budget 2010 | | | 108.1 | 108.1 | 108.1 | 108.1 | 108.1 |
| Budget 2011 | | | | 66.9 | 66.9 | 66.9 | 66.9 |
| Budget 2012 | | | | | 14.2 | 14.2 | 14.2 |
| Budget 2013 | | | | | | 58.6 | 54.2 |
| Budget 2014 | | | | | | | 0 |

Health – Pre-commitment

The Government has agreed that the indicative Health allocation of \$750 million for Budget 2008 may be pre-committed by \$53 million per annum in 2011/12 and outyears. This is to allow for Budget 2007 initiatives that may be further developed in 2007/08 and have a rising profile.

| Budget to be Charged (\$ million) | 2008/09 | 2009/10 | 2010/11 | 2011/12 and Outyears |
|--|----------------|----------------|----------------|-----------------------------|
| Budget 2008 | 34 | 48 | 53 | 53 |

Time-limited Funding

Time-limited funding does not meet the definition of a 'risk' under the PFA, but is further information that is prepared to increase transparency about initiatives with funding profiles that cease or decrease during the forecast period.

The following table outlines those areas where initiatives have time-limited funding that decreases or ceases at some point and may potentially be extended, using a \$5 million materiality threshold. Time-limited funding often relates to pilot programmes, and in some cases Multi-Year Appropriations (MYAs) if they are likely to require further funding in the future.

| Vote | Description of Initiative | Operating Impact (\$million) |
|-----------------------------------|---|---------------------------------------|
| Child, Youth, and Family Services | Pathway to Partnership: Strengthening Community Based Child and Family Services | 3.736 in 2007/08 and 6.759 in 2008/09 |
| Communications | Digital Strategy – High-speed Connectivity for Growth | 20 from 2005/06 to 2008/09 (MYA) |
| Education | Pathway to Partnership: Strengthening Community Based Child and Family Services | 0.149 in 2007/08 and 0.282 in 2008/09 |
| Finance | Equity Injection to ONTRACK | 49.15 in 2007/08 |
| Finance | Loans to ONTRACK | 108.005 in 2007/08 |
| Finance | ONTRACK operating and maintenance costs | 12.8 in 2007/08 |
| Health | Meningococcal Vaccine Delivery | 7.098 in 2007/08 and 6.081 in 2008/09 |
| Social Development | Pathway to Partnership: Strengthening Community Based Child and Family Services | 2.922 in 2007/08 and 6.029 in 2008/09 |
| Youth Development | Pathway to Partnership: Strengthening Community Based Child and Family Services | 0.180 in 2007/08 and 0.343 in 2008/09 |

The following table shows the impact on the operating balance if funding were to be appropriated to maintain funding levels for these initiatives (ie, extend the initiatives beyond their current scheduled completion dates). These amounts would need to be managed within the forecast operating spending.

| Operating Impact (\$ million) | 2007/08 | 2008/09 | 2009/10 | 2010/11 | 2011/12 and Outyears |
|--------------------------------------|----------------|----------------|----------------|----------------|-----------------------------|
| Funding to Extend Initiatives | 0 | 169.955 | 196.449 | 196.449 | 196.449 |

Quantified Risks

The risks outlined in these tables would, if they eventuated, impact on the Government's forecast new operating and/or capital spending amounts.

The Minister of Finance has yet to fully consider the quantum of these risks.

| Quantified Risks as at 5 December 2007 | Operating Balance | Gross Debt | Value of Risk (\$ million) | Funding in Budget 2007 (\$ million) |
|---|-------------------|------------|---|---|
| New Risks | | | | |
| Customs – CusMod Replacement | Decrease | Increase | 22 per annum operating and 100 capital | 1 in 2007/08 |
| Education (Tertiary) – Performance-Based Research Fund | Decrease | - | 6.5 operating in 2009/10 and 13 per annum operating from 2010/11 | - |
| Education (Tertiary) – Upskilling the Workforce Strategy | Decrease | - | 44 operating in 2008/09, 79 operating in 2009/10, and 81 per annum operating from 2010/11 | - |
| Housing – Rural Housing | Decrease | - | 15-20 per annum operating for five years including 2008/09-2011/12 | 2.7 in 2007/08 |
| New Zealand Agency for International Development | Decrease | - | 10 in 2008/09, 5 in 2009/10, and savings of 5 in 2010/11 | 70 in 2007/08, 102 in 2008/09, 174 in 2009/10, and 246 ongoing from 2010/11 |
| Social Development – Youth Court Sentencing Orders | Decrease | Increase | 12 per annum operating and 4 capital | - |
| Changed Risks | | | | |
| Education – Early Childhood Education Ratio Changes | Decrease | - | 51 per annum from 2011/12 | - |
| Education – School Property | Decrease | Increase | 100 capital in 2008/09 and up to 260 capital in each of the three years 2009/10-2011/12 and operating of 12 per annum | 203 capital and 11 operating ongoing |
| Finance – National Rail Network – Obligations of Rail Agreement | - | Increase | 92 to 102 per annum capital from 2008/09 | 104 capital in 2007/08 to 2010/11 |
| Foreign Affairs and Trade – Additional Baseline Funding | Decrease | Increase | 523 operating and 98 capital total over the period 2008/09 to 2012/13 | |
| Health – National Systems Development Programme Tranche 2 | Decrease | Increase | 100 operating (33 ongoing) from 2008/09 to 2011/12 and 64 capital | |

| Quantified Risks as at 5 December 2007 | Operating Balance | Gross Debt | Value of Risk (\$ million) | Funding in Budget 2007 (\$ million) |
|---|-------------------|------------|---|---|
| Police – Increases to Police Staff | Decrease | Increase | Operating of 42 in 2008/09, 45 in 2009/10 and outyears and capital of 54 capital over the forecast period | 49 per annum operating ongoing and 10 capital |
| Social Development – New Zealand Superannuation and Veteran's Pension | Decrease | - | 7 operating in 2007/08, 28 operating in 08/09, 22 operating in 09/10 | 250 operating from 2007/08 to 2010/11 |
| Unchanged Risks | | | | |
| Corrections – Capital Projects | Decrease | Increase | 1,200 capital through to 2014 and operating implications of 123 through 2010/11, 89 operating ongoing | |
| Culture and Heritage – Broadcasting Initiatives | Decrease | - | 24 per annum | 3 per annum |
| Economic Development – Venture Investment Fund | - | Increase | 40 capital in 2009/10 and 2010/11 | - |
| Education (Tertiary) – Vocational Training | Decrease | - | 2.5 in 2008/09, 7.5 in 2009/10, 15 in 2010/11, and 20 in 2011/12 and outyears | 71 from 2007/08 to 2010/11 |
| Health – Indicative Funding for Budgets 2008, 2009, and 2010 | Decrease | - | 716 in 2008/09, 1,502 from 2009/10, and 2,347 per annum from 2008/09 | - |
| Housing – Shared Equity Home Ownership | Decrease | Increase | 30 per annum capital over the forecast period and 1 per annum operating over the forecast period | 1.4 in 2007/08 |
| Housing – Wellington City Council Social Housing Assistance | Decrease | - | 220 operating spread over a 10-15 year period | 1.2 in 2007/08 |
| Justice Sector and Other Agencies – Effective Interventions | Decrease | - | 150 per annum | |
| Justice Sector Agencies – Potential Flow-on Impact of Extra Police | Decrease | Increase | 119 operating from 2008/09 to 2011/12 and 19 capital | |
| New Zealand Defence Force – Defence – Capital Injections | - | Increase | 210 capital from 2008/09 to 2010/11 | 44 capital |

| Quantified Risks as at 5 December 2007 | Operating Balance | Gross Debt | Value of Risk (\$ million) | Funding in Budget 2007 (\$ million) |
|---|-------------------|------------|---|-------------------------------------|
| New Zealand Defence Force – Sale of Skyhawks and Aermacchi Trainers | - | Decrease | US\$110 capital | - |
| Police – International Deployment Capability | Decrease | - | 30 per annum | - |
| Research, Science and Technology – Multi-year Funding Profile | Decrease | - | 30 in 2008/09 and 60 per annum from 2009/10 | 55.5 over three years from 2007/08 |

Unquantified Risks

The risks outlined in these tables would, if they eventuated, impact on the Government's forecast new operating and/or capital spending amounts.

| Unquantified Risks as at 5 December 2007 | Operating Balance | Gross Debt | Funding Received in Budget 2007 (\$million) |
|--|-------------------|------------|---|
| New Risks | | | |
| Agriculture and Forestry – Industry Partnership for Food and Pastoral Innovation | Decrease | Increase | - |
| Social Development – Children, Young Persons, and Their Families Act | Decrease | Increase | - |
| Environment – Purchase of Kyoto Compliant Emission Units | - | Increase | - |
| Housing – Tamaki | - | Increase | - |
| Justice – Financial Action Taskforce Recommendations | Decrease | Increase | - |
| Justice – Greater Auckland Region Service Delivery Strategy | Decrease | Increase | - |
| Local Government – Responses to Rates Inquiry | Decrease | Increase | - |
| Māori Affairs – Māori Business Aotearoa New Zealand | Decrease | Increase | - |
| Prime Minister and Cabinet – Government House Wellington Refurbishment | Decrease | Increase | - |
| Revenue – Changes to the Petroleum Mining Tax Rules | Decrease | - | - |

| Unquantified Risks as at 5 December 2007 | Operating Balance | Gross Debt | Funding Received in Budget 2007 (\$million) |
|---|-------------------|------------|---|
| Changed Risks | | | |
| Finance – SOE Long-term Hold Reviews | - | Decrease | - |
| Health – District Health Board Deficits | Decrease | Increase | - |
| Health – Strengthening Child and Adolescent Oral Health Services | Decrease | - | - |
| Immigration – New Immigration Service Delivery Strategy | Decrease | Increase | - |
| National Library – National Library Building Redevelopment | - | Increase | - |
| Revenue – Life Insurance | Unclear | - | 25 per annum (reduced revenue) |
| Revenue – Management of Inland Revenue Lease Portfolio in Auckland | Decrease | - | - |
| Revenue – Working for Families Review of Rates | Decrease | - | - |
| Transport – Regional Transport Projects | - | Increase | - |
| Unchanged Risks | | | |
| Corrections – Collective Employment Contract Negotiations | Decrease | - | - |
| Economic Development – Radio Spectrum Rights | Increase | - | - |
| Economic Development – Shanghai Expo 2010: New Zealand Participation | Decrease | - | - |
| Education – Schools ICT Network Infrastructure Upgrade | Decrease | Increase | - |
| Education (Tertiary) – Wananga Capital Injections | - | Increase | - |
| Education – Year One Class Sizes | Decrease | Increase | - |
| Education (Tertiary) – Tertiary Education Institutions – Capital Injections | - | Increase | - |
| Education (Tertiary) – Tertiary Student Support Changes | Decrease | Decrease | Operating expenditure of 29 from 2007/08 through to 2010/11; capital savings of 16 through 2007/08 to 2010/11 |
| Finance – Crown Overseas Properties | - | Increase | - |

| Unquantified Risks as at 5 December 2007 | Operating Balance | Gross Debt | Funding Received in Budget 2007 (\$million) |
|--|--------------------------|-------------------|--|
| Finance – National Rail Access Agreement Amendments | Unclear | Unclear | - |
| Fisheries – Māori Interest in Marine Farming | Decrease | - | - |
| Fisheries – Civilian Maritime Aerial Surveillance | Decrease | Increase | - |
| Justice – Strengthening the National Court Infrastructure | Decrease | Increase | - |
| Police – Wage Negotiations | Decrease | - | - |
| Revenue – International Tax Review | Decrease | - | - |
| Revenue – Rebuild of the Student Loan IT System | Decrease | Increase | - |
| Revenue – Reducing Compliance Costs for Small and Medium-sized Enterprises | Unclear | - | - |
| Revenue – Renegotiation of Double Tax Agreements | Decrease | - | - |
| Social Development – Working New Zealand: Work-focused Support | Decrease | - | - |
| Social Development / Housing – Accommodation Supplement Review | Decrease | Increase | - |
| Transport – Cost Guarantee for the State Highway Programme | - | Increase | - |

Risks Removed Since the 2007 Budget Update

The following risks have been removed since the 2007 *Budget Economic and Fiscal Update*:

| Expired Risks | Reason | Funding Received (\$ million) |
|---|---|--|
| Conservation – Lease of Taupo Property Rights from Tuwharetoa | Cabinet has decided to set aside funding (CAB Min (07) 32/1 refers) | Commercially sensitive |
| Economic Development – Increased Stadium Capacity for the Rugby World Cup | Moved to Contingent Liabilities | Operating: 14 in 2006/07; Capital: 20 in 2006/07 |
| Education (Tertiary) – Centres of Research Excellence | Cabinet has decided to set aside funding (POL Min (07) 11/2 refers) | Operating: 10 in 2007/08 and outyears; Capital: 20 in 2007/08 |
| Education – School Staffing Review | Cabinet has decided to set aside funding (CAB Min (07) 37/7 refers) | Operating: 2 in 2007/08, 17 in 2008/09 and outyears; Capital: 10 |
| Environment – Climate Change Policies | Now funded | Operating: 25 in 2007/08, 50 in 2008/09 and 2009/10, 41 in 2010/11 and outyears |
| Finance – Development of Rail Land | Incorporated into other Finance rail risks | None |
| Housing – Hobsonville: Additional Land Purchase | No longer meets SFR criteria – not greater than \$10 million in any one year over the forecast period | None |
| Revenue – Taxation of Redundancy Payments | Funding has been agreed (CAB Min (07) 39/5 refers) | Estimated reduction in tax revenue: 14.6 in 2007/08, 12.6 in 2008/09, 11.6 in 2009/10 and outyears; Operating: 1.089 in 2007/08, 1.311 in 2008/09, 2.356 in 2009/10, 0.485 in 2010/11 and outyears; Capital: 0.159 in 2007/08 and 0.487 in 2009/10 |
| Revenue – Tax Treatment for Relocation Expenses | No longer meets SFR criteria – not greater than \$10 million in any one year over the forecast period | None |
| Revenue – Tax Incentives for Giving to Charities and Other Not-for-profit Organisations | No longer meets SFR criteria – not greater than \$10 million in any one year over the forecast period | None |
| Social Development – New Zealand Superannuation – International Portability | No longer meets SFR criteria – not greater than \$10 million in any one year over the forecast period | None |
| Transport – Extending the State Highway Construction and Revenue Guarantee | The changes to the funding and planning system mean these guarantees will be superseded as user charges will be adjusted to manage cost and revenue pressures | None |
| Transport – Investment in Transport Infrastructure | The Government has agreed to fully hypothecate fuel excise duty to land transport investment from 1 July 2008. | None |

Agriculture and Forestry – Industry Partnership for Food and Pastoral Innovation (new, unquantified risk)

The Government is considering options for a partnership with industry to enhance pastoral sector and food innovation. This would decrease the operating balance and/or increase gross debt. This risk is unquantified as disclosure may compromise the Crown in commercial negotiations.

Corrections – Collective Employment Contract Negotiations (unchanged, unquantified risk)

The Government will be entering into negotiations with the Public Service Association and the Corrections Association of New Zealand to settle six new collective employment agreements. Current agreements expire in the first half of 2008. Any additional funding would decrease the operating balance. This risk is unquantified as disclosure may compromise the Crown in negotiations.

Corrections – Capital Projects (unchanged, quantified risk)

The Government is considering the asset management of current Corrections facilities, and requirements for increased capacity to meet the continued forecast prisoner growth in the foreseeable future, including the replacement of Mt Eden Prison. Estimated costs of upgrade and expansion are \$1.2 billion capital through to 2014, with ongoing operating implications of \$123 million per annum for the programme of capital projects completed by the end of the forecast period, and additional ongoing operating implications of \$89 million from 2013/14 for the remainder of the capital programme. These estimates are based on the 2006 Justice Sector Prisoner Forecast which includes the impact of 1,000 Police and Effective Intervention decisions to date, and in response to the 2006 Capital Asset Management Review. Capital injections would increase gross debt while operating funding would decrease the operating balance.

The Minister of Finance has yet to fully consider the quantum of this risk.

Source: Department of Corrections

Culture and Heritage – Broadcasting initiatives (unchanged, quantified risk)

On 3 February 2005, the Government released a Public Broadcasting Programme of Action. The Programme contains a set of priorities to guide public broadcasting policy over the six-year period to 2009/10, and a series of proposals to give effect to these priorities. The Programme as a whole (if fully implemented) would have total ongoing operating costs rising to around \$44 million in 2009/10. Broadcasting initiatives totalling \$11 million, \$6 million and \$3 million per annum have been included in Budgets 2005, 2006 and 2007, respectively. The Government may consider individual proposals relating to the Programme for the remaining \$24 million per annum over the next three Budgets. If funded, these would decrease the operating balance.

The Minister of Finance has yet to fully consider the quantum of this risk.

Source: Ministry for Culture and Heritage

Customs – CusMod Replacement (new, quantified risk)

Customs' border management systems (CusMod) are over ten years old. Customs received funding in Budget 2007 to develop a business case for replacement systems for consideration in Budget 2008. In accordance with the two-stage approval process for major IT projects, funding for the CusMod replacement is dependent on approval of the two business cases. The indicative cost of the project is up to \$100 million capital and up to \$22 million operating per annum. Any additional funding would decrease the operating balance and increase gross debt.

The Minister of Finance has yet to fully consider the quantum of this risk.

Source: New Zealand Customs Service

Economic Development – Venture Investment Fund (unchanged, quantified risk)

In Budget 2006, the Government agreed to additional investment commitments in the Venture Investment Fund of \$60 million from 2006/07 to 2008/09. The Government is also considering further commitments of \$40 million over two years (2009/10 and 2010/11). This depends on the results of the evaluation of the Venture Investment Fund scheduled for completion by 31 March 2009. This would increase gross debt.

The Minister of Finance has yet to fully consider the quantum of this risk.

Source: Ministry of Economic Development

Economic Development – Radio Spectrum Rights (unchanged, unquantified risk)

The Government sets the processes for the renewal or auction of property rights to radio spectrum in consultation with industry. Any revenue from sale of rights would increase the operating balance by the full amount of the sales less the cost of sales as charged to the Spectrum Sales Appropriation. Offers for rights of renewal to existing owners of spectrum rights are set approximately five years in advance of rights expiring from 2010 onwards with settlement being required prior to granting the new right. If any offers are rejected then they will be allocated by way of auction on the open market. (For this reason the expected revenue from sale of renewal rights is not reflected in current forecasts of revenue).

Economic Development – Shanghai Expo 2010: New Zealand Participation (unchanged, unquantified risk)

The Government has announced New Zealand's participation in the Shanghai Expo 2010 and officials are in the process of developing a detailed proposal for the design and construction of a pavilion to be used at the agreed site for New Zealand at the Expo. The Government is considering meeting part of the overall cost of New Zealand's participation. However, the amount that the Government contributes will depend on the level of industry contribution obtained and the development of a more definitive budget for New Zealand's participation at the Expo. Any contribution from the Government would decrease the operating balance.

Education – Schools ICT Network Infrastructure Upgrade (unchanged, unquantified risk)

Budget 2006 provided \$4 million in capital and \$0.6 million in associated operating funding for a partial roll-out of the Schools ICT Network Infrastructure Upgrade, as part of the School Property Business Case 2006/07. The roll-out is intended to assist schools to meet the costs of upgrading their computer networks to meet the new IT infrastructure standards. The Government will consider further roll-out in future budgets. This would decrease the operating balance and increase gross debt.

This risk is unquantified as disclosure could compromise the Crown in negotiations.

Education (Tertiary) – Wananga Capital Injections (unchanged, unquantified risk)

The Government is currently negotiating with Te Wananga o Raukawa over settlement of its Waitangi Tribunal claim. The Waitangi Tribunal has recommended that the Wananga be compensated for capital expenditure it has incurred on facilities to date, and be provided with funding to bring its facilities up to a standard comparable with other tertiary institutions and to meet additional capital requirements. Negotiations are also taking place with Te Whare Wananga o Awanuiarangi in relation to an outstanding item from the original settlement.

This risk is unquantified as disclosure could compromise the Crown in negotiations with the Wananga, but any capital injections would increase gross debt.

Education (Tertiary) – Performance-Based Research Fund (new, quantified risk)

The Government is considering increasing the Performance-Based Research Fund to \$250 million by 2010. Meeting this proposal would reduce the operating balance by approximately \$13 million per annum from 2010/11 (with \$6.5 million in 2009/10 also). The Minister of Finance has yet to fully consider the quantum of this risk.

Source: Ministry of Education

Education (Tertiary) – Upskilling the Workforce Strategy (new, quantified risk)

The Government is considering a proposal to upskill the existing workforce, which has a focus on increasing literacy, numeracy, and language levels for the workforce. The proposal would decrease the operating balance by \$44 million in 2008/09, \$79 million in 2009/10 and approximately \$81 million in 2010/11 and outyears.

The Minister of Finance has yet to fully consider the quantum of this risk.

Source: Tertiary Education Commission

Education – Early Childhood Education Ratio Changes (changed, quantified risk)

The Government has committed to increasing adult to child ratios as part of the Early Childhood Education Strategic Plan, and consulted on options for new ratios in 2004 and 2005. In October 2006, the Government agreed to initial changes to ratios to implement part of one option consulted on, to take place from July 2009 and 2010. The Government has also communicated that further changes are being considered. The current funding is thought to be insufficient for further changes, so additional funding of approximately up to \$51 million per annum from 2011/12 will be considered as part of Budget 2008. Any increased funding would reduce the operating balance.

The Minister of Finance has yet to fully consider the quantum of this risk.

Source: Ministry of Education

Education – School Property (changed, quantified risk)

Additional capital injections for school accommodation will be required in future years to meet roll growth and to establish new schools. They could cost \$100 million in 2008/09, and up to \$260 million in each of the next three years 2009/10-2011/12, with a corresponding increase in debt. In addition to capital injections, consequential operating costs are likely to increase by approximately \$12 million per annum, which would decrease the operating balance. New expenditure rules have been put in place to time limit new capital budget approvals, but this will take some time to take effect. It is expected that the liability for schools' unspent property entitlements and delayed projects will continue to increase until 2010/2011 before levelling off and then declining.

The Minister of Finance has yet to fully consider the quantum of this risk.

Source: Ministry of Education

Education (Tertiary) – Vocational Training (unchanged, quantified risk)

The Government is considering a number of policies regarding the expansion of vocational training. One of these is to have 250,000 people participating in industry training.

As at Budget 2007, funding supports participation of approximately 220,000 trainees by 2011. To work to achieving a participation of 250,000 trainees, the Industry Training Fund would need to increase by approximately \$2.5 million in 2008/09, \$7.5 million in 2009/10, \$15 million in 2010/11 and \$20 million in 2011/12 and outyears.

This proposal would decrease the operating balance.

The Minister of Finance has yet to fully consider the quantum of this risk.

Source: Tertiary Education Commission

Education – Year One Class Sizes (unchanged, unquantified risk)

The Government will consider providing more teachers to further reduce Year 1 class sizes in future budgets. Any future increase in teachers for this purpose would decrease the operating balance and increase gross debt, but the precise costs have yet to be quantified as the phasing has yet to be determined.

Education (Tertiary) – Tertiary Education Institutions – Capital Injections (unchanged, unquantified risk)

The Government may consider making loans or capital injections to tertiary education institutions where ongoing educational provision or financial viability are at risk.

The Government may also consider making capital injections to tertiary education institutions when a strategic investment to support the development of their infrastructure is warranted.

The provision of capital injections would increase gross debt, but the precise impact is unclear as it would depend on progress made by institutions in managing their pressures, and on decisions taken by Government.

Education (Tertiary) – Tertiary Student Support Changes (unchanged, unquantified risk)

The Government is considering increasing eligibility for student allowances over the parliamentary term. The impact of these changes would reduce the operating balance and increase gross debt, but the quantum is unclear as it would depend upon the options chosen.

Budget 2007 provided around \$29 million in operating funding and around \$16 million in capital savings over the forecast period to inflation adjust the student allowance personal income threshold, increase the student allowance parental income threshold, expand the Step Up scholarship programme, and strengthen the Ngāriumu VC and 28th Māori Battalion Memorial Scholarships.

Further proposals to increase eligibility for student allowances are likely to be considered in future budgets.

Environment – Purchase of Kyoto Compliant Emission Units (new, unquantified risk)

The forecasts currently include a provision for New Zealand's forecast liability under the Kyoto Protocol. The Government has taken a decision to finance part of this liability through the purchase of Kyoto-compliant emission units on the international market. This risk is unquantified as disclosure would harm the Crown in commercial negotiations. This would increase gross debt.

Finance – Crown Overseas Properties (unchanged, unquantified risk)

The Government is considering options relating to the continued use of certain Crown overseas properties.

The risk is unquantified as disclosure could compromise any negotiations the Crown may enter, but any additional operating funding would decrease the operating balance, and/or any additional capital funding would increase gross debt.

Finance – National Rail Access Agreement Amendments (unchanged, unquantified risk)

The Government is considering options for amending the National Rail Access Agreement between Toll and ONTRACK. Any impact on the operating balance or gross debt would depend on the option chosen.

This risk is unquantified as disclosure could compromise the Crown in negotiations.

Finance – National Rail Network – Obligations of Rail Agreement (changed, quantified risk)

Upgrade of National Rail Network

The Government has committed significant expenditure to upgrade and renew the national rail network. However, additional funding for as-yet un-scoped projects may be required in 2008/09. Beyond this, expenditure of around \$60 to \$70 million per annum may also be required from 2008/09 to 2011/12 for renewals, with additional funding on top of this for upgrades, but the exact amount will depend on decisions yet to be made. Under the National Rail Access Agreement, additional funding of this nature would generally be recovered through track access fees. Any additional funding would increase gross debt.

Reconfiguration of Land

The agreement for Sale and Purchase of Rail Network and Associated Assets between the Crown and Toll provides for Toll to reconfigure its operations to enable the release of land it occupies to the Crown (ONTRACK) for other uses. ONTRACK requires funding from the Crown for the reconfiguration costs and the settlement of the land value with Toll. Funding of approximately \$48 million to ONTRACK for land release in 2007/08 was agreed in Budget 2007. Further funding of around \$32 million may be required in 2008/09, with unquantified amounts in years beyond that. The exact amounts of funding will depend on decisions yet to be made, but any additional funding would increase gross debt.

The Minister of Finance has yet to fully consider the quantum of these risks.

Source: The Treasury

Finance – State Owned Enterprise Long-term Hold Reviews (changed, unquantified risk)

To implement its long-term hold ownership policy, the Government has conducted reviews of State-Owned Enterprises (SOEs). These reviews have examined appropriate capital structures to support the strategies of SOEs. One possible outcome of these reviews is that some capital could be returned to the Crown. This may be in the form of a special dividend, which would decrease gross debt.

Fisheries – Māori Interest in Marine Farming (unchanged, unquantified risk)

The Māori Commercial Aquaculture Claims Settlement Act 2004 addresses Māori claims in commercial marine farming space from 21 September 1992 to 31 December 2004 (pre-commencement space) by providing Iwi with 20% equivalent space. This obligation is to be met through three possible options: the provision of additional new space; Crown purchase of existing farms from 2008; or provision of the financial equivalent of space from 2013.

Under the Act, any Māori claim relating to new aquaculture space after 31 December 2004 will be met by the provision of 20% of the new space.

To the extent that financial compensation or Crown purchase of existing farms is necessary to address Māori interests in pre-commencement space (as opposed to using new space), this would decrease the operating balance. This risk is unquantified as the amount or timing of any funding is unclear. In addition, disclosure could compromise the Crown in negotiations with either commercial marine farm owners or Iwi.

Fisheries – Civilian Maritime Aerial Surveillance (unchanged, unquantified risk)

The Government is considering options to provide increased maritime aerial surveillance for civilian agencies in the short to medium range. Options include delivery of a range of different surveillance capabilities by either military or commercial providers. The amount of funding required would depend on the option chosen, if any. Any capital injections required would increase gross debt, while operating funding would decrease the operating balance.

The risk is unquantified as the amount or timing of any funding is unclear.

Foreign Affairs and Trade – Additional Baseline Funding (changed, quantified risk)

The Government is considering funding an additional \$523 million of operating funding and \$98 capital funding related to the ‘Response to Foreign and Trade Policy Changes’ bid, including the opening of new posts. The additional operating funding would decrease the operating balance and associated capital funding would increase gross debt.

The Minister of Finance has yet to fully consider the quantum of this risk.

Source: Ministry of Foreign Affairs and Trade

Health – National Systems Development Programme Tranche 2 (changed, quantified risk)

The Ministry of Health is developing and implementing the National Systems Development Programme (NSDP). NSDP is a four-year information technology project for the central health payment systems and national data collections. The project has been divided into two tranches with a decision on whether to proceed with Tranche 2 expected in July 2008. It is anticipated that implementation of Tranche 2 will require additional capital funding of around \$64 million and operating funding of \$100 million over four years from 2008/09 to 2011/12. \$33 million per annum of the additional operating funding would be required on an ongoing basis. This would decrease the operating balance and increase gross debt.

The Minister of Finance has yet to fully consider the quantum of this risk.

Source: Ministry of Health

Health – Indicative Funding for Budgets 2008, 2009 and 2010 (unchanged, quantified risk)

The Government is considering indicative operating allocations of \$750 million, \$800 million and \$850 million for Budgets 2008, 2009 and 2010 respectively. These amounts indicate the likely level of increased funding to be provided to Vote Health in future budgets and to assist the Minister of Health to plan spending priorities over the period. The final allocations will depend on economic and fiscal conditions at the time of each budget. Finalising the amounts and details of how these allocations will be spent will be subject to normal budget processes. This would decrease the operating balance.

The Government has also agreed that the indicative allocation for Budget 2008 above may be pre-committed up to \$53 million per annum in 2010/11 and outyears. This was shown in the Charges against Future Budgets section of this chapter. The operating balance would be decreased by the totals as follows:

| Budget to be Charged (\$million) | 2008/09 | 2009/10 | 2010/11 | 2011/12 and Outyears |
|---|----------------|----------------|----------------|-----------------------------|
| Budget 2008 | 716 | 702 | 697 | 697 |
| Budget 2009 | - | 800 | 800 | 800 |
| Budget 2010 | - | - | 850 | 850 |

The Minister of Finance has yet to fully consider the quantum of this risk.

Source: Ministry of Health

Health – District Health Board Deficits (changed, unquantified risk)

District Annual Plans from Whanganui, West Coast, Southland (draft) and Capital and Coast District Health Boards (DHBs) indicate projected operating deficits in 2007/08. The Government does not view DHB deficits as acceptable and cost containment strategies are in place.

Any deficits would potentially decrease the operating balance and/or increase gross debt. Specific potential pressures for DHBs include wage bargaining and financing costs of capital projects.

This risk has changed since the 2007 Budget Economic and Fiscal Update to take into account the new projections of DHB deficits.

Health – Strengthening Child and Adolescent Oral Health Services (unchanged, unquantified risk)

The Government has agreed to provide capital funding to District Health Boards for new infrastructure for strengthening child and adolescent oral health services. This capital investment is likely to result in additional operating expenditure, which may be sought from funding to be agreed in Budget 2008. This would decrease the operating balance.

Housing – Rural Housing (new, quantified risk)

The Government is considering a new model for the future delivery of essential repairs to houses as part of the Rural Housing Programme. Funding for the current model for the delivery of essential repairs finishes in 2007/08. The cost of fully implementing the new model would be between \$15 and \$20 million per annum over the next five years. This would have the effect of decreasing the operating balance.

The Minister of Finance has yet to fully consider the quantum of this risk.

Source: Department of Building and Housing

Housing – Shared Equity Home Ownership (unchanged, quantified risk)

The Government is considering a two year shared equity pilot. While the fiscal impacts would depend on the final size of the pilot, the capital outlay required would be approximately \$30 million per annum and the operating expenditure would be approximately \$1 million per annum for the duration of the pilot, plus an unknown amount in subsequent years to maintain the loans. This would have the effect of decreasing the operating balance and increasing gross debt.

The Minister of Finance has yet to fully consider the quantum of this risk.

Source: Department of Building and Housing

Housing – Wellington City Council Social Housing Assistance (unchanged, quantified risk)

The Government has agreed to provide the Wellington City Council with a conditional grant of \$220 million over an investment period of 10 to 15 years (representing approximately \$150 million in net present value terms) to upgrade its social housing portfolio. It is currently in negotiations with the Council about the details of the assistance, including the spread of the funding. The conditional grant would decrease the operating balance.

The Minister of Finance has yet to fully consider the quantum of this risk.

Source: Department of Building and Housing

Housing – Tamaki (new, unquantified risk)

The Government is considering a wider urban development in Tamaki as part of progress to integrated urban communities. Any additional capital funding would increase gross debt.

Immigration – New Immigration Service Delivery Strategy (changed, unquantified risk)

The Government is in the process of developing options for a new immigration service delivery strategy that would allow better management of the risk surrounding immigration decision-making and delivering immigration services. Options are still being developed, and are likely to be considered early in 2008. A portion of the additional funding is expected to be funded by third party revenue and the rest would reduce the operating balance and increase gross debt.

Justice – Financial Action Taskforce Recommendations (new, unquantified risk)

In order to implement the recommendations of the Financial Action Task Force, the Government is considering a new anti-money laundering and counter terrorist financing regime. Increased supervision and enforcement is expected to result in increased costs to the following agencies: the Reserve Bank, the Securities Commission, the Department of Internal Affairs, the Financial Intelligence Unit of the New Zealand Police and the Ministry of Justice. This risk is unquantified as costs are still being finalised but would reduce the operating balance.

Justice – Strengthening the National Court Infrastructure (unchanged, unquantified risk)

The Government is considering options to ensure that Christchurch’s court facilities are able to adequately deliver court and associated justice services to the region. This risk is unquantified as disclosure could compromise any commercial property negotiations the Crown may enter into. Any additional operating funding would decrease the operating balance and any additional capital would increase gross debt.

Justice Sector Agencies – Potential Flow-on Impact of Extra Police (unchanged, quantified risk)

The addition of 1,000 Police will result in additional activity in other justice sector agencies (eg, the Ministry of Justice and the Department of Corrections). Excluding the costs associated with additional prison beds, the Government estimates additional operating costs of \$119 million over the forecast period with an ongoing cost of \$34 million per annum, and capital cost of \$19 million over the forecast period. This would decrease the operating balance and increase gross debt.

The Minister of Finance has yet to fully consider the quantum of this risk.

Source: Ministry of Justice

Justice Sector and Other Agencies – Effective Interventions (unchanged, quantified risk)

As part of a comprehensive approach to reducing crime and the pressures on the prison population, the Government is considering measures to address the precursors of crime, and measures to reduce re-offending. The measures focus on early interventions for vulnerable children, youth offending, restorative justice, preventing crime in local communities, reintegrating offenders, and drug and alcohol treatment for offenders.

Funding of \$37 million per annum was approved in 2006. Further operating funding to implement the approach could be up to \$150 million per annum, depending on the specific options chosen. This would decrease the operating balance.

The Minister of Finance has yet to fully consider the quantum of this risk.

Source: Ministry of Justice

Justice – Greater Auckland Region Service Delivery Strategy (new, unquantified risk)

The Government is considering a strategy to address the need for additional Courts in the greater Auckland region. A wide range of stakeholders are currently being consulted over a variety of service delivery options. Any impact on the operating balance or gross debt will depend on the options chosen.

Courthouses - establishing specialist and purpose-built jury courthouses - establishing a service centre to deal with customer enquiries and process bulk work - moving to electronic filing and an electronic court record - moving file storage offsite to a specialist external provider - establishing a Community Justice Centre(s).

Local Government – Response to Rates Inquiry (new, unquantified risk)

The Government is considering its response to the recommendations of the Independent Inquiry into Local Government Rates, which were reported in August 2007. The potential impact on the operating balance and/or gross debt is unknown at this stage, as it would depend on the nature and scope of any measures that are subsequently pursued.

- Many of the Rates Inquiry's recommendations require local government action
- Central government can offer support in some areas, but the sector needs to take responsibility
- The Government will review regulatory settings around user charging and rating powers to ensure councils can make effective use of these tools
- There is no case for generalised central government assistance for local authorities – but the Government will consider optimising its investment in local government through further targeted assistance in the Budget round
- Rates exemptions will not be removed in the short term –but the Government will review them to ensure the Crown is making a fair contribution as a member of local communities, and
- The Government will keep a watching brief on the affordability of rates and consider making some further adjustments to the Rates Rebate Scheme.

Māori Affairs – Māori Business Aotearoa New Zealand (new, unquantified risk)

The Government has decided to establish a new statutory corporation under the Māori Trustee Act 1953, for the purpose of furthering Māori economic development. The new entity is provisionally entitled Māori Business Aotearoa New Zealand (MBANZ). Any new Crown funding contribution to MBANZ over and above those establishment costs that have already been provided for would decrease the operating balance and/or increase gross debt.

National Library – National Library Building Redevelopment (changed, unquantified risk)

The Government is considering funding redevelopment of the National Library building.

This risk remains unquantified as disclosure would compromise the Crown in negotiations, but any additional capital funding would increase gross debt and any additional operating funding would reduce the operating balance.

New Zealand Agency for International Development – Adjustment of Official Development Assistance Fund (new, quantified risk)

The Government has indicated its intention to increase Official Development Assistance (ODA) as a percentage of Gross National Income (GNI) as follows: 0.31% in 2008/09, 0.33% in 2009/10 and 0.35% in 2010/11. The risk relates to changes in forecast GNI between BEFU 2007 and HYEFU 2007. Based on current forecasts funding may need to be increased by \$10 million in 2008/09, \$5 million in 2009/10, and may be able to be reduced by \$5 million in 2010/11. The net impact of these risks would reduce the operating balance.

The Minister of Finance has yet to fully consider the quantum of this risk.

Source: The Treasury

New Zealand Defence Force – Capital Injections (unchanged, quantified risk)

Implementing the Government's decisions on the future structure of the NZDF will involve a series of capital acquisitions across all three armed services and for HQNZDF to achieve the required capability upgrades. The Government has agreed to a capital injection of up to \$1.244 billion over the 10-year period from 2002 to 2012.

Of the \$1.244 billion, \$1.034 billion has been agreed with the remaining \$210 million likely to be required within the forecast period. The actual expenditure profile will depend on the specification and timing of the individual projects, the contracted prices, and the prevailing exchange rate at the time of purchase.

Any further capital injections would increase gross debt.

The Minister of Finance has yet to fully consider the quantum of this risk.

Source: New Zealand Defence Force

New Zealand Defence Force – Sale of Skyhawks and Aermacchi Trainers (unchanged, quantified risk)

As a result of the Government's decisions on the future structure of the NZDF, NZDF has signed an agreement with Tactical Air Services Inc for the sale of the Skyhawks and Aermacchi trainers for US\$110 million. A formal contract has yet to be signed, but proceeds from the sale would decrease gross debt and increase the operating balance.

The Minister of Finance has yet to fully consider the quantum of this risk.

Source: New Zealand Defence Force

Police – Wage Negotiations (unchanged, unquantified risk)

The Police collective employment agreements expire on 30 June 2008. The Government will be entering into negotiations with police service organisations to settle new collective employment agreements prior to the expiration date of the current agreements. Any

additional funding would decrease the operating balance. This risk is unquantified as disclosure may compromise the Crown in negotiations.

Police – Increases to Police Staff (changed, quantified risk)

The Government has committed to funding an additional 1,000 sworn Police and 250 non-sworn Police staff over Budgets 2006 to 2008. The Government will consider further increases in future Budgets with a view to achieving police officer ratios comparable with those of Australia by 2010. Budget 2007 included \$49 million per annum operating in outyears; and \$10 million capital over the forecast period to provide for the second tranche of additional police (including 90 non-sworn staff and some associated infrastructure costs). The Government intends to roll out the third tranche in Budget 2008. The indicative operating costs are \$42 million in 2008/09 and \$45 million in 2009/10 and out years. Indicative capital costs associated with the third tranche are \$54 million. Additional capital injections would increase gross debt and additional operating funding would decrease the operating balance.

The Minister of Finance has yet to fully consider the quantum of this risk.

Source: New Zealand Police

Police – International Deployment Capability (unchanged, quantified risk)

The Government is considering options to ensure that the New Zealand Police has sufficient capability to manage requests for assistance overseas. The funding required depends on the quantity of personnel and the funding structure associated with the option chosen, but could be in the order of \$30 million operating per annum. Any additional operating funding would decrease the operating balance.

The Minister of Finance has yet to fully consider the quantum of this risk.

Source: New Zealand Police

Prime Minister and Cabinet – Government House Wellington Refurbishment (new, unquantified risk)

The Government is considering options around the refurbishment of Government House Wellington. Options are currently being developed, and decisions on the preferred option and funding are likely to be made in early 2008. Depending on the option chosen and funding decision, this would decrease the operating balance and/or increase gross debt.

This risk is unquantified as disclosure could compromise the Crown in commercial negotiations.

Research, Science and Technology – Multi-year Funding Profile (unchanged, quantified risk)

As part of Budget 2006, the Government signalled its broad intention to move towards a medium-term focus for investment in research, science and technology by indicating increases in the order of \$30 million per annum in Budgets 2008 and 2009, subject to the context of each Budget and the Government's overall fiscal strategy. In Budget 2007, there was \$55.5 million of new investment in research, science and technology over the three years from 2007/08 to 2009/10. Further increases would decrease the operating balance.

The Minister of Finance has yet to fully consider the quantum of this risk.

Source: Ministry of Research, Science and Technology

Revenue – Changes to the Petroleum Mining Tax Rules (new, unquantified risk)

The Government is currently considering modifications to the petroleum mining tax rules. The Government has yet to fully consider the quantum of this risk but it is likely to reduce the operating balance. The extent of the impact will depend on the specific proposals finally approved and the details of the legislation.

Revenue – Life Insurance (changed, unquantified risk)

The Government is considering changes to the tax rules in respect of life insurance, including ensuring consistency of the taxation of life insurers' savings products with similar products of other savings vehicles. A discussion document was issued in November 2007 outlining a broad framework for reform of the life insurance tax rules, relating to risk insurance and further integration of life products into the Portfolio Investment Entity (PIE) rules. The Government will be consulting with interested parties on the reforms and as such has not decided on the final details of the reforms. Accordingly, the impact on the operating balance of this second phase cannot yet be quantified.

Revenue – Management of Inland Revenue's Lease Portfolio in Auckland (changed, unquantified risk)

Inland Revenue is currently exploring options for its lease portfolio in Auckland. This risk is unquantified as disclosure could compromise the Crown in negotiations. This would decrease the operating balance.

Revenue – Working for Families Review of Rates (changed, unquantified risk)

Working for Families legislation requires a review of the amounts of the In-Work Tax Credit and Parental Tax Credits to be undertaken no later than June 2008. This review is to assess whether the current rates still meet the policy objectives behind Working For Families. This policy cannot be quantified until the reviews are completed.

Revenue – International Tax Review (unchanged, unquantified risk)

In Budget 2007 the Government announced the major features of the international tax reform package, which would introduce a tax exemption for the active income of Controlled Foreign Companies. Subsequently two issues papers have been released by officials suggesting detailed design features for the new regime. The proposed reform follows the release of a Government discussion document in December 2006. The cost of the reform package is uncertain as many detailed design decisions have yet to be made but it would reduce the operating balance. The international tax reform package is expected to be included in a Bill introduced in May 2008, with the new rules applying from the 2009/10 income year.

Revenue – Rebuild of the Student Loan IT System (unchanged, unquantified risk)

The Government is considering options for redesigning the student loans IT system. This would decrease the operating balance and/or increase gross debt.

Revenue – Reducing Compliance Costs for Small- and Medium-Sized Enterprises (unchanged, unquantified risk)

The Government is considering measures to simplify the tax rules for small- and medium-sized enterprises. A discussion document was issued in late 2007. The potential impact on the operating balance is unknown at this stage, as it would depend on the nature and scope of any measures that are subsequently pursued.

Revenue – Renegotiation of Double Tax Agreements (unchanged, unquantified risk)

A Government discussion document released in December 2006 considered the case for negotiating lower rates of Non-Resident Withholding Tax (NRWT) in New Zealand's Double Tax Agreements (DTAs). Subsequently, it has been announced that the renegotiation of the New Zealand and Australia DTA is expected to commence shortly. Although any effect on the operating balance will depend on the outcome of bilateral treaty negotiations, to the extent that lower rates are agreed, this will likely have the effect of decreasing the operating balance.

Social Development – New Zealand Superannuation and Veteran's Pension (changed, quantified risk)

The Government has ensured that the net married couple rate of New Zealand Superannuation (NZS) applying for the tax year from 1 April 2007 is equivalent to 66% of the net average ordinary time weekly wage (known as the 66% wage floor). This also applies to the Veteran's Pension, which is set at the same rates as NZS. The Government will review each year the level to be set for the following tax year. Under the 2007 Half Year Economic and Fiscal Update (HYEFU) forecasts CPI-indexation of NZS rates is not predicted to be enough to maintain the 66% wage floor. While the impact on the operating balance will depend on the actual CPI and wage statistics that occur, HYEFU forecasts estimate the cost of maintaining the 66% wage floor on 1 April 2008 would reduce the operating balance by approximately \$7 million in 2007/08, \$28 million in 2008/09 and \$22 million in 2009/10.

Social Development – Working New Zealand: Work-focused Support (unchanged, unquantified risk)

Working New Zealand: Work-focused Support is a package of policy and operational changes aimed at simplifying the benefit system and enhancing the opportunities for beneficiaries to participate in the labour market. The first stage has already been implemented and focused on getting services and support in place to help people move into work and stay employed. The Government is considering further options and costs to simplify the benefit system and further support people to stay in work. The next stage will be submitted for consideration in future Budgets. The remaining proposals are still being developed, but any additional funding would decrease the operating balance.

Social Development / Housing – Accommodation Supplement Review (unchanged, unquantified risk)

The Government is reviewing the Accommodation Supplement to assess how well it is performing as an income support and housing assistance policy. If the review identifies a need to adjust the Accommodation Supplement, the Government will consider policy options in future Budgets. While the amounts are unclear and would depend on the policy options chosen, any additional operating funding would decrease the operating balance.

Social Development – Children, Young Persons and their Families Act (new, unquantified risk)

The Government is considering a number of changes to the Children, Young Persons, and Their Families Act 1989. Most of the costs relating to these changes arise from the proposal to increase the age of a young person from 17 to 18. The fiscal impacts would depend on what proposals are finally approved and the details of the legislation. Any additional operating funding would decrease the operating balance and any additional capital would increase gross debt.

Social Development – Youth Court Sentencing Orders (new, quantified risk)

The Government is considering the inclusion of new Youth Court orders in the Children, Young Persons, and Their Families Act 1989. These new Youth Court orders are extended supervision with residents and extended supervision with activity. The estimated cost is approximately \$12 million per annum in operating funding and \$4 million in capital funding. This would have the effect of decreasing the operating balance and increasing debt.

The Minister of Finance has yet to fully consider the quantum of this risk.

Source: Ministry of Social Development

Transport – Regional transport projects (changed, unquantified risk)

The Government is considering funding options for a number of regional transport projects. There is potential for some of these projects to be debt funded and repaid via a regional fuel tax in those regions. This would increase gross debt.

Transport – Cost guarantee for the State Highway Programme (unchanged, unquantified risk)

In Budget 2006 the Government agreed to provide a cost guarantee for a five-year State Highway Construction Programme. In Budget 2007 funding was provided to cover estimated cost escalation in the State Highway Construction Programme between 2006/07 and 2007/08. Decisions on funding for 2008/09 and beyond have been deferred until Budget 2008. Any further funding decisions would increase gross debt and/or decrease the operating balance.

Contingent Liabilities

Contingent liabilities are costs that the Crown will have to face if a particular event occurs. Typically, contingent liabilities consist of guarantees and indemnities, legal disputes and claims, and uncalled capital. The contingent liabilities facing the Crown are a mixture of operating and balance sheet risks, and they can vary greatly in magnitude and likelihood of realisation. In general, if a contingent liability were realised it would reduce the operating balance and net worth, and increase gross sovereign issued debt. However, in the case of contingencies for uncalled capital, the negative impact would be restricted to gross sovereign issued debt.

Where contingent liabilities have arisen as a consequence of legal action being taken against the Crown, the amount shown is the estimation of the possible amount of any award against the Crown. It does not represent either an admission that the claim is valid or an estimation of the amount of any award against the Crown.

Only contingent liabilities involving amounts of over \$10 million are separately disclosed. Contingent liabilities below \$10 million are included in the “other quantifiable contingent liabilities” total. Comparatives have been adjusted where appropriate to align with the disclosure of new “material” contingent liabilities. The total amount of prior years’ contingent liabilities remains unchanged.

Contingent liabilities have been stated as at 31 October 2007, being the latest set of published contingent liabilities.

Details of each of the following contingent liabilities can be accessed from the Treasury website at <http://www.treasury.govt.nz/forecasts/hyefu/2007>

Quantifiable Contingent Liabilities

| Guarantees and indemnities | Status⁷ | (\$ million) |
|--|---------------------------|---------------------|
| Cook Islands – Asian Development Bank loans | Changed | 14 |
| Indemnification of receivers and managers – Terralink Limited | Unchanged | 10 |
| Ministry of Justice – Treaty settlement, tax liabilities | Unchanged | 105 |
| Ministry of Transport – funding guarantee | Unchanged | 10 |
| Guarantees and indemnities of SOEs and Crown entities | Unchanged | 18 |
| Other guarantees and indemnities | Changed | 14 |
| | | 171 |
| Uncalled capital | | |
| Asian Development Bank | Changed | 1,002 |
| Bank for International Settlements | New | 25 |
| European Bank for Reconstruction and Development | Changed | 13 |
| International Bank for Reconstruction and Development | Changed | 1,074 |
| | | 2,114 |
| Legal proceedings and disputes | | |
| Health – legal claims | Changed | 53 |
| Tax in dispute | Changed | 322 |
| Other legal claims against SOEs and Crown entities | Unchanged | 33 |
| Other legal claims | Unchanged | 76 |
| | | 484 |
| Other quantifiable contingent liabilities | | |
| International finance organisations | Changed | 1,531 |
| Ministry of Economic Development – 2011 Rugby World Cup, Eden Park Upgrade | Unchanged | 146 |
| New Zealand Export Credit Office – export guarantees | New | 29 |
| Reserve Bank – demonetised currency | Unchanged | 23 |
| Social Development – claim for judicial review | Changed | 83 |
| Transpower New Zealand Limited | Unchanged | 98 |
| Other quantifiable contingent liabilities of SOEs and Crown entities | Changed | 50 |
| Other quantifiable contingent liabilities | Changed | 54 |
| | | 2,014 |
| Total quantifiable contingent liabilities | | 4,783 |

⁷ Relative to reporting in the 30 June 2007 *Financial Statements of the Government of New Zealand*.

Unquantifiable Contingent Liabilities

| Guarantees and indemnities | Status |
|--|---------------|
| AgriQuality Limited (formerly Asure New Zealand Limited) | Changed |
| At Work Insurance Limited | Unchanged |
| Auckland Rail lease | Unchanged |
| Bona Vacantia property | Unchanged |
| Building Industry Authority | Unchanged |
| District Court Judges, Justices of the Peace, Coroners and Disputes Tribunal | Unchanged |
| Earthquake Commission (EQC) | Unchanged |
| Electricity Corporation of New Zealand Limited (ECNZ) | Unchanged |
| Ministry of Fisheries – indemnity provided for delivery of registry services | Unchanged |
| Genesis Power Ltd (Genesis Energy) | Unchanged |
| Geothermal carbon tax indemnity | Unchanged |
| Housing New Zealand Corporation (HNZC) | Unchanged |
| Indemnities against acts of war and terrorism | Unchanged |
| Maui Partners | Unchanged |
| National Provident Fund | Unchanged |
| New Zealand Railways Corporation | Unchanged |
| Persons exercising investigating powers | Unchanged |
| Ports of Auckland | Unchanged |
| Public Trust | Unchanged |
| State Insurance and Rural Bank – Tax liabilities | Unchanged |
| Synfuels-Waitara Outfall Indemnity | Unchanged |
| Tainui Corporation | Unchanged |
| Toll NZ Ltd – purchase of rail network assets | Changed |
| Other unquantifiable contingent liabilities | |
| Abuse claims | Unchanged |
| Accident Compensation Corporation (ACC) litigations | Changed |
| Environmental liabilities | Changed |
| Rugby World Cup 2011 – joint venture arrangements | Unchanged |
| Treaty of Waitangi claims | Unchanged |
| Treaty of Waitangi claims – settlement relativity payments | Unchanged |
| Other contingencies | |
| Foreshore and seabed | Unchanged |

Generally Accepted Accounting Practice (GAAP) Series Tables

Forecast Financial Statements

These forecasts have been prepared in accordance with the Public Finance Act 1989.

They are based on the accounting policies and assumptions that follow. As with all such assumptions, there is a degree of uncertainty surrounding them. This uncertainty increases as the forecast horizon extends.

The forecasts have been prepared in accordance with the Statement of Responsibility and reflect the judgements and information known at the time they were prepared. They reflect all Government decisions and circumstances communicated to 5 December 2007.

Finalisation dates and key assumptions that underpin the preparation of the GAAP tables are outlined in the Executive Summary on page 15.

Statement of Accounting Policies and Forecast Assumptions

Significant Accounting Policies

These Forecast Financial Statements have been prepared in accordance with the accounting policies expected to be used in the comparable audited actual Financial Statements of the Government.

These Forecast Financial Statements comply with generally accepted accounting policies (GAAP) as required by the Public Finance Act 1989 and have been prepared in accordance with New Zealand equivalents to International Financial Reporting Standards (NZ IFRS), as appropriate for public benefit entities.

All forecasts use the accrual basis of accounting. Forecasts have been prepared for the consolidated financial statements of the government reporting entity, including all entities controlled by the Government (as defined by applicable financial reporting standards).

Changes in Accounting Policies

All policies have been applied on a consistent basis during the forecast period. There have been no changes in accounting policies during the period.

Forecast Policies

These Forecast Financial Statements have been prepared on the basis of Treasury's best professional judgment. Key assumptions used are set out on page 17.

For the purposes of the Forecast Financial Statements, no revaluations of property, plant and equipment are projected beyond the current year.

Detailed Accounting Policies and Forecast Assumptions

The specific accounting and forecasting policies are reproduced in full on Treasury's website at <http://www.treasury.govt.nz/budget/forecasts/hyefu2007/>.

Government Reporting Entity as at 5 December 2007

These forecast financial statements are for the Government reporting entity as specified in section 26Q(4) of the Public Finance Act 1989. This comprises Ministers of the Crown and the following entities:

| Core Crown segment | | |
|--|---|--|
| <p>Departments</p> <p>Agriculture and Forestry Archives New Zealand Building and Housing Conservation Corrections Crown Law Culture and Heritage Customs Defence Economic Development Education Education Review Office Environment Fisheries Food Safety Authority Foreign Affairs and Trade Government Communications Security Bureau Health Inland Revenue Internal Affairs Justice Labour</p> | <p>Departments</p> <p>Land Information New Zealand Māori Development National Library New Zealand Defence Force Office of the Clerk Pacific Island Affairs Parliamentary Counsel Office Parliamentary Service Police Prime Minister and Cabinet Research, Science and Technology Security Intelligence Service Serious Fraud Office Social Development State Services Commission Statistics Transport Treasury Women's Affairs</p> | <p>State-owned enterprises</p> <p>Airways Corporation of New Zealand Limited Animal Control Products Limited AsureQuality Limited Electricity Corporation of New Zealand Limited Genesis Power Limited Kordia Group Limited Landcorp Farming Limited Learning Media Limited Meridian Energy Limited Meteorological Service of New Zealand Limited Mighty River Power Limited New Zealand Post Limited New Zealand Railways Corporation Quotable Value Limited Solid Energy New Zealand Limited Terralink Limited (in liquidation) Timberlands West Coast Limited Transpower New Zealand Limited</p> |
| <p>Others</p> <p>Government Superannuation Fund New Zealand Superannuation Fund Reserve Bank of New Zealand</p> | <p>Offices of Parliament</p> <p>Office of the Controller and Auditor-General Office of the Ombudsmen Parliamentary Commissioner for the Environment</p> | <p>Air New Zealand Limited (included for disclosure purposes as if it were a SOE)</p> |

Crown entities

| | |
|---|---|
| Accident Compensation Corporation | New Zealand Film Commission |
| Accounting Standards Review Board | New Zealand Fire Service Commission |
| Alcohol Advisory Council of New Zealand | New Zealand Historic Places Trust (Pouhere Taonga) |
| Arts Council of New Zealand Toi Aotearoa | New Zealand Lotteries Commission |
| Broadcasting Commission | New Zealand Qualifications Authority |
| Broadcasting Standards Authority | New Zealand Symphony Orchestra |
| Career Services | New Zealand Teachers Council |
| Charities Commission | New Zealand Tourism Board |
| Children's Commissioner | New Zealand Trade and Enterprise |
| Civil Aviation Authority of New Zealand | New Zealand Venture Investment Fund Limited |
| Commerce Commission | Office of Film and Literature Classification |
| Crown Health Financing Agency | Pharmaceutical Management Agency |
| Crown research institutes (9) | Police Complaints Authority |
| District health boards (21) | Privacy Commissioner |
| Drug Free Sport New Zealand | Public Trust |
| Earthquake Commission | Radio New Zealand Limited |
| Electoral Commission | Retirement Commissioner |
| Electricity Commission | School boards of trustees (2,463) |
| Energy Efficiency and Conservation Authority | Securities Commission |
| Environmental Risk Management Authority | Social Workers Registration Board |
| Families Commission | Sport and Recreation New Zealand |
| Foundation for Research, Science and Technology | Standards Council |
| Government Superannuation Fund Authority | Takeovers Panel |
| Guardians of New Zealand Superannuation | Te Reo Whakapuaki Irirangi (Te Māngai Pāho) |
| Health and Disability Commissioner | Te Taura Whiri i te Reo Māori (Māori Language Commission) |
| Health Research Council of New Zealand | Television New Zealand Limited |
| Health Sponsorship Council | Tertiary Education Commission |
| Housing New Zealand Corporation | Tertiary education institutions (31) |
| Human Rights Commission | Testing Laboratory Registration Council |
| Land Transport New Zealand | Transit New Zealand |
| Law Commission | Transport Accident Investigation Commission |
| Legal Services Agency | |
| Maritime New Zealand | |
| Mental Health Commission | |
| Museum of New Zealand Te Papa Tongarewa Board | |
| New Zealand Antarctic Institute | |
| New Zealand Artificial Limb Board | |
| New Zealand Blood Service | |

Crown entity subsidiaries are consolidated by their parents and not listed separately in this table

Organisations named or described in Schedule 4 to the Public Finance Act 1989

| | |
|--|--|
| Agriculture and Marketing Research and Development Trust | New Zealand Lottery Grants Board |
| Asia New Zealand Foundation | Ngāi Tahu Ancillary Claims Trust |
| Fish and game councils (12) | Pacific Co-operation Foundation |
| Leadership Development Centre Trust | Pacific Islands Business Development Trust |
| New Zealand Fish and Game Council | Research and Education Advanced Network New Zealand Limited |
| New Zealand Game Bird Habitat Trust Board | Reserves boards (24) |
| New Zealand Government Property Corporation | Road Safety Trust |
| | Sentencing Council |

Forecast Statement of Financial Performance

for the years ending 30 June

| | | 2007 | 2008 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|------|---------------|---------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| | | | Previous | | | | | |
| | Note | Actual \$m | Budget \$m | Forecast \$m | Forecast \$m | Forecast \$m | Forecast \$m | Forecast \$m |
| Revenue | | | | | | | | |
| Taxation revenue | 1 | 53,023 | 54,173 | 56,639 | 57,492 | 60,498 | 63,407 | 66,495 |
| Other sovereign revenue | 1 | 3,701 | 3,693 | 3,774 | 3,825 | 4,343 | 4,809 | 4,904 |
| Forecast revenue reduction contingency | 1 | - | - | - | (375) | (1,500) | (1,600) | (1,700) |
| Total Revenue Levied through the Crown's Sovereign Power | | 56,724 | 57,866 | 60,413 | 60,942 | 63,341 | 66,616 | 69,699 |
| Sales of goods and services | | 12,357 | 13,253 | 13,004 | 13,859 | 14,566 | 15,216 | 15,876 |
| Interest revenue and dividends | 2 | 2,984 | 3,366 | 3,716 | 3,939 | 3,951 | 4,224 | 4,345 |
| Other revenue | | 2,362 | 2,387 | 2,475 | 2,540 | 2,624 | 2,654 | 2,692 |
| Total Revenue Earned through the Crown's Operations | | 17,703 | 19,006 | 19,195 | 20,338 | 21,141 | 22,094 | 22,913 |
| Total Revenue (excluding gains) | | 74,427 | 76,872 | 79,608 | 81,280 | 84,482 | 88,710 | 92,612 |
| Expenses | | | | | | | | |
| Social assistance and official development assistance | 3 | 16,346 | 17,892 | 18,352 | 18,923 | 19,607 | 20,677 | 21,706 |
| Personnel expenses | 4 | 15,281 | 15,657 | 16,271 | 16,394 | 16,505 | 16,600 | 16,677 |
| Depreciation and amortisation | 5 | 3,338 | 3,296 | 3,459 | 3,643 | 3,818 | 4,010 | 4,199 |
| Other operating expenses | 5 | 27,517 | 28,997 | 28,665 | 29,527 | 29,865 | 30,408 | 30,859 |
| Interest expenses | 6 | 2,893 | 2,748 | 3,255 | 2,842 | 2,768 | 2,942 | 2,973 |
| Insurance expenses | 7 | 3,713 | 3,010 | 3,581 | 3,842 | 4,092 | 4,333 | 4,572 |
| Forecast new operating spending | 8 | - | 314 | 201 | 2,057 | 4,015 | 5,956 | 7,926 |
| Top-down expense adjustment | 8 | - | - | (750) | (275) | (250) | (200) | (150) |
| Total Expenses (excluding losses) | | 69,088 | 71,914 | 73,034 | 76,953 | 80,420 | 84,726 | 88,762 |
| Operating Balance before gains/(losses) | | 5,339 | 4,958 | 6,574 | 4,327 | 4,062 | 3,984 | 3,850 |
| Net gains/(losses) on financial instruments | 9 | 1,569 | 1,377 | 1,873 | 1,431 | 1,539 | 1,781 | 1,984 |
| Net gains/(losses) on non-financial instruments | | 985 | - | (1,237) | 96 | 105 | 102 | 135 |
| Total Gains/(losses) | | 2,554 | 1,377 | 636 | 1,527 | 1,644 | 1,883 | 2,119 |
| Net surplus/(deficit) from associates and joint ventures | | 186 | 96 | 178 | 199 | 218 | 227 | 259 |
| Operating Balance from continuing activities | | 8,079 | 6,431 | 7,388 | 6,053 | 5,924 | 6,094 | 6,228 |
| Gain/(loss) from discontinued operations | | (92) | - | - | - | - | - | - |
| Operating Balance (including minority interest) | | 7,987 | 6,431 | 7,388 | 6,053 | 5,924 | 6,094 | 6,228 |
| Attributable to minority interest | | 12 | - | - | - | - | - | - |
| Operating Balance | 10 | 7,999 | 6,431 | 7,388 | 6,053 | 5,924 | 6,094 | 6,228 |

The accompanying Notes and Accounting policies are an integral part of these Statements.

Forecast Statement of Financial Performance (continued) – Functional Expense Analysis

for the years ending 30 June

| | 2007 | 2008 | 2008 | 2009 | 2010 | 2011 | 2012 |
|--|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| | Actual | Previous | Forecast | Forecast | Forecast | Forecast | Forecast |
| | \$m | Budget | \$m | \$m | \$m | \$m | \$m |
| | | \$m | | | | | |
| Total Crown expenses | | | | | | | |
| By functional classification | | | | | | | |
| Social security and welfare | 20,947 | 21,271 | 21,568 | 22,226 | 22,910 | 23,965 | 25,082 |
| GSF pension expenses | 648 | 629 | 629 | 603 | 568 | 558 | 545 |
| Health | 10,511 | 11,699 | 11,589 | 11,642 | 11,729 | 11,722 | 11,748 |
| Education | 9,887 | 10,321 | 10,550 | 10,578 | 10,590 | 10,701 | 10,796 |
| Core government services | 4,329 | 2,132 | 2,680 | 2,585 | 2,623 | 3,018 | 3,037 |
| Law and order | 2,840 | 3,076 | 3,126 | 3,137 | 3,146 | 3,146 | 3,158 |
| Defence | 1,449 | 1,597 | 1,598 | 1,638 | 1,727 | 1,836 | 1,905 |
| Transport and communications | 6,872 | 7,671 | 7,632 | 7,803 | 8,061 | 8,113 | 8,455 |
| Economic and industrial services | 4,601 | 5,879 | 6,277 | 6,985 | 7,473 | 7,792 | 8,046 |
| Primary services | 1,247 | 1,319 | 1,363 | 1,335 | 1,334 | 1,338 | 1,343 |
| Heritage, culture and recreation | 1,941 | 2,218 | 2,266 | 2,754 | 2,676 | 2,778 | 2,824 |
| Housing and community development | 902 | 961 | 968 | 961 | 968 | 979 | 992 |
| Other | 20 | 79 | 82 | 82 | 82 | 82 | 82 |
| Finance costs | 2,893 | 2,748 | 3,255 | 2,842 | 2,768 | 2,942 | 2,973 |
| Forecast for future new spending | - | 314 | 201 | 2,057 | 4,015 | 5,956 | 7,926 |
| Top-down expense adjustment | - | - | (750) | (275) | (250) | (200) | (150) |
| Total Crown Expenses excluding losses | 69,087 | 71,914 | 73,034 | 76,953 | 80,420 | 84,726 | 88,762 |

Below is an analysis of core Crown expenses by functional classification. Core Crown expenses include expenses incurred by the Crown, Departments, Reserve Bank and the NZS Fund, but not Crown entities and SOEs.

| | | | | | | | |
|---|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| Core Crown expenses | | | | | | | |
| By functional classification | | | | | | | |
| Social security and welfare | 17,214 | 17,698 | 17,914 | 18,315 | 18,744 | 19,554 | 20,426 |
| GSF pension expenses | 648 | 629 | 629 | 603 | 568 | 558 | 545 |
| Health | 10,357 | 11,613 | 11,480 | 11,552 | 11,622 | 11,623 | 11,642 |
| Education | 9,261 | 9,719 | 9,863 | 9,945 | 10,009 | 10,103 | 10,171 |
| Core government services | 4,469 | 2,479 | 2,957 | 2,955 | 3,042 | 3,243 | 3,270 |
| Law and order | 2,748 | 2,836 | 2,910 | 2,913 | 2,904 | 2,901 | 2,903 |
| Defence | 1,529 | 1,641 | 1,641 | 1,683 | 1,771 | 1,880 | 1,950 |
| Transport and communications | 2,275 | 2,792 | 2,784 | 2,849 | 2,726 | 2,717 | 2,946 |
| Economic and industrial services | 1,548 | 2,276 | 2,710 | 2,876 | 3,109 | 3,273 | 3,415 |
| Primary services | 457 | 494 | 527 | 493 | 484 | 480 | 484 |
| Heritage, culture and recreation | 798 | 977 | 1,072 | 1,482 | 1,366 | 1,371 | 1,352 |
| Housing and community development | 275 | 304 | 313 | 283 | 268 | 266 | 265 |
| Other | 68 | 80 | 82 | 82 | 82 | 82 | 82 |
| Finance costs | 2,330 | 2,244 | 2,804 | 2,724 | 2,646 | 2,825 | 2,807 |
| Forecast for future new spending | - | 314 | 201 | 2,057 | 4,015 | 5,956 | 7,926 |
| Top-down expense adjustment | - | - | (750) | (275) | (250) | (200) | (150) |
| Total Core Crown Expenses excluding losses | 53,977 | 56,096 | 57,137 | 60,537 | 63,106 | 66,632 | 70,034 |

The accompanying Notes and Accounting policies are an integral part of these Statements.

Forecast Statement of Cash Flows

for the years ending 30 June

| | 2007 | 2008 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|-----------------|--------------------|-----------------|----------------|----------------|-----------------|----------------|
| | Actual | Previous Budget | Forecast | Forecast | Forecast | Forecast | Forecast |
| | \$m | \$m | \$m | \$m | \$m | \$m | \$m |
| Cash Flows From Operations | | | | | | | |
| Cash was provided from | | | | | | | |
| Taxation receipts | 52,150 | 54,266 | 55,316 | 56,858 | 59,932 | 62,903 | 65,831 |
| Other sovereign receipts | 3,418 | 3,472 | 3,571 | 3,991 | 3,913 | 4,026 | 4,113 |
| Forecast revenue reduction contingency | - | - | - | (375) | (1,500) | (1,600) | (1,700) |
| Sales of goods and services | 12,777 | 13,394 | 13,127 | 14,032 | 14,690 | 15,374 | 16,082 |
| Interest and dividends | 2,533 | 2,760 | 3,467 | 3,610 | 3,599 | 3,849 | 3,958 |
| Other operating receipts | 2,294 | 2,302 | 2,420 | 2,461 | 2,516 | 2,535 | 2,556 |
| Total cash provided from operations | 73,172 | 76,194 | 77,901 | 80,577 | 83,150 | 87,087 | 90,840 |
| Cash was disbursed to | | | | | | | |
| Social assistance and official development assistance | 18,436 | 19,529 | 17,294 | 17,935 | 18,445 | 19,381 | 20,260 |
| Personnel and operating payments | 39,838 | 44,025 | 47,316 | 48,247 | 48,920 | 50,041 | 50,834 |
| Interest payments | 2,442 | 2,530 | 3,052 | 2,730 | 2,742 | 2,820 | 2,912 |
| Forecast for future new spending | - | 314 | 201 | 2,057 | 4,015 | 5,956 | 7,926 |
| Top-down expense adjustment | - | - | (750) | (275) | (250) | (200) | (150) |
| Total cash disbursed to operations | 60,716 | 66,398 | 67,113 | 70,694 | 73,872 | 77,998 | 81,782 |
| Net Cash Flows From Operations | 12,456 | 9,796 | 10,788 | 9,883 | 9,278 | 9,089 | 9,058 |
| Cash Flows From Investing Activities | | | | | | | |
| Cash was provided from/(disbursed to) | | | | | | | |
| Net purchase of physical assets | (5,213) | (6,661) | (6,799) | (5,852) | (6,355) | (6,364) | (5,944) |
| Net purchase of shares and other securities | (8,157) | (4,491) | (6,535) | (1,973) | (1,000) | (4,565) | (84) |
| Net purchase of intangible assets | (206) | (144) | (258) | (178) | (150) | (128) | (139) |
| Net issue/(repayment) of advances | (1,014) | (1,628) | (458) | (762) | (717) | (698) | (666) |
| Net acquisition of investments in associates | (288) | (95) | (335) | (211) | (2) | (20) | (20) |
| Capital contingency provision | - | (184) | - | (1,003) | (773) | (924) | (1,110) |
| Top-down capital adjustment | - | - | 250 | 100 | 100 | 100 | 100 |
| Net Cash Flows From Investing Activities | (14,878) | (13,203) | (14,135) | (9,879) | (8,897) | (12,599) | (7,863) |
| Net Cash Flows From Operating and Investing Activities | (2,422) | (3,407) | (3,347) | 4 | 381 | (3,510) | 1,195 |
| Cash Flows From Financing Activities | | | | | | | |
| Cash was provided from/(disbursed to) | | | | | | | |
| Issues of circulating currency | 81 | 178 | 182 | 177 | 186 | 195 | 205 |
| Net repayment/(issues) of Government stock ¹ | (3,758) | 2,223 | 2,875 | (739) | (1,809) | 2,168 | (1,836) |
| Net repayment of foreign-currency borrowing | 1,780 | (1,130) | (1,624) | (801) | (370) | 366 | 111 |
| Net repayment/(issues) of other New Zealand dollar borrowing | 4,893 | 2,225 | 1,896 | 1,718 | 1,730 | 1,120 | 1,015 |
| Net Cash Flows From Financing Activities | 2,996 | 3,496 | 3,329 | 355 | (263) | 3,849 | (505) |
| Net Movement in Cash | 574 | 89 | (18) | 359 | 118 | 339 | 690 |
| Opening Cash Balance | 3,676 | 3,107 | 4,208 | 4,232 | 4,591 | 4,709 | 5,048 |
| Foreign-exchange (losses)/gains on opening cash | (42) | - | 42 | - | - | - | - |
| Closing Cash Balance | 4,208 | 3,196 | 4,232 | 4,591 | 4,709 | 5,048 | 5,738 |

¹ Net issues of Government stock include movements within government stock holdings of entities such as NZS Fund, ACC and EQC. The Bonds reconciliation at the end of these accounts outlines proceeds and repayments of domestic bonds.

The accompanying Notes and Accounting policies are an integral part of these Statements.

Forecast Statement of Cash Flows (continued)

for the years ending 30 June

| | 2007 | 2008 | 2008 | 2009 | 2010 | 2011 | 2012 |
|--|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| | Actual | Previous | Forecast | Forecast | Forecast | Forecast | Forecast |
| | \$m | Budget | \$m | \$m | \$m | \$m | \$m |
| Reconciliation Between the Net Cash Flows from Operations and the Operating Balance | | | | | | | |
| Net Cash Flows from Operations | 12,456 | 9,796 | 10,788 | 9,883 | 9,278 | 9,089 | 9,058 |
| <i>Items included in the operating balance but not in net cash flows from operations.</i> | | | | | | | |
| Gains/(losses) | | | | | | | |
| Gains/(losses) on financial instruments | 1,569 | 1,377 | 1,873 | 1,431 | 1,539 | 1,781 | 1,984 |
| Gains/(losses) on non-financial instruments | 985 | - | (1,237) | 96 | 105 | 102 | 135 |
| Total Gains/(losses) | 2,554 | 1,377 | 636 | 1,527 | 1,644 | 1,883 | 2,119 |
| Movements in Working Capital | | | | | | | |
| Increase/(decrease) in receivables | 60 | 218 | 1,322 | 96 | 296 | 291 | 208 |
| Increase/(decrease) in inventories | 79 | 41 | 91 | 94 | 32 | (46) | (31) |
| Increase/(decrease) in prepayments | (77) | (2) | (80) | 40 | (9) | (3) | 2 |
| Decrease/(increase) in deferred revenue | (85) | - | 110 | (8) | (1) | 3 | 2 |
| Decrease/(increase) in payables | (1,168) | (569) | (151) | (634) | (251) | 258 | 359 |
| | (1,191) | (312) | 1,292 | (412) | 67 | 503 | 540 |
| Other Non-cash Items in Operating Balance | | | | | | | |
| Depreciation and amortisation | (3,338) | (3,296) | (3,459) | (3,643) | (3,818) | (4,010) | (4,199) |
| Write-down on initial recognition of loans | (2,141) | (518) | (616) | (625) | (646) | (679) | (690) |
| Impairment on financial assets (excl receivables) | 37 | (38) | 3 | 1 | 1 | 1 | 1 |
| Net interest revenue | (131) | 389 | 47 | 217 | 326 | 253 | 327 |
| Decrease/(increase) in defined benefit retirement plan liabilities | 1,147 | (51) | (55) | 7 | 54 | 75 | 102 |
| Decrease/(increase) in insurance liabilities | (1,580) | (1,013) | (1,426) | (1,101) | (1,200) | (1,248) | (1,289) |
| Other | 186 | 97 | 178 | 199 | 218 | 227 | 259 |
| Total Other Non-cash Items | (5,820) | (4,430) | (5,328) | (4,945) | (5,065) | (5,381) | (5,489) |
| Operating Balance | 7,999 | 6,431 | 7,388 | 6,053 | 5,924 | 6,094 | 6,228 |

The accompanying Notes and Accounting policies are an integral part of these Statements.

Forecast Statement of Recognised Income and Expense

for the years ending 30 June

| | 2007 | 2008 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---------------|--------------------|--------------|--------------|--------------|--------------|--------------|
| | Actual | Previous Budget | Forecast | Forecast | Forecast | Forecast | Forecast |
| | \$m | \$m | \$m | \$m | \$m | \$m | \$m |
| Revaluation of physical assets | 5,163 | - | 58 | - | (1) | - | - |
| Effective portion of changes in value of fair-value hedges | (384) | 39 | 173 | 4 | 14 | 5 | 6 |
| Net change in fair value of cash flow hedges transferred to the operating statement | (18) | 74 | 5 | (1) | - | - | - |
| Net change in fair value of cash flow hedges transferred to the hedged item | (4) | - | (23) | - | - | - | - |
| Foreign currency translation differences for foreign operations | (62) | - | 3 | - | - | - | - |
| Valuation gain/(losses) on investments available for sale taken to reserves | 10 | - | 8 | - | - | - | - |
| Other movements | 11 | - | (1) | 1 | 4 | 5 | 1 |
| Total income/(expense) recognised directly in Net Worth | 4,716 | 113 | 223 | 4 | 17 | 10 | 7 |
| Operating Balance (including minority interest) | 7,987 | 6,431 | 7,388 | 6,053 | 5,924 | 6,094 | 6,228 |
| Total recognised income and expense | 12,703 | 6,544 | 7,611 | 6,057 | 5,941 | 6,104 | 6,235 |
| Attributable to: | | | | | | | |
| - minority interest | (12) | - | - | - | - | - | - |
| - the Crown | 12,715 | 6,544 | 7,611 | 6,057 | 5,941 | 6,104 | 6,235 |
| Total recognised income and expense | 12,703 | 6,544 | 7,611 | 6,057 | 5,941 | 6,104 | 6,235 |

This statement reports changes in net worth due to the operating balance, items of income or expense that are recognised directly in net worth, the effect of certain accounting changes and corrections of errors .

The accompanying Notes and Accounting policies are an integral part of these Statements.

Forecast Statement of Financial Position

as at 30 June

| | | 2007 | 2008 | 2008 | 2009 | 2010 | 2011 | 2012 |
|--|------|----------------|---------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| | Note | Actual \$m | Previous Budget \$m | Forecast \$m | Forecast \$m | Forecast \$m | Forecast \$m | Forecast \$m |
| Assets | | | | | | | | |
| Cash and cash equivalents | 11 | 4,208 | 3,196 | 4,232 | 4,591 | 4,709 | 5,048 | 5,738 |
| Receivables | 11 | 12,029 | 12,547 | 13,352 | 13,447 | 13,744 | 14,034 | 14,242 |
| Marketable securities and derivatives in gain | 11 | 29,831 | 32,885 | 35,601 | 36,759 | 37,465 | 42,166 | 41,956 |
| Share investments | 11 | 13,827 | 17,273 | 15,601 | 17,284 | 18,787 | 20,117 | 22,213 |
| Advances | 11 | 14,031 | 15,087 | 16,424 | 18,899 | 21,404 | 21,957 | 22,453 |
| Inventory | | 823 | 982 | 914 | 1,008 | 1,040 | 994 | 963 |
| Prepayments and other assets | | 1,309 | 1,205 | 1,338 | 1,547 | 1,640 | 1,739 | 1,865 |
| Property, plant & equipment | 13 | 95,613 | 95,950 | 98,662 | 100,884 | 103,537 | 106,081 | 108,138 |
| Equity accounted investments ¹ | | 6,921 | 6,647 | 7,518 | 7,899 | 8,155 | 8,427 | 8,715 |
| Intangible assets and goodwill | | 1,653 | 1,555 | 1,794 | 1,786 | 1,776 | 1,717 | 1,915 |
| Forecast for new capital spending | | - | 184 | - | 1,003 | 1,756 | 2,680 | 3,790 |
| Top-down capital adjustment | | - | (200) | (250) | (350) | (450) | (550) | (650) |
| Total Assets | | 180,245 | 187,311 | 195,186 | 204,757 | 213,563 | 224,410 | 231,338 |
| Liabilities | | | | | | | | |
| Issued currency | | 3,444 | 3,730 | 3,625 | 3,802 | 3,988 | 4,184 | 4,389 |
| Payables | 15 | 8,103 | 9,036 | 8,334 | 8,492 | 8,557 | 8,535 | 8,492 |
| Deferred revenue | | 978 | 845 | 868 | 876 | 877 | 874 | 872 |
| Borrowings | | 41,914 | 46,364 | 46,363 | 47,956 | 49,351 | 53,106 | 52,434 |
| Insurance liabilities | 16 | 17,419 | 19,011 | 19,677 | 20,777 | 21,977 | 23,225 | 24,514 |
| Retirement plan liabilities | 17 | 7,160 | 8,414 | 7,479 | 7,497 | 7,475 | 7,424 | 7,328 |
| Provisions | 18 | 4,523 | 3,850 | 4,525 | 4,985 | 5,025 | 4,645 | 4,657 |
| Total Liabilities | | 83,541 | 91,250 | 90,871 | 94,385 | 97,250 | 101,993 | 102,686 |
| Total Assets less Total Liabilities | | 96,704 | 96,061 | 104,315 | 110,372 | 116,313 | 122,417 | 128,652 |
| Net Worth | | | | | | | | |
| Taxpayer funds | 19 | 44,169 | 48,239 | 51,555 | 57,609 | 63,538 | 69,637 | 75,866 |
| Revaluation reserve | 19 | 52,371 | 47,402 | 52,429 | 52,429 | 52,428 | 52,428 | 52,428 |
| Other reserves | 19 | (132) | 127 | 35 | 38 | 51 | 56 | 62 |
| Total Net Worth attributable to the Crown | | 96,408 | 95,768 | 104,019 | 110,076 | 116,017 | 122,121 | 128,356 |
| Net worth attributable to minority interest | | 296 | 293 | 296 | 296 | 296 | 296 | 296 |
| Total Net Worth | | 96,704 | 96,061 | 104,315 | 110,372 | 116,313 | 122,417 | 128,652 |

¹ Tertiary education institutions constitute most equity accounted investments.

The accompanying Notes and Accounting policies are an integral part of these Statements.

Forecast Statement of Borrowings

for the years ending 30 June

| | 2007 Actual \$m | 2008 Previous Budget \$m | 2008 Forecast \$m | 2009 Forecast \$m | 2010 Forecast \$m | 2011 Forecast \$m | 2012 Forecast \$m |
|---|-----------------------|-----------------------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|
| Borrowings | | | | | | | |
| Government stock | 15,778 | 17,732 | 18,240 | 17,737 | 16,004 | 18,379 | 16,765 |
| Treasury bills | 2,098 | 2,786 | 2,776 | 2,578 | 2,578 | 2,578 | 2,578 |
| Government retail stock | 364 | 358 | 379 | 377 | 377 | 377 | 377 |
| Settlement Cash with Reserve Bank | 7,507 | 7,523 | 7,894 | 7,894 | 7,894 | 7,894 | 7,894 |
| Derivatives in loss ¹ | 1,126 | 300 | 422 | 311 | 341 | 368 | 397 |
| Finance lease liabilities | 954 | 958 | 959 | 950 | 942 | 938 | 933 |
| Other borrowings | 14,087 | 16,707 | 15,693 | 18,109 | 21,215 | 22,572 | 23,490 |
| Total Borrowings² | 41,914 | 46,364 | 46,363 | 47,956 | 49,351 | 53,106 | 52,434 |
| Total Sovereign-Guaranteed Debt ³ | 31,174 | 33,167 | 33,682 | 32,881 | 31,145 | 33,409 | 31,534 |
| Total Non-Sovereign Debt | 10,740 | 13,197 | 12,681 | 15,075 | 18,206 | 19,697 | 20,900 |
| Total Borrowings² | 41,914 | 46,364 | 46,363 | 47,956 | 49,351 | 53,106 | 52,434 |
| Gross and Net Debt analysis: | | | | | | | |
| Total Borrowings ² | 41,914 | 46,364 | 46,363 | 47,956 | 49,351 | 53,106 | 52,434 |
| Core Crown borrowings | 35,885 | 38,876 | 38,845 | 38,435 | 37,020 | 39,611 | 38,053 |
| Add back NZS Fund holdings of sovereign-issued debt and NZS Fund borrowings | 912 | 1,524 | 752 | 893 | 1,053 | 1,249 | 1,413 |
| Gross sovereign-issued debt⁴ | 36,797 | 40,400 | 39,597 | 39,328 | 38,073 | 40,860 | 39,466 |
| Less Reserve Bank Settlement Cash | (7,507) | (7,523) | (7,894) | (7,894) | (7,894) | (7,894) | (7,894) |
| Add back changes to DMO borrowing due to settlement cash ⁵ | 1,600 | 1,600 | 1,600 | 1,600 | 1,600 | 1,600 | 1,600 |
| Gross sovereign-issued debt excluding Reserve Bank Settlement Cash | 30,890 | 34,477 | 33,303 | 33,034 | 31,779 | 34,566 | 33,172 |
| Less core Crown financial assets ⁶ | 44,909 | 51,184 | 52,699 | 55,552 | 57,618 | 63,850 | 65,880 |
| Net Core Crown debt (incl. NZS Fund)⁷ | (8,112) | (10,784) | (13,102) | (16,224) | (19,545) | (22,990) | (26,414) |
| Add back NZS Fund financial assets | 12,523 | 15,439 | 15,085 | 17,980 | 21,250 | 24,782 | 28,519 |
| Net Core Crown Debt (excl. NZS Fund)⁸ | 4,411 | 4,655 | 1,983 | 1,756 | 1,705 | 1,792 | 2,105 |

Notes on Borrowings

- Derivatives are included in either borrowings or marketable securities, deposits and equity investments depending on their value at balance date. This treatment leads to fluctuations in individual items within the Statement of Borrowings, primarily due to exchange rate movements.
- Total Borrowings (Gross Debt) is the total borrowings (both sovereign-guaranteed and non-sovereign guaranteed) of the total Crown. This equates to the amount in the total Crown balance sheet and represents the complete picture of whole-of-Crown debt obligations to external parties.
- Total Borrowings (Gross Debt) can be split into sovereign-guaranteed and non-sovereign-guaranteed debt. This split reflects the fact that borrowings by SOEs and Crown entities is not explicitly guaranteed by the Crown. No debt of SOEs and Crown entities is currently guaranteed by the Crown.
- Gross sovereign-issued debt is debt issued by the sovereign (i.e., core Crown) and includes Government stock held by the NZS Fund, ACC or EQC for example. In other words, the total sovereign-issued debt does not eliminate any internal cross-holdings held by these entities.
- The Reserve Bank has used \$1.6b of settlement cash to purchase reserves that were to have been funded by DMO borrowing. Therefore the impact of Settlement Cash on GSID is adjusted by this amount.
- Core Crown financial assets exclude receivables.
- Net core Crown debt is the Government Sovereign issued debt less financial assets. This can provide information about the sustainability of the Government's accounts, and is used by some international agencies when determining the credit-worthiness of a country. However, as some financial assets are not easily converted into cash, and some are restricted, it is important to view net debt alongside gross sovereign-issued debt.
- Adding back the NZ Superannuation Fund Assets provides the financial liabilities less financial assets of the Core Crown, excluding those assets set aside to meet part of the future cost of New Zealand superannuation.

The accompanying Notes and Accounting policies are an integral part of these Statements.

Statement of Actual Commitments

as at 31 October

| | As at 31 Oct 2007 \$m | As at 30 June 2007 \$m |
|--|--------------------------------|---------------------------------|
| Capital Commitments | | |
| Specialist military equipment | 590 | 823 |
| Land and buildings | 721 | 605 |
| Other property, plant and equipment | 2,707 | 2,617 |
| Other capital commitments | 190 | 184 |
| Tertiary Education Institutions | 90 | 90 |
| Total Capital Commitments | 4,298 | 4,319 |
| Operating Commitments | | |
| Non-cancellable accommodation leases | 2,250 | 2,296 |
| Other non-cancellable leases | 2,320 | 2,355 |
| Non-cancellable contracts for the supply of goods and services | 1,650 | 1,626 |
| Other operating commitments | 7,586 | 7,278 |
| Tertiary Education Institutions | 303 | 303 |
| Total Operating Commitments | 14,109 | 13,858 |
| Total Commitments | 18,407 | 18,177 |
| Total Commitments by Institutional Segment | | |
| Core Crown | 16,701 | 19,944 |
| Crown entities | 10,115 | 9,835 |
| State-owned enterprises | 3,526 | 3,508 |
| Inter-segment eliminations | (11,935) | (15,110) |
| Total Commitments | 18,407 | 18,177 |

Statement of Actual Contingent Liabilities and Assets

as at 31 October

| | As at 31 Oct 2007 \$m | As at 30 June 2007 \$m |
|---|--------------------------------|---------------------------------|
| Quantifiable Contingent Liabilities | | |
| Guarantees and indemnities | 171 | 171 |
| Uncalled capital | 2,114 | 2,076 |
| Legal proceedings and disputes | 484 | 1,170 |
| Other contingent liabilities | 2,014 | 1,829 |
| Total Quantifiable Contingent Liabilities | 4,783 | 5,246 |
| Total Quantifiable Contingent Liabilities by Institutional Segment | | |
| Core Crown | 4,575 | 5,071 |
| Crown entities | 44 | 45 |
| State-owned enterprises | 184 | 150 |
| Inter-segment eliminations | (20) | (20) |
| Total Quantifiable Contingent Liabilities | 4,783 | 5,246 |
| Quantifiable Contingent Assets | | |
| Core Crown | 89 | 86 |
| Crown entities | 5 | - |
| Total Quantifiable Contingent Assets | 94 | 86 |

The accompanying Notes and Accounting policies are an integral part of these Statements.

A detailed Statement of Contingent Liabilities and Assets (quantified and unquantified) is outlined on pages 108 to 110 of the Specific Fiscal Risk chapter.

The Statement of Specific Risks (quantified and unquantified) is outlined on pages 93 to 107 of the Specific Fiscal Risk chapter.

Notes to the Forecast Financial Statements

| | 2007 Actual \$m | 2008 Previous Budget \$m | 2008 Forecast \$m | 2009 Forecast \$m | 2010 Forecast \$m | 2011 Forecast \$m | 2012 Forecast \$m |
|--|-----------------------|-----------------------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|
| NOTE 1: Revenue Collected Through the Crown's Sovereign Power | | | | | | | |
| Taxation Revenue (accrual) | | | | | | | |
| Individuals | | | | | | | |
| PAYE | 20,987 | 22,334 | 22,578 | 23,978 | 25,409 | 27,086 | 28,733 |
| Other persons | 4,440 | 4,553 | 5,120 | 5,360 | 5,535 | 5,788 | 6,014 |
| Refunds | (1,080) | (1,102) | (1,175) | (1,180) | (1,282) | (1,289) | (1,323) |
| Fringe benefit tax | 468 | 474 | 519 | 523 | 547 | 574 | 598 |
| Total Individuals | 24,815 | 26,259 | 27,042 | 28,681 | 30,209 | 32,159 | 34,022 |
| Corporate Tax | | | | | | | |
| Gross companies tax | 8,808 | 8,222 | 9,174 | 7,587 | 8,298 | 8,499 | 8,957 |
| Refunds | (296) | (255) | (310) | (300) | (300) | (300) | (300) |
| Non-resident withholding tax | 1,189 | 1,005 | 1,268 | 1,311 | 1,290 | 1,211 | 1,266 |
| Foreign-source dividend w/holding payments | 149 | 102 | 93 | 77 | 77 | 77 | 77 |
| Total Corporate Tax | 9,850 | 9,074 | 10,225 | 8,675 | 9,365 | 9,487 | 10,000 |
| Other Income Tax | | | | | | | |
| Resident w/holding tax on interest income | 2,227 | 2,340 | 2,554 | 2,809 | 2,873 | 2,904 | 2,988 |
| Resident w/holding tax on dividend income | 89 | 92 | 87 | 100 | 234 | 280 | 282 |
| Estate and gift duties | 2 | 2 | 3 | 3 | 3 | 3 | 3 |
| Total Other Income Tax | 2,318 | 2,434 | 2,644 | 2,912 | 3,110 | 3,187 | 3,273 |
| Total Income Tax | 36,983 | 37,767 | 39,911 | 40,268 | 42,684 | 44,833 | 47,295 |
| Goods and Services Tax | | | | | | | |
| Gross goods and services tax | 19,533 | 19,726 | 20,174 | 21,295 | 22,244 | 23,313 | 24,195 |
| Refunds | (8,325) | (8,231) | (8,390) | (9,201) | (9,714) | (10,208) | (10,649) |
| Total Goods and Services Tax | 11,208 | 11,495 | 11,784 | 12,094 | 12,530 | 13,105 | 13,546 |
| Other Indirect Taxation | | | | | | | |
| Petroleum fuels excise | 819 | 903 | 885 | 904 | 908 | 910 | 953 |
| Tobacco excise | 238 | 148 | 138 | 148 | 150 | 153 | 155 |
| Customs duty | 1,836 | 1,865 | 1,870 | 1,902 | 1,950 | 2,027 | 2,121 |
| Road user charges | 786 | 877 | 875 | 964 | 1,021 | 1,081 | 1,086 |
| Alcohol excise | 553 | 586 | 579 | 609 | 639 | 669 | 700 |
| Gaming duties | 230 | 215 | 238 | 245 | 252 | 258 | 266 |
| Motor vehicle fees | 222 | 219 | 219 | 221 | 226 | 232 | 233 |
| Energy resources levies | 54 | 34 | 48 | 44 | 44 | 44 | 44 |
| Approved issuer levy and cheque duty | 94 | 64 | 92 | 93 | 94 | 95 | 96 |
| Total Other Indirect Taxation | 4,832 | 4,911 | 4,944 | 5,130 | 5,284 | 5,469 | 5,654 |
| Total Indirect Taxation | 16,040 | 16,406 | 16,728 | 17,224 | 17,814 | 18,574 | 19,200 |
| Total Taxation Revenue | 53,023 | 54,173 | 56,639 | 57,492 | 60,498 | 63,407 | 66,495 |
| Other Sovereign Revenue (accrual) | | | | | | | |
| ACC levies | 2,667 | 2,654 | 2,712 | 2,722 | 2,803 | 2,876 | 2,956 |
| Fire Service levies | 265 | 261 | 283 | 248 | 281 | 283 | 285 |
| EQC levies | 84 | 86 | 85 | 87 | 89 | 91 | 93 |
| Other miscellaneous items | 685 | 692 | 694 | 768 | 1,170 | 1,559 | 1,570 |
| Total Other Sovereign Revenue | 3,701 | 3,693 | 3,774 | 3,825 | 4,343 | 4,809 | 4,904 |
| Forecast revenue reduction contingency | - | - | - | (375) | (1,500) | (1,600) | (1,700) |
| Total Sovereign Revenue | 56,724 | 57,866 | 60,413 | 60,942 | 63,341 | 66,616 | 69,699 |

Notes to the Forecast Financial Statements

| | 2007 | 2008 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---------------|--------------------|---------------|---------------|---------------|---------------|---------------|
| | Actual | Previous Budget | Forecast | Forecast | Forecast | Forecast | Forecast |
| | \$m | \$m | \$m | \$m | \$m | \$m | \$m |
| NOTE 1 (continued): Receipts Collected Through the Crown's Sovereign Power | | | | | | | |
| Income Tax Receipts (cash) | | | | | | | |
| Individuals | | | | | | | |
| PAYE | 21,012 | 22,334 | 22,527 | 23,924 | 25,354 | 27,031 | 28,678 |
| Other persons | 5,121 | 5,430 | 5,905 | 6,268 | 6,559 | 6,771 | 7,025 |
| Refunds | (1,850) | (2,017) | (2,217) | (2,325) | (2,405) | (2,430) | (2,494) |
| Fringe benefit tax | 482 | 470 | 490 | 515 | 540 | 566 | 590 |
| Total Individuals | 24,765 | 26,217 | 26,705 | 28,382 | 30,048 | 31,938 | 33,799 |
| Corporate Tax | | | | | | | |
| Gross companies tax | 9,120 | 9,184 | 9,619 | 8,213 | 8,817 | 8,974 | 9,195 |
| Refunds | (1,153) | (1,041) | (1,211) | (1,057) | (1,023) | (925) | (834) |
| Non-resident withholding tax | 1,135 | 981 | 1,229 | 1,276 | 1,257 | 1,241 | 1,280 |
| Foreign-source dividend w/holding payments | 141 | 102 | 93 | 77 | 77 | 77 | 77 |
| Total Corporate Tax | 9,243 | 9,226 | 9,730 | 8,509 | 9,128 | 9,367 | 9,718 |
| Other Income Tax | | | | | | | |
| Resident w/holding tax on interest income | 2,192 | 2,340 | 2,558 | 2,811 | 2,875 | 2,906 | 2,990 |
| Resident w/holding tax on dividend income | 90 | 92 | 84 | 100 | 234 | 280 | 282 |
| Estate and gift duties | 3 | 2 | 3 | 3 | 3 | 3 | 3 |
| Total Other Income Tax | 2,285 | 2,434 | 2,645 | 2,914 | 3,112 | 3,189 | 3,275 |
| Total Income Tax | 36,293 | 37,877 | 39,080 | 39,805 | 42,288 | 44,494 | 46,792 |
| Goods and Services Tax | | | | | | | |
| Gross goods and services tax | 18,691 | 19,354 | 19,443 | 20,731 | 21,681 | 22,755 | 23,641 |
| Refunds | (7,625) | (7,877) | (8,156) | (8,808) | (9,321) | (9,815) | (10,256) |
| Total Goods and Services Tax | 11,066 | 11,477 | 11,287 | 11,923 | 12,360 | 12,940 | 13,385 |
| Other Indirect Taxation | | | | | | | |
| Petroleum fuels excise | 835 | 903 | 885 | 904 | 908 | 910 | 953 |
| Tobacco excise | 265 | 148 | 138 | 148 | 150 | 153 | 155 |
| Customs duty | 1,778 | 1,865 | 1,870 | 1,902 | 1,950 | 2,027 | 2,121 |
| Road user charges | 791 | 877 | 875 | 964 | 1,021 | 1,081 | 1,086 |
| Alcohol excise | 549 | 586 | 579 | 609 | 639 | 669 | 700 |
| Gaming duties | 236 | 215 | 238 | 245 | 252 | 258 | 266 |
| Motor vehicle fees | 208 | 219 | 219 | 221 | 226 | 232 | 233 |
| Energy resources levies | 55 | 35 | 53 | 44 | 44 | 44 | 44 |
| Approved issuer levy and cheque duty | 74 | 64 | 92 | 93 | 94 | 95 | 96 |
| Total Other Indirect Taxation | 4,791 | 4,912 | 4,949 | 5,130 | 5,284 | 5,469 | 5,654 |
| Total Indirect Taxation | 15,857 | 16,389 | 16,236 | 17,053 | 17,644 | 18,409 | 19,039 |
| Total Tax Receipts Collected | 52,150 | 54,266 | 55,316 | 56,858 | 59,932 | 62,903 | 65,831 |
| Other Sovereign Receipts (cash) | | | | | | | |
| ACC levies | 2,607 | 2,561 | 2,610 | 2,989 | 2,888 | 2,984 | 3,055 |
| Fire Service levies | 268 | 263 | 271 | 278 | 283 | 285 | 287 |
| EQC levies | 84 | 86 | 86 | 88 | 90 | 91 | 93 |
| Other miscellaneous items | 459 | 562 | 604 | 636 | 652 | 666 | 678 |
| Total Other Sovereign Receipts | 3,418 | 3,472 | 3,571 | 3,991 | 3,913 | 4,026 | 4,113 |
| Forecast revenue reduction contingency | - | - | - | (375) | (1,500) | (1,600) | (1,700) |
| Total Sovereign Receipts | 55,568 | 57,738 | 58,887 | 60,474 | 62,345 | 65,329 | 68,244 |

Notes to the Forecast Financial Statements

| | 2007 | 2008 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|--------------|--------------------|--------------|--------------|--------------|--------------|--------------|
| | Actual | Previous Budget | Forecast | Forecast | Forecast | Forecast | Forecast |
| | \$m | \$m | \$m | \$m | \$m | \$m | \$m |
| NOTE 2: Interest Revenue and Dividends | | | | | | | |
| <i>By type</i> | | | | | | | |
| Interest revenue | 2,540 | 2,865 | 3,201 | 3,328 | 3,245 | 3,422 | 3,440 |
| Dividends | 444 | 501 | 515 | 611 | 706 | 802 | 905 |
| Total Interest Revenue and Dividends | 2,984 | 3,366 | 3,716 | 3,939 | 3,951 | 4,224 | 4,345 |
| <i>By source</i> | | | | | | | |
| NZ Superannuation Fund | 396 | 425 | 504 | 611 | 725 | 849 | 981 |
| Other core Crown | 2,184 | 2,162 | 2,486 | 2,848 | 2,725 | 2,890 | 3,017 |
| Crown entities | 746 | 880 | 920 | 952 | 999 | 1,043 | 1,099 |
| State-owned enterprises | 484 | 481 | 493 | 236 | 266 | 264 | 272 |
| Inter-segment eliminations | (826) | (582) | (687) | (708) | (764) | (822) | (1,024) |
| Total Interest Revenue and Dividends | 2,984 | 3,366 | 3,716 | 3,939 | 3,951 | 4,224 | 4,345 |

NOTE 3: Social Assistance and Official Development Assistance

| | | | | | | | |
|--|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| New Zealand superannuation | 6,810 | 7,292 | 7,343 | 7,719 | 8,178 | 8,712 | 9,378 |
| Domestic purposes benefit | 1,468 | 1,456 | 1,466 | 1,482 | 1,508 | 1,537 | 1,575 |
| Unemployment benefit | 613 | 497 | 458 | 437 | 449 | 450 | 471 |
| Invalids benefit | 1,132 | 1,201 | 1,195 | 1,250 | 1,306 | 1,357 | 1,406 |
| Family support | 1,699 | 1,964 | 2,023 | 1,934 | 1,930 | 2,032 | 2,016 |
| Accommodation supplement | 877 | 909 | 885 | 906 | 927 | 946 | 972 |
| Sickness benefit | 573 | 608 | 600 | 607 | 610 | 608 | 608 |
| Student allowances | 382 | 402 | 397 | 409 | 417 | 424 | 430 |
| Disability allowances | 270 | 279 | 279 | 290 | 303 | 315 | 330 |
| KiwiSaver | - | 501 | 834 | 981 | 1,155 | 1,290 | 1,440 |
| Other social assistance benefits | 2,192 | 2,382 | 2,460 | 2,482 | 2,331 | 2,443 | 2,518 |
| Total Social assistance | 16,016 | 17,491 | 17,939 | 18,496 | 19,114 | 20,114 | 21,143 |
| Official development assistance | 330 | 401 | 413 | 427 | 493 | 563 | 563 |
| Total Social Assistance and Official Development Assistance | 16,346 | 17,892 | 18,352 | 18,923 | 19,607 | 20,677 | 21,706 |

ACC payments are now classified as insurance expenses under NZ IFRS (refer note 7).

NOTE 4: Personnel Expenses

| | | | | | | | |
|---------------------------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| Core Crown | 5,113 | 5,434 | 5,579 | 5,558 | 5,476 | 5,528 | 5,542 |
| Crown entities | 8,160 | 8,213 | 8,579 | 8,646 | 8,774 | 8,760 | 8,769 |
| State-owned enterprises | 2,012 | 2,011 | 2,117 | 2,194 | 2,259 | 2,317 | 2,371 |
| Inter-segment eliminations | (4) | (1) | (4) | (4) | (4) | (5) | (5) |
| Total Personnel Expenses | 15,281 | 15,657 | 16,271 | 16,394 | 16,505 | 16,600 | 16,677 |

NOTE 5: Operating Expenses

| | | | | | | | |
|---------------------------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| Core Crown | 30,079 | 30,102 | 30,847 | 31,441 | 31,500 | 31,733 | 32,092 |
| Crown entities | 13,480 | 15,291 | 14,396 | 14,285 | 14,188 | 14,326 | 14,382 |
| State-owned enterprises | 8,283 | 9,180 | 9,012 | 9,704 | 10,248 | 10,568 | 10,871 |
| Inter-segment eliminations | (20,987) | (22,280) | (22,131) | (22,260) | (22,253) | (22,209) | (22,287) |
| Total operating expenses | 30,855 | 32,293 | 32,124 | 33,170 | 33,683 | 34,418 | 35,058 |

Notes to the Forecast Financial Statements

| | 2007 Actual \$m | 2008 Previous Budget \$m | 2008 Forecast \$m | 2009 Forecast \$m | 2010 Forecast \$m | 2011 Forecast \$m | 2012 Forecast \$m |
|---|-----------------------|-----------------------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|
| NOTE 6: Interest Expenses | | | | | | | |
| <i>By type</i> | | | | | | | |
| Interest on financial liabilities | 2,876 | 2,335 | 3,125 | 2,717 | 2,646 | 2,814 | 2,796 |
| Interest unwind on provisions | 17 | 413 | 130 | 125 | 122 | 128 | 177 |
| Total interest expenses | 2,893 | 2,748 | 3,255 | 2,842 | 2,768 | 2,942 | 2,973 |
| <i>By source</i> | | | | | | | |
| Core Crown | 2,330 | 2,245 | 2,804 | 2,723 | 2,646 | 2,825 | 2,807 |
| Crown entities | 274 | 306 | 296 | 303 | 302 | 296 | 308 |
| State-owned Enterprises | 685 | 704 | 724 | 422 | 449 | 472 | 529 |
| Inter-segment eliminations | (396) | (507) | (569) | (606) | (629) | (651) | (671) |
| Total interest expenses | 2,893 | 2,748 | 3,255 | 2,842 | 2,768 | 2,942 | 2,973 |
| NOTE 7: Insurance Expenses | | | | | | | |
| <i>By type</i> | | | | | | | |
| ACC payments | 1,967 | 2,016 | 2,216 | 2,447 | 2,593 | 2,771 | 2,966 |
| Other insurance expenses | 1,746 | 994 | 1,365 | 1,395 | 1,499 | 1,562 | 1,606 |
| Total insurance expenses | 3,713 | 3,010 | 3,581 | 3,842 | 4,092 | 4,333 | 4,572 |
| NOTE 8: Forecast New Operating Spending | | | | | | | |
| New operating spending up to Budget 2008 | - | 314 | 201 | 240 | 340 | 397 | 397 |
| Forecast for future new spending | - | - | - | 1,817 | 3,675 | 5,559 | 7,529 |
| Total forecast new operating spending | - | 314 | 201 | 2,057 | 4,015 | 5,956 | 7,926 |
| Top-down expense adjustment | - | - | (750) | (275) | (250) | (200) | (150) |
| New operating spending up to Budget 2008 represents expenses included in Budget 2007 that have yet to be allocated. | | | | | | | |
| Forecast new operating spending indicates in broad terms the potential spending increases that could be introduced in each future remaining budget round. As some of this spending has already been allocated to the Defence funding package, this line represents the unallocated portion. Total potential spending increases included in the forecasts are \$2 billion for the next four Budgets. | | | | | | | |
| NOTE 9: Gains and losses on financial instruments | | | | | | | |
| <i>By source</i> | | | | | | | |
| Core Crown | 1,180 | 1,155 | 1,424 | 1,188 | 1,324 | 1,533 | 1,687 |
| Crown entities | 369 | 485 | 633 | 558 | 544 | 592 | 640 |
| State-owned enterprises | 62 | 18 | 75 | (52) | (62) | (73) | (71) |
| Inter-segment eliminations | (42) | (281) | (259) | (263) | (267) | (271) | (272) |
| Net gains/(losses) on financial instruments | 1,569 | 1,377 | 1,873 | 1,431 | 1,539 | 1,781 | 1,984 |
| NOTE 10: Source of Operating Balance | | | | | | | |
| Core Crown | 6,498 | 4,464 | 6,206 | 4,166 | 4,089 | 4,395 | 4,489 |
| Crown entities | 1,006 | 1,242 | 580 | 1,135 | 968 | 938 | 901 |
| State-owned enterprises | 821 | 1,068 | 986 | 1,125 | 1,251 | 1,173 | 1,368 |
| Inter-segment eliminations | (326) | (343) | (384) | (373) | (384) | (412) | (530) |
| Total Operating Balance | 7,999 | 6,431 | 7,388 | 6,053 | 5,924 | 6,094 | 6,228 |

Notes to the Forecast Financial Statements

| | 2007 | 2008 | 2008 | 2009 | 2010 | 2011 | 2012 |
|--|---------------|--------------------|---------------|---------------|---------------|----------------|----------------|
| | Actual | Previous Budget | Forecast | Forecast | Forecast | Forecast | Forecast |
| | \$m | \$m | \$m | \$m | \$m | \$m | \$m |
| NOTE 11: Financial Assets | | | | | | | |
| Cash and cash equivalents | 4,208 | 3,196 | 4,232 | 4,591 | 4,709 | 5,048 | 5,738 |
| Tax receivables | 6,371 | 7,078 | 7,226 | 7,369 | 7,441 | 7,452 | 7,606 |
| Trade and other receivables | 5,658 | 5,469 | 6,126 | 6,078 | 6,303 | 6,582 | 6,636 |
| Student loans (refer note 12) | 6,011 | 6,252 | 6,478 | 6,989 | 7,489 | 7,967 | 8,407 |
| Kiwibank mortgages | 3,637 | 5,127 | 5,751 | 7,622 | 9,552 | 9,552 | 9,552 |
| Long-term deposits | 2,052 | 2,037 | 2,260 | 2,375 | 2,468 | 2,565 | 2,630 |
| Reserve position at the IMF | 183 | 212 | 166 | 156 | 146 | 135 | 124 |
| Other loans | 2,148 | 1,459 | 1,769 | 1,757 | 1,749 | 1,738 | 1,740 |
| Share investments | 13,827 | 17,273 | 15,601 | 17,284 | 18,787 | 20,117 | 22,213 |
| Derivatives in gain | 2,349 | 464 | 785 | 559 | 469 | 392 | 333 |
| Other marketable securities | 27,482 | 32,421 | 34,816 | 36,200 | 36,996 | 41,774 | 41,623 |
| Total Financial Assets | 73,926 | 80,988 | 85,210 | 90,980 | 96,109 | 103,322 | 106,602 |
| Financial assets by portfolio | | | | | | | |
| Reserve Bank and DMO managed funds | 22,577 | 26,013 | 27,488 | 26,672 | 25,001 | 27,087 | 24,926 |
| NZ Superannuation Fund | 12,576 | 15,439 | 15,169 | 18,289 | 21,715 | 25,400 | 29,258 |
| Other core Crown | 14,622 | 14,311 | 14,928 | 15,528 | 16,027 | 16,471 | 16,993 |
| Intra-segment eliminations | (952) | (1,536) | (781) | (1,018) | (1,398) | (1,752) | (2,007) |
| Total Core Crown | 48,823 | 54,227 | 56,804 | 59,471 | 61,345 | 67,206 | 69,170 |
| ACC portfolio | 10,588 | 11,695 | 12,071 | 12,892 | 13,710 | 14,486 | 15,186 |
| EQC portfolio | 1,920 | 2,174 | 2,075 | 2,266 | 2,474 | 2,702 | 2,954 |
| Other Crown entities | 4,064 | 3,670 | 4,145 | 4,275 | 4,494 | 4,670 | 4,763 |
| Total Crown Entities | 16,572 | 17,539 | 18,291 | 19,433 | 20,678 | 21,858 | 22,903 |
| Total State-Owned Enterprises | 8,531 | 9,222 | 10,115 | 12,076 | 14,086 | 14,258 | 14,529 |
| Total Financial Assets by portfolio | 73,926 | 80,988 | 85,210 | 90,980 | 96,109 | 103,322 | 106,602 |
| NOTE 12: Student Loans | | | | | | | |
| Nominal value (including accrued interest) | 9,413 | 9,983 | 10,078 | 10,785 | 11,477 | 12,143 | 12,771 |
| Opening book value | 5,298 | 5,761 | 6,011 | 6,478 | 6,989 | 7,489 | 7,967 |
| Fair value writedown on new borrowings | (538) | (526) | (507) | (534) | (557) | (581) | (603) |
| Amount borrowed in the year | 1,176 | 1,278 | 1,250 | 1,317 | 1,375 | 1,433 | 1,489 |
| Repayments made during the year | (555) | (621) | (594) | (620) | (693) | (776) | (872) |
| Interest unwind | 774 | 391 | 394 | 425 | 454 | 482 | 508 |
| Impairment | (151) | (31) | (85) | (87) | (89) | (90) | (92) |
| Other movements | 7 | - | 9 | 10 | 10 | 10 | 10 |
| Closing book value | 6,011 | 6,252 | 6,478 | 6,989 | 7,489 | 7,967 | 8,407 |

Notes to the Forecast Financial Statements

| | 2007 Actual \$m | 2008 Previous Budget \$m | 2008 Forecast \$m | 2009 Forecast \$m | 2010 Forecast \$m | 2011 Forecast \$m | 2012 Forecast \$m |
|---|-----------------------|-----------------------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|
| NOTE 13: Property, Plant and Equipment | | | | | | | |
| <i>By Class of asset</i> | | | | | | | |
| Net Carrying Value | | | | | | | |
| Land (valuation) | 21,138 | 18,963 | 20,793 | 21,050 | 21,333 | 21,340 | 21,297 |
| Buildings (valuation) | 20,824 | 21,349 | 21,841 | 21,941 | 21,914 | 22,026 | 21,992 |
| Electricity distribution network (cost) | 1,972 | 2,219 | 2,085 | 2,384 | 2,864 | 3,521 | 4,059 |
| Electricity generation assets (valuation) | 10,401 | 10,057 | 11,177 | 12,155 | 13,259 | 14,047 | 14,706 |
| Aircraft (ex SME) (valuation) | 2,092 | 2,064 | 1,890 | 1,772 | 1,614 | 2,174 | 2,898 |
| State highways (valuation) | 19,417 | 19,415 | 20,137 | 20,841 | 21,387 | 21,938 | 22,565 |
| Rail network (valuation) | 10,570 | 10,804 | 10,783 | 11,112 | 11,560 | 11,873 | 12,073 |
| Specialist military equipment (valuation) | 3,116 | 3,628 | 3,197 | 3,152 | 3,169 | 2,955 | 2,566 |
| Other plant and equipment (cost) | 3,691 | 5,882 | 4,425 | 4,120 | 4,058 | 3,805 | 3,557 |
| Specified cultural and heritage assets (valuation) | 2,392 | 1,569 | 2,334 | 2,357 | 2,379 | 2,402 | 2,425 |
| Total Property, Plant & Equipment | 95,613 | 95,950 | 98,662 | 100,884 | 103,537 | 106,081 | 108,138 |
| NOTE 14: NZ Superannuation Fund | | | | | | | |
| Revenue | 434 | 447 | 555 | 685 | 819 | 963 | 1,117 |
| Other expenses | 127 | 110 | 123 | 154 | 185 | 216 | 249 |
| Tax expenses | 733 | 349 | 276 | 336 | 399 | 470 | 545 |
| Gains/(losses) | 1,520 | 867 | 761 | 923 | 1,097 | 1,283 | 1,482 |
| Operating Balance | 1,094 | 855 | 917 | 1,118 | 1,332 | 1,560 | 1,805 |
| Opening net worth | 9,855 | 12,910 | 12,973 | 15,993 | 19,488 | 23,140 | 27,016 |
| Gross contribution from the Crown | 2,049 | 2,103 | 2,103 | 2,376 | 2,321 | 2,316 | 2,281 |
| Income after tax | 1,094 | 964 | 917 | 1,118 | 1,332 | 1,560 | 1,805 |
| Other movements in reserves | (25) | - | - | 1 | (1) | - | - |
| Closing Net Worth | 12,973 | 15,977 | 15,993 | 19,488 | 23,140 | 27,016 | 31,102 |
| <i>comprising:</i> | | | | | | | |
| Financial assets | 12,576 | 15,439 | 15,169 | 18,289 | 21,715 | 25,400 | 29,258 |
| Net other assets | 397 | 538 | 824 | 1,199 | 1,425 | 1,616 | 1,844 |
| Closing Net Worth | 12,973 | 15,977 | 15,993 | 19,488 | 23,140 | 27,016 | 31,102 |
| Reconciliation Core Crown to Core Crown excluding NZSF | | | | | | | |
| Core Crown revenue | 58,174 | 59,402 | 62,409 | 63,496 | 65,832 | 69,458 | 72,740 |
| Less NZSF revenue | 434 | 447 | 555 | 685 | 819 | 963 | 1,117 |
| Add back NZSF tax | 733 | 349 | 276 | 336 | 399 | 470 | 545 |
| Core Crown revenue excluding NZSF | 58,473 | 59,304 | 62,130 | 63,147 | 65,412 | 68,965 | 72,168 |
| Core Crown expenses | 53,977 | 56,095 | 57,137 | 60,537 | 63,106 | 66,632 | 70,034 |
| Less NZSF expenses | 119 | 110 | 110 | 138 | 167 | 197 | 229 |
| Core Crown expenses excluding NZSF | 53,858 | 55,985 | 57,027 | 60,399 | 62,939 | 66,435 | 69,805 |
| Core Crown OBEGAL (excluding net NZSF revenue) | 4,615 | 3,319 | 5,103 | 2,748 | 2,473 | 2,530 | 2,363 |
| NOTE 15: Payables | | | | | | | |
| Accounts payable | 4,924 | 5,556 | 5,177 | 5,335 | 5,400 | 5,378 | 5,335 |
| Taxes repayable | 3,179 | 3,480 | 3,157 | 3,157 | 3,157 | 3,157 | 3,157 |
| Total Payables | 8,103 | 9,036 | 8,334 | 8,492 | 8,557 | 8,535 | 8,492 |

Notes to the Forecast Financial Statements

| | 2007 | 2008 | 2008 | 2009 | 2010 | 2011 | 2012 |
|--|--------|----------|----------|----------|----------|----------|----------|
| | Actual | Previous | Forecast | Forecast | Forecast | Forecast | Forecast |
| | \$m | Budget | \$m | \$m | \$m | \$m | \$m |

NOTE 16: Insurance liabilities

| | | | | | | | |
|------------------------------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| ACC liability | 17,328 | 18,949 | 19,594 | 20,694 | 21,892 | 23,139 | 24,427 |
| EQC liability | 68 | 42 | 69 | 70 | 71 | 72 | 73 |
| Other insurance liabilities | 23 | 20 | 14 | 13 | 14 | 14 | 14 |
| Total Insurance Liabilities | 17,419 | 19,011 | 19,677 | 20,777 | 21,977 | 23,225 | 24,514 |

ACC liability

Calculation information

PricewaterhouseCoopers Actuarial Pty Ltd have prepared an independent actuarial estimate of the ACC outstanding claims liability as at 30 June 2007. This estimate includes the expected future payments relating to accidents that occurred prior to balance date (whether or not the associated claims have been reported to, or accepted by, ACC) and also the expected future administrative expenses of managing these claims.

The key economic variables that impact on changes to the valuation are the long-term Labour Cost Index (LCI), average weekly earnings and the discount rate of 6.10% (6.61% at 30 June 2007). Other key variables in each valuation are the forecast increases in claim costs over and above the economic variables above, and the assumed rate at which long-term claimants will leave the scheme over the period. This assessment is largely based on scheme history.

Presentation approach

The projected outstanding claims liability is included within total liabilities. ACC has available to it a portfolio of assets that partially offset the claims liability. The assets (less cross holdings of NZ Government stock) are included in the asset portion of the Crown's overall Statement of Financial Position.

Gross ACC liability

| | | | | | | | |
|-------------------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| Opening gross liability | 15,761 | 17,924 | 17,328 | 19,594 | 20,694 | 21,892 | 23,139 |
| Net change | 1,567 | 1,025 | 2,266 | 1,100 | 1,198 | 1,247 | 1,288 |
| Closing gross liability | 17,328 | 18,949 | 19,594 | 20,694 | 21,892 | 23,139 | 24,427 |

Less net assets available to ACC

| | | | | | | | |
|-------------------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| Opening net asset value | 10,298 | 11,724 | 11,757 | 13,362 | 14,327 | 15,254 | 16,136 |
| Net change | 1,459 | 1,024 | 1,605 | 965 | 927 | 882 | 800 |
| Closing net asset value | 11,757 | 12,748 | 13,362 | 14,327 | 15,254 | 16,136 | 16,936 |

Net ACC reserves (net liability)

| | | | | | | | |
|---|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Opening reserves position | (5,463) | (6,200) | (5,571) | (6,232) | (6,367) | (6,638) | (7,003) |
| Net change | (108) | (1) | (661) | (135) | (271) | (365) | (488) |
| Closing reserves position (net liability) | (5,571) | (6,201) | (6,232) | (6,367) | (6,638) | (7,003) | (7,491) |

Notes to the Forecast Financial Statements

| | 2007 | 2008 | 2008 | 2009 | 2010 | 2011 | 2012 |
|--|--------|--------------------|----------|----------|----------|----------|----------|
| | Actual | Previous Budget | Forecast | Forecast | Forecast | Forecast | Forecast |
| | \$m | \$m | \$m | \$m | \$m | \$m | \$m |

NOTE 17: Retirement Plan Liabilities

| | | | | | | | |
|--|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Government Superannuation Fund | 7,160 | 8,402 | 7,204 | 7,197 | 7,143 | 7,068 | 6,966 |
| Other funds | - | 12 | 275 | 300 | 332 | 356 | 362 |
| Total Retirement Plan Liabilities | 7,160 | 8,414 | 7,479 | 7,497 | 7,475 | 7,424 | 7,328 |

The net liability of the Government Superannuation Fund (GSF), as at 31 October (the valuation date), has been calculated by the Government Actuary for inclusion within the 2007 Half Year Update. The GSF net liability arises from closed schemes for past and present public sector employees (set out in the GSF Act 1956). The Projected Unit Credit Method, based on 31 October 2007 membership data, was used for the valuation. This method requires the benefits payable from the GSF in respect of past service to be calculated and then discounted back to the valuation date.

The projected GSF net liability included in the 2007 Half Year Update was calculated using discount rates derived from the market yield curve as at 31 October 2007. This resulted in long-term before-tax discount rates ranging from 7.19% in 2008 to 6.10% in 2016 and beyond. The principal long-term financial assumptions used in the calculation were an inflation rate of 2.25% and an annual salary increases rate, before any promotional effects, of 3.0%.

The 2007/08 projected movement in the net liability is \$44 million, reflecting an increase in the GSF liability of \$126 million offset by an increase in the GSF assets of \$82 million.

The increase in the projected GSF liability of \$126 million includes an actuarial loss of \$326 million at 31 October 2007, of which \$21 million resulted from experience adjustments with the balance due to a change in discount rate assumptions on valuation date. The remainder of the increase in the GSF liability is the net of the current service cost, interest cost and benefits paid to members.

The increase in the projected GSF assets of \$82 million includes an actuarial gain of \$33 million at 31 October 2007. The increase in GSF assets is due to the net of expected investments returns, contributions received by the GSF and benefits paid to members.

The changes in the projected GSF net liability from 2007/08 onwards reflects the net of the expected current service cost, interest cost, investment returns and contributions.

GSF net defined benefit retirement liability

GSF liability

| | | | | | | | |
|-----------------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| Opening GSF liability | 12,098 | 12,365 | 11,167 | 11,293 | 11,359 | 11,373 | 11,362 |
| Net projected change | (931) | 158 | 126 | 66 | 14 | (11) | (44) |
| Closing GSF liability | 11,167 | 12,523 | 11,293 | 11,359 | 11,373 | 11,362 | 11,318 |

Less net assets available to GSF

| | | | | | | | |
|--|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Opening net asset value | 3,799 | 4,014 | 4,007 | 4,089 | 4,162 | 4,230 | 4,294 |
| Investment valuation changes | 354 | 225 | 227 | 230 | 235 | 239 | 242 |
| Contribution and other income less membership payments | (146) | (118) | (145) | (157) | (167) | (175) | (184) |
| Closing net asset value | 4,007 | 4,121 | 4,089 | 4,162 | 4,230 | 4,294 | 4,352 |

Net GSF liability

| | | | | | | | |
|----------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Opening unfunded liability | 8,299 | 8,351 | 7,160 | 7,204 | 7,197 | 7,143 | 7,068 |
| Net projected change | (1,139) | 51 | 44 | (7) | (54) | (75) | (102) |
| Net liability | 7,160 | 8,402 | 7,204 | 7,197 | 7,143 | 7,068 | 6,966 |

Notes to the Forecast Financial Statements

| | 2007 | 2008 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---------------|--------------------|---------------|---------------|---------------|---------------|---------------|
| | Actual | Previous Budget | Forecast | Forecast | Forecast | Forecast | Forecast |
| | \$m | \$m | \$m | \$m | \$m | \$m | \$m |
| NOTE 18: Provisions | | | | | | | |
| Provision for Kyoto | 704 | 557 | 956 | 956 | 956 | 956 | 956 |
| Provision for National Provident Fund guarantee | 771 | 805 | 771 | 771 | 771 | 771 | 771 |
| Provision for employee entitlements | 1,819 | 1,621 | 1,668 | 1,658 | 1,674 | 1,660 | 1,666 |
| Other provisions | 1,229 | 867 | 1,130 | 1,600 | 1,624 | 1,258 | 1,264 |
| Total Provisions | 4,523 | 3,850 | 4,525 | 4,985 | 5,025 | 4,645 | 4,657 |
| Analysis of Provision for Kyoto | | | | | | | |
| Opening balance | 656 | 557 | 704 | 956 | 956 | 956 | 956 |
| Additional provisions made in the year | 48 | - | 252 | - | - | - | - |
| Closing balance | 704 | 557 | 956 | 956 | 956 | 956 | 956 |
| NOTE 19: Changes in Net Worth | | | | | | | |
| Opening taxpayers funds | 36,214 | 42,219 | 44,169 | 51,555 | 57,609 | 63,538 | 69,637 |
| Operating balance excluding minority interest | 7,999 | 6,431 | 7,388 | 6,053 | 5,924 | 6,094 | 6,228 |
| Transfers from/(to) other reserves | (44) | (411) | (2) | 1 | 5 | 5 | 1 |
| Closing Taxpayers Funds | 44,169 | 48,239 | 51,555 | 57,609 | 63,538 | 69,637 | 75,866 |
| Opening revaluation reserve | 47,153 | 47,459 | 52,371 | 52,429 | 52,429 | 52,428 | 52,428 |
| Net revaluations | 5,163 | 2 | 58 | - | (1) | - | - |
| Transfers from/(to) other reserves | 55 | (59) | - | - | - | - | - |
| Closing Revaluation Reserve | 52,371 | 47,402 | 52,429 | 52,429 | 52,428 | 52,428 | 52,428 |
| Opening other reserves | 326 | 93 | (132) | 35 | 38 | 51 | 56 |
| Net movements | (458) | 34 | 167 | 3 | 13 | 5 | 6 |
| Closing Other Reserves | (132) | 127 | 35 | 38 | 51 | 56 | 62 |

Notes to the Forecast Financial Statements

| | 2007 | 2008 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|----------------|--------------------|----------------|--------------|----------------|----------------|----------------|
| | Actual | Previous Budget | Forecast | Forecast | Forecast | Forecast | Forecast |
| | \$m | \$m | \$m | \$m | \$m | \$m | \$m |
| NOTE 20: Reconciliation of core Crown operating cash flows to residual core Crown cash | | | | | | | |
| Core Crown Cash Flows from Operations | | | | | | | |
| Total tax receipts | 53,271 | 55,120 | 56,212 | 57,764 | 61,072 | 64,105 | 67,232 |
| Total other sovereign receipts | 391 | 477 | 514 | 544 | 561 | 574 | 586 |
| Forecast revenue reduction contingency | - | - | - | (375) | (1,500) | (1,600) | (1,700) |
| Interest, profits and dividends | 1,896 | 1,857 | 2,351 | 2,713 | 2,567 | 2,725 | 2,842 |
| Sale of goods & services and other receipts | 1,461 | 1,472 | 1,566 | 1,543 | 1,515 | 1,526 | 1,542 |
| Subsidies and transfer payments | (17,317) | (18,789) | (18,930) | (19,613) | (20,305) | (21,302) | (22,208) |
| Personnel and operating costs | (28,912) | (32,611) | (33,119) | (33,156) | (33,087) | (33,297) | (33,712) |
| Finance costs | (2,220) | (2,176) | (2,647) | (2,709) | (2,691) | (2,747) | (2,772) |
| Forecast for future new operating spending | - | (314) | (201) | (2,057) | (4,015) | (5,956) | (7,926) |
| Top-down expense adjustment | - | - | 750 | 275 | 250 | 200 | 150 |
| Net Cash Flows from core Crown Operations | 8,570 | 5,036 | 6,496 | 4,929 | 4,367 | 4,228 | 4,034 |
| Net purchase of physical assets | (1,760) | (1,802) | (2,023) | (1,197) | (1,270) | (1,049) | (986) |
| Net increase in advances | (1,743) | (1,087) | (1,323) | (856) | (756) | (837) | (659) |
| Net purchase of investments | (366) | (637) | (538) | (360) | (126) | (53) | (35) |
| Contribution to NZ Superannuation Fund | (2,048) | (2,103) | (2,103) | (2,376) | (2,321) | (2,316) | (2,281) |
| Purchase of Reserve Bank reserves | - | (200) | - | - | - | - | - |
| Forecast for future new capital spending | - | (184) | - | (1,003) | (773) | (924) | (1,110) |
| Top-down capital adjustment | - | - | 250 | 100 | 100 | 100 | 100 |
| Residual Cash | 2,653 | (977) | 759 | (763) | (779) | (851) | (937) |
| Financed by: | | | | | | | |
| Other net sale/(purchase) of marketable securities and deposits | (5,926) | (1,651) | (4,506) | 871 | 1,781 | (1,934) | 2,435 |
| Total Operating and Investing Activities | (3,273) | (2,628) | (3,747) | 108 | 1,002 | (2,785) | 1,498 |
| Used in: | | | | | | | |
| Net repayment/(issue) of other New Zealand-dollar borrowing | 4,963 | 710 | 2,203 | 402 | 267 | 25 | 303 |
| Net repayment/(issue) of foreign currency borrowing | 1,775 | (993) | (1,495) | (630) | (205) | (53) | (499) |
| Issues of circulating currency | 81 | 178 | 182 | 177 | 186 | 195 | 205 |
| Decrease/(increase) in cash | (458) | 3 | 185 | (34) | 9 | (135) | (279) |
| | 6,361 | (102) | 1,075 | (85) | 257 | 32 | (270) |
| Net Cash Inflow/(Outflow) to be Offset by Domestic Bonds | 3,088 | (2,730) | (2,672) | 23 | 1,259 | (2,753) | 1,228 |
| Gross Cash Proceeds from Domestic Bonds | | | | | | | |
| Domestic bonds (market) | 2,294 | 2,520 | 2,453 | 2,459 | 2,487 | 2,507 | 2,497 |
| Domestic bonds (non-market) | 632 | 210 | 219 | 669 | 765 | 246 | 1,201 |
| Total Gross Cash Proceeds from Domestic Bonds | 2,926 | 2,730 | 2,672 | 3,128 | 3,252 | 2,753 | 3,698 |
| Repayment of domestic bonds (market) | (5,593) | - | - | (2,700) | (3,977) | - | (3,976) |
| Repayment of domestic bonds (non-market) | (421) | - | - | (451) | (534) | - | (950) |
| Net (Repayments of)/Cash Proceeds from Domestic Bonds | (3,088) | 2,730 | 2,672 | (23) | (1,259) | 2,753 | (1,228) |

Forecast Statement of Segments

STATEMENT OF FINANCIAL PERFORMANCE

for the year ended 30 June 2007

| | Core Crown | Crown Entities | State-owned Enterprises | Inter-segment eliminations | Total Crown |
|--|---------------|----------------|-------------------------|----------------------------|---------------|
| | 2007 | 2007 | 2007 | 2007 | 2007 |
| | Actual | Actual | Actual | Actual | Actual |
| | \$m | \$m | \$m | \$m | \$m |
| Revenue | | | | | |
| Taxation revenue | 53,445 | - | - | (422) | 53,023 |
| Other sovereign revenue | 653 | 3,641 | - | (593) | 3,701 |
| Sales of goods and services | 1,073 | 11,328 | 10,692 | (10,736) | 12,357 |
| Interest revenue and dividends | 2,580 | 746 | 484 | (826) | 2,984 |
| Other revenue | 423 | 10,436 | 703 | (9,200) | 2,362 |
| Forecast for future revenue | - | - | - | - | - |
| Total Revenue (excluding gains) | 58,174 | 26,151 | 11,879 | (21,777) | 74,427 |
| Expenses | | | | | |
| Social assistance and official development assistance | 16,453 | - | - | (107) | 16,346 |
| Personnel expenses | 5,113 | 8,160 | 2,012 | (4) | 15,281 |
| Other operating expenses | 30,081 | 17,183 | 8,290 | (20,986) | 34,568 |
| Interest expenses | 2,330 | 274 | 685 | (396) | 2,893 |
| Forecast for future new spending | - | - | - | - | - |
| Total Expenses (excluding losses) | 53,977 | 25,617 | 10,987 | (21,493) | 69,088 |
| Operating Balance before gains/(losses) | 4,197 | 534 | 892 | (284) | 5,339 |
| Total Gains/(losses) | 2,344 | 364 | (111) | (43) | 2,554 |
| Net surplus/(deficit) from associates and joint ventures | 48 | 108 | 29 | 1 | 186 |
| Gain/(loss) from discontinued operations | (92) | - | - | - | (92) |
| Attributable to minority interest in Air NZ | - | - | 12 | - | 12 |
| Operating Balance | 6,497 | 1,006 | 822 | (326) | 7,999 |
| Expenses by functional classification | | | | | |
| Social security and welfare | 17,214 | 4,146 | - | (413) | 20,947 |
| Health | 10,357 | 9,005 | - | (8,851) | 10,511 |
| Education | 9,261 | 6,900 | 24 | (6,298) | 9,887 |
| Transport and communications | 2,275 | 1,593 | 5,354 | (2,350) | 6,872 |
| Other | 12,540 | 3,699 | 4,924 | (3,185) | 17,978 |
| Finance costs | 2,330 | 274 | 685 | (396) | 2,893 |
| Forecast for future new spending | - | - | - | - | - |
| Total Crown Expenses excluding losses | 53,977 | 25,617 | 10,987 | (21,493) | 69,088 |

STATEMENT OF FINANCIAL POSITION

as at 30 June 2007

| | Core Crown | Crown Entities | State-owned Enterprises | Inter-segment eliminations | Total Crown |
|---|----------------|----------------|-------------------------|----------------------------|----------------|
| | 2007 | 2007 | 2007 | 2007 | 2007 |
| | Actual | Actual | Actual | Actual | Actual |
| | \$m | \$m | \$m | \$m | \$m |
| Assets | | | | | |
| Cash and cash equivalents | 1,096 | 2,868 | 492 | (248) | 4,208 |
| Receivables | 7,558 | 3,636 | 1,727 | (892) | 12,029 |
| Other financial assets | 43,378 | 15,979 | 6,722 | (8,390) | 57,689 |
| Property, plant & equipment | 26,200 | 41,328 | 28,085 | - | 95,613 |
| Equity accounted investments | 24,968 | 6,331 | 89 | (24,467) | 6,921 |
| Intangible assets and goodwill | 799 | 361 | 492 | 1 | 1,653 |
| Other assets | 1,072 | 253 | 833 | (26) | 2,132 |
| Forecast for new capital spending | - | - | - | - | - |
| Total Assets | 105,071 | 70,756 | 38,440 | (34,022) | 180,245 |
| Liabilities | | | | | |
| Borrowings | 35,885 | 4,424 | 10,301 | (8,696) | 41,914 |
| Other liabilities | 18,515 | 23,022 | 5,368 | (5,278) | 41,627 |
| Total Liabilities | 54,400 | 27,446 | 15,669 | (13,974) | 83,541 |
| Total Assets less Total Liabilities | 50,671 | 43,310 | 22,771 | (20,048) | 96,704 |
| Net Worth | | | | | |
| Taxpayer funds | 39,075 | 20,930 | 7,148 | (22,984) | 44,169 |
| Reserves | 11,596 | 22,380 | 15,221 | 3,042 | 52,239 |
| Net worth attributable to minority interest in Air NZ | - | - | 402 | (106) | 296 |
| Total Net Worth | 50,671 | 43,310 | 22,771 | (20,048) | 96,704 |

Forecast Statement of Segments (continued)

STATEMENT OF FINANCIAL PERFORMANCE

for the year ended 30 June 2008

| | Core Crown | Crown Entities | State-owned Enterprises | Inter-segment eliminations | Total Crown |
|--|---------------|----------------|-------------------------|----------------------------|---------------|
| | 2008 | 2008 | 2008 | 2008 | 2008 |
| | Forecast | Forecast | Forecast | Forecast | Forecast |
| | \$m | \$m | \$m | \$m | \$m |
| Revenue | | | | | |
| Taxation revenue | 57,166 | - | - | (527) | 56,639 |
| Other sovereign revenue | 662 | 3,759 | - | (647) | 3,774 |
| Sales of goods and services | 1,141 | 11,907 | 11,233 | (11,277) | 13,004 |
| Interest revenue and dividends | 2,990 | 920 | 493 | (687) | 3,716 |
| Other revenue | 450 | 10,942 | 880 | (9,797) | 2,475 |
| Forecast revenue reduction contingency | - | - | - | - | - |
| Total Revenue (excluding gains) | 62,409 | 27,528 | 12,606 | (22,935) | 79,608 |
| Expenses | | | | | |
| Social assistance and official development assistance | 18,458 | - | - | (106) | 18,352 |
| Personnel expenses | 5,579 | 8,579 | 2,117 | (4) | 16,271 |
| Other operating expenses | 30,845 | 17,971 | 9,017 | (22,128) | 35,705 |
| Interest expenses | 2,804 | 296 | 724 | (569) | 3,255 |
| Forecast for future new spending | (549) | - | - | - | (549) |
| Total Expenses (excluding losses) | 57,137 | 26,846 | 11,858 | (22,807) | 73,034 |
| Operating Balance before gains/(losses) | 5,272 | 682 | 748 | (128) | 6,574 |
| Total Gains/(losses) | 904 | (224) | 211 | (255) | 636 |
| Net surplus/(deficit) from associates and joint ventures | 30 | 122 | 26 | - | 178 |
| Gain/(loss) from discontinued operations | - | - | - | - | - |
| Attributable to minority interest in Air NZ | - | - | - | - | - |
| Operating Balance | 6,206 | 580 | 985 | (383) | 7,388 |
| Expenses by functional classification | | | | | |
| Social security and welfare | 17,914 | 4,091 | - | (437) | 21,568 |
| Health | 11,480 | 8,993 | - | (8,884) | 11,589 |
| Education | 9,863 | 7,432 | 24 | (6,769) | 10,550 |
| Transport and communications | 2,784 | 2,001 | 5,564 | (2,717) | 7,632 |
| Other | 12,841 | 4,033 | 5,546 | (3,431) | 18,989 |
| Finance costs | 2,804 | 296 | 724 | (569) | 3,255 |
| Forecast for future new spending | (549) | - | - | - | (549) |
| Total Crown Expenses excluding losses | 57,137 | 26,846 | 11,858 | (22,807) | 73,034 |

STATEMENT OF FINANCIAL POSITION

as at 30 June 2008

| | Core Crown | Crown Entities | State-owned Enterprises | Inter-segment eliminations | Total Crown |
|---|----------------|----------------|-------------------------|----------------------------|----------------|
| | 2008 | 2008 | 2008 | 2008 | 2008 |
| | Forecast | Forecast | Forecast | Forecast | Forecast |
| | \$m | \$m | \$m | \$m | \$m |
| Assets | | | | | |
| Cash and cash equivalents | 1,085 | 2,821 | 574 | (248) | 4,232 |
| Receivables | 8,363 | 4,170 | 1,664 | (845) | 13,352 |
| Other financial assets | 51,065 | 17,471 | 8,250 | (9,160) | 67,626 |
| Property, plant & equipment | 26,536 | 42,704 | 29,422 | - | 98,662 |
| Equity accounted investments | 25,983 | 6,625 | 191 | (25,281) | 7,518 |
| Intangible assets and goodwill | 910 | 373 | 511 | - | 1,794 |
| Other assets | 1,225 | 254 | 781 | (8) | 2,252 |
| Forecast for new capital spending | (250) | - | - | - | (250) |
| Total Assets | 114,917 | 74,418 | 41,393 | (35,542) | 195,186 |
| Liabilities | | | | | |
| Borrowings | 38,845 | 4,638 | 12,302 | (9,422) | 46,363 |
| Other liabilities | 19,156 | 25,264 | 5,439 | (5,351) | 44,508 |
| Total Liabilities | 58,001 | 29,902 | 17,741 | (14,773) | 90,871 |
| Total Assets less Total Liabilities | 56,916 | 44,516 | 23,652 | (20,769) | 104,315 |
| Net Worth | | | | | |
| Taxpayer funds | 45,281 | 22,130 | 8,024 | (23,880) | 51,555 |
| Reserves | 11,635 | 22,386 | 15,332 | 3,111 | 52,464 |
| Net worth attributable to minority interest in Air NZ | - | - | 296 | - | 296 |
| Total Net Worth | 56,916 | 44,516 | 23,652 | (20,769) | 104,315 |

Forecast Statement of Segments (continued)

STATEMENT OF FINANCIAL PERFORMANCE

for the year ended 30 June 2009

| | Core Crown | Crown Entities | State-owned Enterprises | Inter-segment eliminations | Total Crown |
|--|---------------|----------------|-------------------------|----------------------------|---------------|
| | 2009 | 2009 | 2009 | 2009 | 2009 |
| | Forecast | Forecast | Forecast | Forecast | Forecast |
| | \$m | \$m | \$m | \$m | \$m |
| Revenue | | | | | |
| Taxation revenue | 58,072 | - | - | (580) | 57,492 |
| Other sovereign revenue | 735 | 3,771 | - | (681) | 3,825 |
| Sales of goods and services | 1,157 | 12,141 | 12,087 | (11,526) | 13,859 |
| Interest revenue and dividends | 3,459 | 952 | 236 | (708) | 3,939 |
| Other revenue | 448 | 10,703 | 990 | (9,601) | 2,540 |
| Forecast revenue reduction contingency | (375) | - | - | - | (375) |
| Total Revenue (excluding gains) | 63,496 | 27,567 | 13,313 | (23,096) | 81,280 |
| Expenses | | | | | |
| Social assistance and official development assistance | 19,035 | - | - | (112) | 18,923 |
| Personnel expenses | 5,558 | 8,646 | 2,194 | (4) | 16,394 |
| Other operating expenses | 31,439 | 18,121 | 9,709 | (22,257) | 37,012 |
| Interest expenses | 2,723 | 303 | 422 | (606) | 2,842 |
| Forecast for future new spending | 1,782 | - | - | - | 1,782 |
| Total Expenses (excluding losses) | 60,537 | 27,070 | 12,325 | (22,979) | 76,953 |
| Operating Balance before gains/(losses) | 2,959 | 497 | 988 | (117) | 4,327 |
| Total Gains/(losses) | 1,162 | 517 | 107 | (259) | 1,527 |
| Net surplus/(deficit) from associates and joint ventures | 47 | 122 | 30 | - | 199 |
| Gain/(loss) from discontinued operations | - | - | - | - | - |
| Attributable to minority interest in Air NZ | - | - | - | - | - |
| Operating Balance | 4,168 | 1,136 | 1,125 | (376) | 6,053 |
| Expenses by functional classification | | | | | |
| Social security and welfare | 18,315 | 4,372 | - | (461) | 22,226 |
| Health | 11,552 | 8,961 | - | (8,871) | 11,642 |
| Education | 9,945 | 7,376 | 24 | (6,767) | 10,578 |
| Transport and communications | 2,849 | 1,979 | 5,743 | (2,768) | 7,803 |
| Other | 13,371 | 4,079 | 6,136 | (3,506) | 20,080 |
| Finance costs | 2,723 | 303 | 422 | (606) | 2,842 |
| Forecast for future new spending | 1,782 | - | - | - | 1,782 |
| Total Crown Expenses excluding losses | 60,537 | 27,070 | 12,325 | (22,979) | 76,953 |

STATEMENT OF FINANCIAL POSITION

as at 30 June 2009

| | Core Crown | Crown Entities | State-owned Enterprises | Inter-segment eliminations | Total Crown |
|---|----------------|----------------|-------------------------|----------------------------|----------------|
| | 2009 | 2009 | 2009 | 2009 | 2009 |
| | Forecast | Forecast | Forecast | Forecast | Forecast |
| | \$m | \$m | \$m | \$m | \$m |
| Assets | | | | | |
| Cash and cash equivalents | 1,212 | 2,913 | 713 | (247) | 4,591 |
| Receivables | 8,538 | 4,099 | 1,730 | (920) | 13,447 |
| Other financial assets | 53,649 | 19,036 | 10,002 | (9,745) | 72,942 |
| Property, plant & equipment | 26,418 | 43,657 | 30,809 | - | 100,884 |
| Equity accounted investments | 26,526 | 6,827 | 171 | (25,625) | 7,899 |
| Intangible assets and goodwill | 954 | 358 | 474 | - | 1,786 |
| Other assets | 1,470 | 264 | 827 | (6) | 2,555 |
| Forecast for new capital spending | 653 | - | - | - | 653 |
| Total Assets | 119,420 | 77,154 | 44,726 | (36,543) | 204,757 |
| Liabilities | | | | | |
| Borrowings | 38,435 | 4,866 | 14,616 | (9,961) | 47,956 |
| Other liabilities | 19,903 | 26,265 | 5,680 | (5,419) | 46,429 |
| Total Liabilities | 58,338 | 31,131 | 20,296 | (15,380) | 94,385 |
| Total Assets less Total Liabilities | 61,082 | 46,023 | 24,430 | (21,163) | 110,372 |
| Net Worth | | | | | |
| Taxpayer funds | 49,447 | 23,611 | 8,821 | (24,270) | 57,609 |
| Reserves | 11,635 | 22,412 | 15,313 | 3,107 | 52,467 |
| Net worth attributable to minority interest in Air NZ | - | - | 296 | - | 296 |
| Total Net Worth | 61,082 | 46,023 | 24,430 | (21,163) | 110,372 |

Forecast Statement of Segments (continued)

STATEMENT OF FINANCIAL PERFORMANCE

for the year ended 30 June 2010

| | Core Crown | Crown Entities | State-owned Enterprises | Inter-segment eliminations | Total Crown |
|--|---------------|----------------|-------------------------|----------------------------|---------------|
| | 2010 | 2010 | 2010 | 2010 | 2010 |
| | Forecast | Forecast | Forecast | Forecast | Forecast |
| | \$m | \$m | \$m | \$m | \$m |
| Revenue | | | | | |
| Taxation revenue | 61,118 | - | - | (620) | 60,498 |
| Other sovereign revenue | 1,136 | 3,919 | - | (712) | 4,343 |
| Sales of goods and services | 1,179 | 12,428 | 12,753 | (11,794) | 14,566 |
| Interest revenue and dividends | 3,450 | 999 | 266 | (764) | 3,951 |
| Other revenue | 449 | 10,335 | 1,064 | (9,224) | 2,624 |
| Forecast revenue reduction contingency | (1,500) | - | - | - | (1,500) |
| Total Revenue (excluding gains) | 65,832 | 27,681 | 14,083 | (23,114) | 84,482 |
| Expenses | | | | | |
| Social assistance and official development assistance | 19,719 | - | - | (112) | 19,607 |
| Personnel expenses | 5,476 | 8,774 | 2,259 | (4) | 16,505 |
| Other operating expenses | 31,500 | 18,273 | 10,254 | (22,252) | 37,775 |
| Interest expenses | 2,646 | 302 | 449 | (629) | 2,768 |
| Forecast for future new spending | 3,765 | - | - | - | 3,765 |
| Total Expenses (excluding losses) | 63,106 | 27,349 | 12,962 | (22,997) | 80,420 |
| Operating Balance before gains/(losses) | | | | | |
| | 2,726 | 332 | 1,121 | (117) | 4,062 |
| Total Gains/(losses) | 1,295 | 513 | 102 | (266) | 1,644 |
| Net surplus/(deficit) from associates and joint ventures | 67 | 123 | 28 | - | 218 |
| Gain/(loss) from discontinued operations | - | - | - | - | - |
| Attributable to minority interest in Air NZ | - | - | - | - | - |
| Operating Balance | 4,088 | 968 | 1,251 | (383) | 5,924 |
| Expenses by functional classification | | | | | |
| Social security and welfare | 18,744 | 4,642 | - | (476) | 22,910 |
| Health | 11,622 | 8,987 | - | (8,880) | 11,729 |
| Education | 10,009 | 7,361 | 24 | (6,804) | 10,590 |
| Transport and communications | 2,726 | 1,911 | 5,986 | (2,562) | 8,061 |
| Other | 13,594 | 4,146 | 6,503 | (3,646) | 20,597 |
| Finance costs | 2,646 | 302 | 449 | (629) | 2,768 |
| Forecast for future new spending | 3,765 | - | - | - | 3,765 |
| Total Crown Expenses excluding losses | 63,106 | 27,349 | 12,962 | (22,997) | 80,420 |

STATEMENT OF FINANCIAL POSITION

as at 30 June 2010

| | Core Crown | Crown Entities | State-owned Enterprises | Inter-segment eliminations | Total Crown |
|---|----------------|----------------|-------------------------|----------------------------|----------------|
| | 2010 | 2010 | 2010 | 2010 | 2010 |
| | Forecast | Forecast | Forecast | Forecast | Forecast |
| | \$m | \$m | \$m | \$m | \$m |
| Assets | | | | | |
| Cash and cash equivalents | 1,304 | 3,001 | 652 | (248) | 4,709 |
| Receivables | 8,534 | 4,274 | 1,825 | (889) | 13,744 |
| Other financial assets | 55,462 | 20,395 | 11,982 | (10,183) | 77,656 |
| Property, plant & equipment | 26,327 | 44,374 | 32,836 | - | 103,537 |
| Equity accounted investments | 26,744 | 6,961 | 173 | (25,723) | 8,155 |
| Intangible assets and goodwill | 939 | 332 | 505 | - | 1,776 |
| Other assets | 1,566 | 247 | 872 | (5) | 2,680 |
| Forecast for new capital spending | 1,306 | - | - | - | 1,306 |
| Total Assets | 122,182 | 79,584 | 48,845 | (37,048) | 213,563 |
| Liabilities | | | | | |
| Borrowings | 37,020 | 5,009 | 17,686 | (10,364) | 49,351 |
| Other liabilities | 19,991 | 27,504 | 5,838 | (5,434) | 47,899 |
| Total Liabilities | 57,011 | 32,513 | 23,524 | (15,798) | 97,250 |
| Total Assets less Total Liabilities | 65,171 | 47,071 | 25,321 | (21,250) | 116,313 |
| Net Worth | | | | | |
| Taxpayer funds | 53,536 | 24,641 | 9,716 | (24,355) | 63,538 |
| Reserves | 11,635 | 22,430 | 15,309 | 3,106 | 52,480 |
| Net worth attributable to minority interest in Air NZ | - | - | 296 | - | 296 |
| Total Net Worth | 65,171 | 47,071 | 25,321 | (21,249) | 116,314 |

Forecast Statement of Segments (continued)

STATEMENT OF FINANCIAL PERFORMANCE

for the year ended 30 June 2011

| | Core Crown | Crown Entities | State-owned Enterprises | Inter-segment eliminations | Total Crown |
|--|---------------|----------------|-------------------------|----------------------------|---------------|
| | 2011 | 2011 | 2011 | 2011 | 2011 |
| | Forecast | Forecast | Forecast | Forecast | Forecast |
| | \$m | \$m | \$m | \$m | \$m |
| Revenue | | | | | |
| Taxation revenue | 64,131 | - | - | (724) | 63,407 |
| Other sovereign revenue | 1,525 | 4,030 | - | (746) | 4,809 |
| Sales of goods and services | 1,217 | 12,482 | 13,302 | (11,785) | 15,216 |
| Interest revenue and dividends | 3,739 | 1,043 | 264 | (822) | 4,224 |
| Other revenue | 446 | 10,407 | 844 | (9,043) | 2,654 |
| Forecast revenue reduction contingency | (1,600) | - | - | - | (1,600) |
| Total Revenue (excluding gains) | 69,458 | 27,962 | 14,410 | (23,120) | 88,710 |
| Expenses | | | | | |
| Social assistance and official development assistance | 20,792 | - | - | (115) | 20,677 |
| Personnel expenses | 5,528 | 8,760 | 2,317 | (5) | 16,600 |
| Other operating expenses | 31,731 | 18,651 | 10,574 | (22,205) | 38,751 |
| Interest expenses | 2,825 | 296 | 472 | (651) | 2,942 |
| Forecast for future new spending | 5,756 | - | - | - | 5,756 |
| Total Expenses (excluding losses) | 66,632 | 27,707 | 13,363 | (22,976) | 84,726 |
| Operating Balance before gains/(losses) | 2,826 | 255 | 1,047 | (144) | 3,984 |
| Total Gains/(losses) | 1,493 | 560 | 98 | (268) | 1,883 |
| Net surplus/(deficit) from associates and joint ventures | 76 | 124 | 28 | (1) | 227 |
| Gain/(loss) from discontinued operations | - | - | - | - | - |
| Attributable to minority interest in Air NZ | - | - | - | - | - |
| Operating Balance | 4,395 | 939 | 1,173 | (413) | 6,094 |
| Expenses by functional classification | | | | | |
| Social security and welfare | 19,554 | 4,904 | - | (493) | 23,965 |
| Health | 11,623 | 8,970 | - | (8,871) | 11,722 |
| Education | 10,103 | 7,365 | 24 | (6,791) | 10,701 |
| Transport and communications | 2,717 | 1,960 | 6,069 | (2,633) | 8,113 |
| Other | 14,054 | 4,212 | 6,798 | (3,537) | 21,527 |
| Finance costs | 2,825 | 296 | 472 | (651) | 2,942 |
| Forecast for future new spending | 5,756 | - | - | - | 5,756 |
| Total Crown Expenses excluding losses | 66,632 | 27,707 | 13,363 | (22,976) | 84,726 |

STATEMENT OF FINANCIAL POSITION

as at 30 June 2011

| | Core Crown | Crown Entities | State-owned Enterprises | Inter-segment eliminations | Total Crown |
|---|----------------|----------------|-------------------------|----------------------------|----------------|
| | 2011 | 2011 | 2011 | 2011 | 2011 |
| | Forecast | Forecast | Forecast | Forecast | Forecast |
| | \$m | \$m | \$m | \$m | \$m |
| Assets | | | | | |
| Cash and cash equivalents | 1,548 | 3,014 | 734 | (248) | 5,048 |
| Receivables | 8,551 | 4,499 | 1,908 | (924) | 14,034 |
| Other financial assets | 61,255 | 21,721 | 11,989 | (10,725) | 84,240 |
| Property, plant & equipment | 25,918 | 45,162 | 35,001 | - | 106,081 |
| Equity accounted investments | 26,894 | 7,086 | 199 | (25,752) | 8,427 |
| Intangible assets and goodwill | 912 | 305 | 500 | - | 1,717 |
| Other assets | 1,664 | 246 | 827 | (4) | 2,733 |
| Forecast for new capital spending | 2,130 | - | - | - | 2,130 |
| Total Assets | 128,872 | 82,033 | 51,158 | (37,653) | 224,410 |
| Liabilities | | | | | |
| Borrowings | 39,611 | 5,247 | 19,129 | (10,881) | 53,106 |
| Other liabilities | 19,695 | 28,780 | 5,914 | (5,502) | 48,887 |
| Total Liabilities | 59,306 | 34,027 | 25,043 | (16,383) | 101,993 |
| Total Assets less Total Liabilities | 69,566 | 48,006 | 26,115 | (21,270) | 122,417 |
| Net Worth | | | | | |
| Taxpayer funds | 57,931 | 25,567 | 10,514 | (24,375) | 69,637 |
| Reserves | 11,635 | 22,439 | 15,305 | 3,105 | 52,484 |
| Net worth attributable to minority interest in Air NZ | - | - | 296 | - | 296 |
| Total Net Worth | 69,566 | 48,006 | 26,115 | (21,270) | 122,417 |

Forecast Statement of Segments (continued)

STATEMENT OF FINANCIAL PERFORMANCE

for the year ended 30 June 2012

| | Core Crown | Crown Entities | State-owned Enterprises | Inter-segment eliminations | Total Crown |
|--|---------------|----------------|-------------------------|----------------------------|---------------|
| | 2012 | 2012 | 2012 | 2012 | 2012 |
| | Forecast | Forecast | Forecast | Forecast | Forecast |
| | \$m | \$m | \$m | \$m | \$m |
| Revenue | | | | | |
| Taxation revenue | 67,207 | - | - | (712) | 66,495 |
| Other sovereign revenue | 1,536 | 4,116 | - | (748) | 4,904 |
| Sales of goods and services | 1,252 | 12,535 | 13,851 | (11,762) | 15,876 |
| Interest revenue and dividends | 3,998 | 1,099 | 272 | (1,024) | 4,345 |
| Other revenue | 447 | 10,444 | 891 | (9,090) | 2,692 |
| Forecast revenue reduction contingency | (1,700) | - | - | - | (1,700) |
| Total Revenue (excluding gains) | 72,740 | 28,194 | 15,014 | (23,336) | 92,612 |
| Expenses | | | | | |
| Social assistance and official development assistance | 21,820 | - | - | (114) | 21,706 |
| Personnel expenses | 5,542 | 8,769 | 2,371 | (5) | 16,677 |
| Other operating expenses | 32,089 | 18,947 | 10,877 | (22,283) | 39,630 |
| Interest expenses | 2,807 | 308 | 529 | (671) | 2,973 |
| Forecast for future new spending | 7,776 | - | - | - | 7,776 |
| Total Expenses (excluding losses) | 70,034 | 28,024 | 13,777 | (23,073) | 88,762 |
| Operating Balance before gains/(losses) | 2,706 | 170 | 1,237 | (263) | 3,850 |
| Total Gains/(losses) | 1,677 | 607 | 104 | (269) | 2,119 |
| Net surplus/(deficit) from associates and joint ventures | 107 | 124 | 28 | - | 259 |
| Gain/(loss) from discontinued operations | - | - | - | - | - |
| Attributable to minority interest in Air NZ | - | - | - | - | - |
| Operating Balance | 4,490 | 901 | 1,369 | (532) | 6,228 |
| Expenses by functional classification | | | | | |
| Social security and welfare | 20,426 | 5,164 | - | (508) | 25,082 |
| Health | 11,642 | 8,996 | - | (8,890) | 11,748 |
| Education | 10,171 | 7,383 | 24 | (6,782) | 10,796 |
| Transport and communications | 2,946 | 1,897 | 6,255 | (2,643) | 8,455 |
| Other | 14,266 | 4,276 | 6,969 | (3,579) | 21,932 |
| Finance costs | 2,807 | 308 | 529 | (671) | 2,973 |
| Forecast for future new spending | 7,776 | - | - | - | 7,776 |
| Total Crown Expenses excluding losses | 70,034 | 28,024 | 13,777 | (23,073) | 88,762 |

STATEMENT OF FINANCIAL POSITION

as at 30 June 2012

| | Core Crown | Crown Entities | State-owned Enterprises | Inter-segment eliminations | Total Crown |
|---|----------------|----------------|-------------------------|----------------------------|----------------|
| | 2012 | 2012 | 2012 | 2012 | 2012 |
| | Forecast | Forecast | Forecast | Forecast | Forecast |
| | \$m | \$m | \$m | \$m | \$m |
| Assets | | | | | |
| Cash and cash equivalents | 1,942 | 3,031 | 1,012 | (247) | 5,738 |
| Receivables | 8,573 | 4,605 | 1,899 | (835) | 14,242 |
| Other financial assets | 62,725 | 23,022 | 11,990 | (11,115) | 86,622 |
| Property, plant & equipment | 25,389 | 45,855 | 36,894 | - | 108,138 |
| Equity accounted investments | 27,067 | 7,210 | 219 | (25,781) | 8,715 |
| Intangible assets and goodwill | 1,135 | 283 | 497 | - | 1,915 |
| Other assets | 1,784 | 248 | 799 | (3) | 2,828 |
| Forecast for new capital spending | 3,140 | - | - | - | 3,140 |
| Total Assets | 131,755 | 84,254 | 53,310 | (37,981) | 231,338 |
| Liabilities | | | | | |
| Borrowings | 38,053 | 5,280 | 20,339 | (11,238) | 52,434 |
| Other liabilities | 19,647 | 30,087 | 6,048 | (5,530) | 50,252 |
| Total Liabilities | 57,700 | 35,367 | 26,387 | (16,768) | 102,686 |
| Total Assets less Total Liabilities | 74,055 | 48,887 | 26,923 | (21,213) | 128,652 |
| Net Worth | | | | | |
| Taxpayer funds | 62,420 | 26,440 | 11,325 | (24,319) | 75,866 |
| Reserves | 11,635 | 22,447 | 15,302 | 3,106 | 52,490 |
| Net worth attributable to minority interest in Air NZ | - | - | 296 | - | 296 |
| Total Net Worth | 74,055 | 48,887 | 26,923 | (21,213) | 128,652 |

Core Crown Expense Tables

| (\$ million) | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|-------------------------------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| | Actual | Actual | Actual | Actual | Actual | Forecast | Forecast | Forecast | Forecast | Forecast |
| Social security and welfare | 13,907 | 14,252 | 14,682 | 15,598 | 17,214 | 17,914 | 18,315 | 18,744 | 19,554 | 20,426 |
| GSF | 2,625 | 660 | 2,442 | 1,671 | 648 | 629 | 603 | 568 | 558 | 545 |
| Health | 7,501 | 8,111 | 8,813 | 9,547 | 10,357 | 11,480 | 11,552 | 11,622 | 11,623 | 11,642 |
| Education | 7,016 | 7,585 | 7,930 | 9,914 | 9,261 | 9,863 | 9,945 | 10,009 | 10,103 | 10,171 |
| Core government services | 1,780 | 1,741 | 2,217 | 2,169 | 4,469 | 2,957 | 2,955 | 3,042 | 3,243 | 3,270 |
| Law and order | 1,734 | 1,843 | 1,977 | 2,235 | 2,748 | 2,910 | 2,913 | 2,904 | 2,901 | 2,903 |
| Defence | 1,199 | 1,311 | 1,275 | 1,383 | 1,529 | 1,641 | 1,683 | 1,771 | 1,880 | 1,950 |
| Transport and communications | 1,408 | 1,461 | 1,635 | 1,818 | 2,275 | 2,784 | 2,849 | 2,726 | 2,717 | 2,946 |
| Economic and industrial services | 1,054 | 1,192 | 1,444 | 1,592 | 1,548 | 2,710 | 2,876 | 3,109 | 3,273 | 3,415 |
| Primary services | 355 | 368 | 394 | 467 | 457 | 527 | 493 | 484 | 480 | 484 |
| Heritage, culture and recreation | 515 | 634 | 991 | 1,194 | 798 | 1,072 | 1,482 | 1,366 | 1,371 | 1,352 |
| Housing and community development | 102 | 139 | 163 | 202 | 275 | 313 | 283 | 268 | 266 | 265 |
| Other | 75 | 52 | 32 | 49 | 68 | 82 | 82 | 82 | 82 | 82 |
| Finance costs | 2,360 | 2,252 | 2,274 | 2,356 | 2,330 | 2,804 | 2,724 | 2,646 | 2,825 | 2,807 |
| Net foreign exchange (gains)/losses | 118 | 7 | (35) | (295) | .. | .. | .. | .. | .. | .. |
| Forecast for future new spending | .. | .. | .. | .. | .. | 201 | 2,057 | 4,015 | 5,956 | 7,926 |
| Top- down expense adjustment | .. | .. | .. | .. | .. | (750) | (275) | (250) | (200) | (150) |
| Core Crown expenses | 41,749 | 41,608 | 46,234 | 49,900 | 53,977 | 57,137 | 60,537 | 63,106 | 66,632 | 70,034 |

Source: The Treasury

Table 6.1 – Social security and welfare expenses

| (\$ million) | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| | Actual | Actual | Actual | Actual | Actual | Forecast | Forecast | Forecast | Forecast | Forecast |
| Welfare benefits | 12,884 | 13,181 | 13,326 | 14,246 | 15,435 | 16,405 | 16,791 | 17,224 | 18,079 | 18,952 |
| Social rehabilitation & compensation | 146 | 118 | 152 | 145 | 163 | 164 | 172 | 176 | 181 | 180 |
| Departmental expenses | 666 | 705 | 781 | 858 | 1,053 | 918 | 895 | 885 | 834 | 834 |
| Other non-departmental expenses | 211 | 248 | 423 | 349 | 563 | 427 | 457 | 459 | 460 | 460 |
| Social security and welfare expenses | 13,907 | 14,252 | 14,682 | 15,598 | 17,214 | 17,914 | 18,315 | 18,744 | 19,554 | 20,426 |

Source: The Treasury

Table 6.2 – New Zealand superannuation and welfare benefit expenses

| (\$ million) | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---------------------------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| | Actual | Actual | Actual | Actual | Actual | Forecast | Forecast | Forecast | Forecast | Forecast |
| New Zealand Superannuation | 5,642 | 5,889 | 6,083 | 6,414 | 6,810 | 7,343 | 7,719 | 8,178 | 8,712 | 9,378 |
| Domestic Purposes Benefit | 1,520 | 1,569 | 1,547 | 1,493 | 1,468 | 1,466 | 1,481 | 1,508 | 1,537 | 1,575 |
| Unemployment Benefit | 1,274 | 1,084 | 831 | 712 | 612 | 458 | 437 | 449 | 450 | 471 |
| Accommodation Supplement | 706 | 702 | 750 | 843 | 877 | 885 | 906 | 927 | 946 | 972 |
| Invalids Benefit | 914 | 976 | 1,026 | 1,073 | 1,132 | 1,195 | 1,250 | 1,306 | 1,358 | 1,406 |
| Sickness Benefit | 421 | 470 | 510 | 541 | 573 | 600 | 607 | 610 | 608 | 609 |
| Disability Allowance | 241 | 257 | 267 | 261 | 270 | 279 | 290 | 303 | 315 | 330 |
| Transitional Retirement Benefit | 47 | 11 | .. | .. | .. | .. | .. | .. | .. | .. |
| Income Related Rents | 296 | 340 | 370 | 395 | 434 | 464 | 495 | 526 | 557 | 590 |
| Family Tax Credit | 862 | 833 | 846 | 1,285 | 1,699 | 2,023 | 1,934 | 1,930 | 2,032 | 2,016 |
| Child Tax Credit | 143 | 155 | 141 | 154 | 44 | 13 | 12 | 9 | 8 | 8 |
| Special Benefit | 82 | 140 | 175 | 162 | 106 | 69 | 53 | 47 | 45 | 45 |
| In Work Tax Credit | .. | .. | .. | 70 | 461 | 593 | 607 | 605 | 615 | 613 |
| Benefits paid in Australia | 121 | 103 | 91 | 80 | 71 | 58 | 51 | 45 | 40 | 34 |
| Paid Parental Leave | 56 | 63 | 76 | 96 | 122 | 121 | 134 | 139 | 148 | 155 |
| Other benefits | 559 | 589 | 613 | 667 | 756 | 838 | 815 | 642 | 708 | 750 |
| Welfare benefit expenses | 12,884 | 13,181 | 13,326 | 14,246 | 15,435 | 16,405 | 16,791 | 17,224 | 18,079 | 18,952 |

Source: The Treasury

Table 6.3 – Beneficiary numbers

| (Thousands) | 2003 Actual | 2004 Actual | 2005 Actual | 2006 Actual | 2007 Actual | 2008 Forecast | 2009 Forecast | 2010 Forecast | 2011 Forecast | 2012 Forecast |
|----------------------------|----------------|----------------|----------------|----------------|----------------|------------------|------------------|------------------|------------------|------------------|
| New Zealand Superannuation | 454 | 461 | 469 | 482 | 495 | 509 | 521 | 535 | 550 | 569 |
| Domestic Purposes Benefit | 110 | 110 | 109 | 106 | 100 | 97 | 95 | 94 | 93 | 93 |
| Unemployment Benefit | 126 | 104 | 78 | 64 | 52 | 38 | 34 | 34 | 33 | 34 |
| Accommodation Supplement | 261 | 249 | 243 | 249 | 251 | 245 | 247 | 250 | 252 | 256 |
| Invalids Benefit | 67 | 70 | 74 | 76 | 78 | 80 | 83 | 85 | 87 | 88 |
| Sickness Benefit | 38 | 42 | 45 | 47 | 48 | 49 | 49 | 48 | 46 | 45 |

Source: The Treasury

Table 6.4 – GSF pension expenses

| (\$ million) | 2003 Actual | 2004 Actual | 2005 Actual | 2006 Actual | 2007 Actual | 2008 Forecast | 2009 Forecast | 2010 Forecast | 2011 Forecast | 2012 Forecast |
|-----------------------------------|----------------|----------------|----------------|----------------|----------------|------------------|------------------|------------------|------------------|------------------|
| Pension expenses | 978 | 975 | 1,032 | 1,392 | 648 | 629 | 603 | 568 | 558 | 545 |
| Revaluation of Unfunded Liability | 1,647 | (315) | 1,410 | 279 | .. | .. | .. | .. | .. | .. |
| GSF pension expenses | 2,625 | 660 | 2,442 | 1,671 | 648 | 629 | 603 | 568 | 558 | 545 |

Source: The Treasury

Table 6.5 – Health expenses

| (\$ million) | 2003 Actual | 2004 Actual | 2005 Actual | 2006 Actual | 2007 Actual | 2008 Forecast | 2009 Forecast | 2010 Forecast | 2011 Forecast | 2012 Forecast |
|--------------------------------|----------------|----------------|----------------|----------------|----------------|------------------|------------------|------------------|------------------|------------------|
| Departmental outputs | 148 | 161 | 157 | 174 | 183 | 207 | 193 | 192 | 190 | 190 |
| Health service purchasing | 6,783 | 7,452 | 8,113 | 8,805 | 9,614 | 10,674 | 10,723 | 10,759 | 10,739 | 10,758 |
| Other non-departmental outputs | 59 | 71 | 160 | 135 | 99 | 99 | 99 | 92 | 85 | 85 |
| Health payments to ACC | 482 | 409 | 356 | 372 | 424 | 465 | 501 | 543 | 573 | 573 |
| Other expenses | 29 | 18 | 27 | 61 | 37 | 35 | 36 | 36 | 36 | 36 |
| Health expenses | 7,501 | 8,111 | 8,813 | 9,547 | 10,357 | 11,480 | 11,552 | 11,622 | 11,623 | 11,642 |

Source: The Treasury

Table 6.6 – Health service purchasing

| (\$ million) | 2003 Actual | 2004 Actual | 2005 Actual | 2006 Actual | 2007 Actual | 2008 Forecast | 2009 Forecast | 2010 Forecast | 2011 Forecast | 2012 Forecast |
|--------------------------------------|----------------|----------------|----------------|----------------|----------------|------------------|------------------|------------------|------------------|------------------|
| Payments to District Health Boards | 5,328 | 6,441 | 7,262 | 7,814 | 8,547 | 9,582 | 9,573 | 9,560 | 9,547 | 9,566 |
| National Disability Support Services | 1,260 | 793 | 620 | 699 | 755 | 840 | 830 | 829 | 828 | 828 |
| Public Health Service Purchasing | 195 | 218 | 231 | 292 | 312 | 252 | 320 | 370 | 364 | 364 |
| Health service purchasing | 6,783 | 7,452 | 8,113 | 8,805 | 9,614 | 10,674 | 10,723 | 10,759 | 10,739 | 10,758 |

Source: The Treasury

Table 6.7 – Education expenses

| (\$ million) | 2003 Actual | 2004 Actual | 2005 Actual | 2006 Actual | 2007 Actual | 2008 Forecast | 2009 Forecast | 2010 Forecast | 2011 Forecast | 2012 Forecast |
|-------------------------------|----------------|----------------|----------------|----------------|----------------|------------------|------------------|------------------|------------------|------------------|
| Early childhood education | 373 | 393 | 444 | 555 | 617 | 800 | 832 | 883 | 934 | 964 |
| Primary and secondary schools | 3,449 | 3,692 | 3,934 | 4,153 | 4,324 | 4,495 | 4,497 | 4,468 | 4,460 | 4,467 |
| Tertiary funding | 2,470 | 2,535 | 2,496 | 4,047 | 3,122 | 3,302 | 3,341 | 3,406 | 3,462 | 3,495 |
| Departmental expenses | 621 | 679 | 737 | 821 | 869 | 863 | 853 | 847 | 846 | 845 |
| Other education expenses | 103 | 286 | 319 | 338 | 329 | 403 | 422 | 405 | 401 | 400 |
| Education expenses | 7,016 | 7,585 | 7,930 | 9,914 | 9,261 | 9,863 | 9,945 | 10,009 | 10,103 | 10,171 |

Source: The Treasury

Table 6.8 – Primary and secondary education expenses

| (\$ million) | 2003 Actual | 2004 Actual | 2005 Actual | 2006 Actual | 2007 Actual | 2008 Forecast | 2009 Forecast | 2010 Forecast | 2011 Forecast | 2012 Forecast |
|--------------------------|----------------|----------------|----------------|----------------|----------------|------------------|------------------|------------------|------------------|------------------|
| Primary | 1,749 | 1,884 | 1,964 | 2,062 | 2,141 | 2,214 | 2,216 | 2,231 | 2,230 | 2,240 |
| Secondary | 1,269 | 1,385 | 1,524 | 1,618 | 1,681 | 1,748 | 1,758 | 1,715 | 1,709 | 1,705 |
| School transport | 103 | 106 | 109 | 118 | 125 | 129 | 132 | 135 | 137 | 140 |
| Special needs support | 227 | 221 | 231 | 245 | 263 | 271 | 272 | 273 | 272 | 271 |
| Professional Development | 86 | 84 | 95 | 101 | 104 | 120 | 105 | 101 | 98 | 97 |
| Schooling Improvement | 15 | 12 | 11 | 9 | 10 | 13 | 14 | 13 | 14 | 14 |
| expenses | 3,449 | 3,692 | 3,934 | 4,153 | 4,324 | 4,495 | 4,497 | 4,468 | 4,460 | 4,467 |
| Places (year) | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
| Primary | 469,000 | 464,000 | 457,000 | 457,951 | 452,000 | 450,000 | 452,000 | 453,000 | 454,000 | 460,000 |
| Secondary | 265,000 | 277,000 | 284,000 | 288,711 | 287,000 | 286,000 | 283,000 | 281,000 | 281,000 | 280,000 |

Sources: Ministry of Education, The Treasury

Table 6.9 – Tertiary education expenses

| (\$ million) | 2003 Actual | 2004 Actual | 2005 Actual | 2006 Actual | 2007 Actual | 2008 Forecast | 2009 Forecast | 2010 Forecast | 2011 Forecast | 2012 Forecast |
|--|----------------|----------------|----------------|----------------|----------------|------------------|------------------|------------------|------------------|------------------|
| Tuition | 1,729 | 1,770 | 1,647 | 1,865 | 1,962 | 2,189 | 2,186 | 2,220 | 2,243 | 2,245 |
| Other tertiary funding | 62 | 66 | 68 | 110 | 138 | 185 | 185 | 183 | 184 | 185 |
| Tertiary student allowances | 388 | 380 | 359 | 354 | 383 | 396 | 409 | 417 | 424 | 430 |
| Initial fair value change in student loans | .. | .. | .. | 1,415 | .. | .. | .. | .. | .. | .. |
| Student loans | 291 | 319 | 422 | 303 | 639 | 532 | 561 | 586 | 611 | 635 |
| Tertiary education expenses | 2,470 | 2,535 | 2,496 | 4,047 | 3,122 | 3,302 | 3,341 | 3,406 | 3,462 | 3,495 |
| Places (year) | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
| EFT students | 245,152 | 247,975 | 240,734 | 227,416 | 225,833 | 228,211 | 231,158 | 233,481 | 235,208 | 236,639 |

Sources: Ministry of Education, The Treasury

Table 6.10 – Core Government service expenses

| (\$ million) | 2003 Actual | 2004 Actual | 2005 Actual | 2006 Actual | 2007 Actual | 2008 Forecast | 2009 Forecast | 2010 Forecast | 2011 Forecast | 2012 Forecast |
|---|----------------|----------------|----------------|----------------|----------------|------------------|------------------|------------------|------------------|------------------|
| Official development assistance | 230 | 237 | 297 | 330 | 330 | 413 | 427 | 493 | 563 | 563 |
| Indemnity and guarantee expenses | 197 | 9 | .. | .. | .. | .. | .. | .. | .. | .. |
| Departmental expenses | 1,025 | 1,096 | 1,570 | 1,403 | 1,390 | 1,553 | 1,509 | 1,499 | 1,556 | 1,554 |
| Non-Departmental Expenses | .. | .. | .. | .. | 220 | 145 | 169 | 196 | 273 | 302 |
| Tax receivable write-down | .. | .. | .. | .. | 2,159 | 450 | 450 | 450 | 450 | 450 |
| Science expenses | 250 | 283 | 170 | 157 | 163 | 173 | 174 | 176 | 176 | 176 |
| Other expenses | 78 | 116 | 180 | 279 | 207 | 223 | 226 | 228 | 225 | 225 |
| Core Government service expenses | 1,780 | 1,741 | 2,217 | 2,169 | 4,469 | 2,957 | 2,955 | 3,042 | 3,243 | 3,270 |

Source: The Treasury

Table 6.11 – Law and order expenses

| (\$ million) | 2003 Actual | 2004 Actual | 2005 Actual | 2006 Actual | 2007 Actual | 2008 Forecast | 2009 Forecast | 2010 Forecast | 2011 Forecast | 2012 Forecast |
|-------------------------------|----------------|----------------|----------------|----------------|----------------|------------------|------------------|------------------|------------------|------------------|
| Police | 800 | 844 | 896 | 976 | 1,091 | 1,190 | 1,190 | 1,179 | 1,178 | 1,178 |
| Ministry of Justice | 15 | 178 | 257 | 299 | 454 | 376 | 370 | 363 | 363 | 364 |
| Department of Corrections | 403 | 439 | 483 | 572 | 661 | 775 | 781 | 788 | 786 | 787 |
| Department for Courts | 211 | 53 | .. | .. | .. | .. | .. | .. | .. | .. |
| Other departments | 77 | 81 | 72 | 76 | 103 | 106 | 109 | 113 | 113 | 113 |
| Department expenses | 1,506 | 1,595 | 1,708 | 1,923 | 2,309 | 2,447 | 2,450 | 2,443 | 2,440 | 2,442 |
| Non-departmental outputs | 177 | 178 | 218 | 262 | 368 | 320 | 320 | 318 | 318 | 318 |
| Other expenses | 51 | 70 | 51 | 50 | 71 | 143 | 143 | 143 | 143 | 143 |
| Law and order expenses | 1,734 | 1,843 | 1,977 | 2,235 | 2,748 | 2,910 | 2,913 | 2,904 | 2,901 | 2,903 |

Source: The Treasury

Table 6.12 – Defence expenses

| (\$ million) | 2003 Actual | 2004 Actual | 2005 Actual | 2006 Actual | 2007 Actual | 2008 Forecast | 2009 Forecast | 2010 Forecast | 2011 Forecast | 2012 Forecast |
|----------------------------|----------------|----------------|----------------|----------------|----------------|------------------|------------------|------------------|------------------|------------------|
| NZDF Core expenses | 1,095 | 1,182 | 1,203 | 1,306 | 1,602 | 1,594 | 1,635 | 1,723 | 1,832 | 1,901 |
| NZDF write-offs | 23 | 72 | .. | .. | .. | .. | .. | .. | .. | .. |
| NZDF East Timor deployment | 20 | .. | .. | .. | .. | .. | .. | .. | .. | .. |
| MSD East Timor deployment | 13 | 12 | 10 | 10 | 10 | .. | .. | .. | .. | .. |
| Other expenses | 48 | 45 | 62 | 67 | (83) | 47 | 48 | 48 | 48 | 49 |
| Defence expenses | 1,199 | 1,311 | 1,275 | 1,383 | 1,529 | 1,641 | 1,683 | 1,771 | 1,880 | 1,950 |

Source: The Treasury

Table 6.13 – Transport and communication expenses

| (\$ million) | 2003 Actual | 2004 Actual | 2005 Actual | 2006 Actual | 2007 Actual | 2008 Forecast | 2009 Forecast | 2010 Forecast | 2011 Forecast | 2012 Forecast |
|---|----------------|----------------|----------------|----------------|----------------|------------------|------------------|------------------|------------------|------------------|
| Land Transport NZ ¹ | 1,131 | 1,222 | 1,346 | 1,482 | 2,007 | 2,283 | 2,291 | 2,082 | 2,159 | 1,917 |
| Departmental outputs | 80 | 83 | 97 | 101 | 114 | 133 | 126 | 126 | 125 | 125 |
| Other non-departmental expenses | 61 | 84 | 79 | 109 | (43) | 123 | 115 | 159 | 297 | 726 |
| Goodwill amortisation | 47 | 47 | 47 | 47 | 47 | .. | .. | .. | .. | .. |
| Rail write-offs | 81 | 19 | .. | .. | .. | .. | .. | .. | .. | .. |
| Rail costs | .. | 3 | 63 | 77 | 142 | 236 | 309 | 357 | 134 | 176 |
| Other expenses | 8 | 3 | 3 | 2 | 8 | 9 | 8 | 2 | 2 | 2 |
| Transport and communication expenses | 1,408 | 1,461 | 1,635 | 1,818 | 2,275 | 2,784 | 2,849 | 2,726 | 2,717 | 2,946 |

¹Since 2004/05 funding has been provided to Land Transport NZ. Prior to this, funding was received by Transfund.

Source: The Treasury

Table 6.14 – Economic and industrial services expenses

| (\$ million) | 2003 Actual | 2004 Actual | 2005 Actual | 2006 Actual | 2007 Actual | 2008 Forecast | 2009 Forecast | 2010 Forecast | 2011 Forecast | 2012 Forecast |
|---|----------------|----------------|----------------|----------------|----------------|------------------|------------------|------------------|------------------|------------------|
| Departmental outputs | 424 | 478 | 508 | 549 | 548 | 610 | 596 | 589 | 583 | 582 |
| Employment initiatives | 217 | 222 | 224 | 202 | 206 | 223 | 221 | 217 | 217 | 217 |
| Non-departmental outputs | 277 | 444 | 549 | 751 | 826 | 899 | 934 | 996 | 1,037 | 1,031 |
| Reserve Electricity Generation | .. | .. | .. | 26 | 16 | 36 | 26 | 26 | 26 | 25 |
| Flood relief | .. | 15 | 52 | 8 | .. | .. | .. | .. | .. | .. |
| KiwiSaver | .. | .. | .. | .. | .. | 834 | 981 | 1,155 | 1,290 | 1,440 |
| Other expenses | 136 | 33 | 111 | 56 | (48) | 108 | 118 | 126 | 120 | 120 |
| Economic and industrial service expenses | 1,054 | 1,192 | 1,444 | 1,592 | 1,548 | 2,710 | 2,876 | 3,109 | 3,273 | 3,415 |

Source: The Treasury

Table 6.15 – Employment initiatives

| (\$ million) | 2003 Actual | 2004 Actual | 2005 Actual | 2006 Actual | 2007 Actual | 2008 Forecast | 2009 Forecast | 2010 Forecast | 2011 Forecast | 2012 Forecast |
|-------------------------------------|----------------|----------------|----------------|----------------|----------------|------------------|------------------|------------------|------------------|------------------|
| Training incentive allowance | 37 | 42 | 36 | 32 | 29 | 44 | 44 | 44 | 44 | 44 |
| Community employment projects | 21 | 16 | 6 | .. | .. | .. | .. | .. | .. | .. |
| Subsidised work | 95 | 100 | 102 | 84 | 88 | 85 | 82 | 78 | 78 | 78 |
| Employment support for disabled | 61 | 61 | 74 | 82 | 86 | 90 | 91 | 91 | 91 | 91 |
| Other employment assistance schemes | 3 | 3 | 6 | 4 | 3 | 4 | 4 | 4 | 4 | 4 |
| Employment initiatives | 217 | 222 | 224 | 202 | 206 | 223 | 221 | 217 | 217 | 217 |

Source: The Treasury

Table 6.16 – Primary service expenses

| (\$ million) | 2003 Actual | 2004 Actual | 2005 Actual | 2006 Actual | 2007 Actual | 2008 Forecast | 2009 Forecast | 2010 Forecast | 2011 Forecast | 2012 Forecast |
|---------------------------------|----------------|----------------|----------------|----------------|----------------|------------------|------------------|------------------|------------------|------------------|
| Departmental expenses | 265 | 269 | 272 | 350 | 341 | 389 | 367 | 361 | 359 | 359 |
| Non-departmental outputs | 80 | 81 | 114 | 97 | 99 | 119 | 110 | 108 | 106 | 110 |
| Other expenses | 10 | 18 | 8 | 20 | 17 | 19 | 16 | 15 | 15 | 15 |
| Primary service expenses | 355 | 368 | 394 | 467 | 457 | 527 | 493 | 484 | 480 | 484 |

Source: The Treasury

Table 6.17 – Heritage, culture and recreation expenses

| (\$ million) | 2003 Actual | 2004 Actual | 2005 Actual | 2006 Actual | 2007 Actual | 2008 Forecast | 2009 Forecast | 2010 Forecast | 2011 Forecast | 2012 Forecast |
|--|----------------|----------------|----------------|----------------|----------------|------------------|------------------|------------------|------------------|------------------|
| Community grants | 6 | 3 | 6 | 7 | 7 | 7 | 7 | 7 | 7 | 7 |
| Kyoto protocol | .. | .. | 310 | 345 | 2 | .. | .. | .. | .. | .. |
| Emmission Trading Scheme | | | | | .. | .. | 597 | 477 | 477 | 477 |
| Departmental outputs | 253 | 269 | 292 | 322 | 354 | 401 | 404 | 407 | 413 | 414 |
| Non-departmental outputs | 212 | 258 | 317 | 351 | 397 | 479 | 416 | 418 | 417 | 397 |
| Other expenses | 44 | 104 | 66 | 169 | 38 | 185 | 58 | 57 | 57 | 57 |
| Heritage, culture and recreation expenses | 515 | 634 | 991 | 1,194 | 798 | 1,072 | 1,482 | 1,366 | 1,371 | 1,352 |

Source: The Treasury

Table 6.18 – Housing and community development expenses

| (\$ million) | 2003 Actual | 2004 Actual | 2005 Actual | 2006 Actual | 2007 Actual | 2008 Forecast | 2009 Forecast | 2010 Forecast | 2011 Forecast | 2012 Forecast |
|---------------------------------|----------------|----------------|----------------|----------------|----------------|------------------|------------------|------------------|------------------|------------------|
| Housing subsidies | 25 | 27 | 31 | 23 | 25 | 29 | 29 | 28 | 29 | 29 |
| Departmental outputs | 57 | 77 | 100 | 117 | 134 | 160 | 142 | 133 | 130 | 129 |
| Other non-departmental expenses | 20 | 35 | 32 | 62 | 116 | 124 | 112 | 107 | 107 | 107 |
| expenses | 102 | 139 | 163 | 202 | 275 | 313 | 283 | 268 | 266 | 265 |

Source: The Treasury

Glossary of Terms

ACC unfunded liability

The future cost of past ACC claims, less the asset reserves held to meet these claims. The ACC outstanding claims liability is the gross liability of the future cost of past ACC claims.

Baselines

The level of funding approved for any given spending area (eg, Education). All amounts within baselines are included in the forecasts.

Contingent liability

Contingent liabilities are costs, which the Crown will have to face if a particular event occurs. Typically, contingent liabilities consist of guarantees and indemnities, and legal disputes and claims.

Core Crown

The core Crown represents the revenues, expenses, assets and liabilities of the Crown, departments, Offices of Parliament, the Reserve Bank, GSF and the NZS Fund.

Corporate tax

The sum of net company tax, non-resident withholding tax (NRWT), foreign dividend withholding payments (FDWP) and withholding tax on resident dividend income (DWT).

Current account (Balance of Payments)

A measure of the flows of income between New Zealand and the rest of the world. A net inflow to New Zealand is a current account surplus, while a net outflow is a deficit. The current account balance is commonly expressed as a percentage of GDP.

Customs duty

Duty levied on the imports of certain goods.

Cyclically adjusted or structural fiscal balance

An estimate of the fiscal balance (eg, OBEGAL) adjusted for short-term fluctuations of actual GDP around trend GDP. The estimate provides a picture of the underlying trend fiscal position and an indication of the effects of policy decisions. Because it is based on a number of assumptions and is sensitive to new information, the estimate is subject to some uncertainty.

Demographic changes

Changes to the structure of the population, for example the age, sex or ethnic make-up of the population.

Domestic bond programme

The amount of new government stock expected to be issued over the financial year.

Excise duties

Tax levied on the domestic production of alcohol, tobacco and light petroleum products (CNG, LPG and petrol).

Financial assets

Cash or shares (equity), a right to receive cash or shares (equity), or a right to exchange a financial asset or liability on favourable terms.

Fiscal impulse

A summary measure of how changes in fiscal policy affect aggregate demand. To isolate discretionary changes, fiscal impulse is calculated on a cyclically-adjusted basis and excluding net interest payments. To better capture the role of capital spending the indicator is derived from cash flow information.

Fiscal intentions (short-term)

Under the Public Finance Act 1989, the Government must indicate explicitly its intentions for operating expenses, operating revenues, the operating balance, debt and net worth over (at least) the next three years.

Fiscal objectives (long-term)

The Government's long-term goals for operating expenses, operating revenue, the operating balance, debt and net worth, as required by the Public Finance Act 1989. The objectives must be consistent with the principles of responsible fiscal management outlined in the Act and cover a period of 10 or more years.

Forecast new capital spending

An amount provided in the forecasts to represent the balance sheet impact of capital initiatives expected to be introduced over the forecast period.

Forecast new operating spending

An amount included in the forecasts to provide for the operating balance impact of policy initiatives and changes to demographics and other forecasting changes expected to occur over the forecast period.

Gross Crown debt

The total borrowings (both sovereign guaranteed and non-sovereign guaranteed and including derivatives in loss) of the total Crown. This is the amount in the total Crown Statement of Financial Position for Reserve Bank settlement deposits plus other borrowings. It represents the complete picture of whole-of-Crown debt obligations to external parties, excluding payables.

Gross domestic product (GDP)

A measure of the value of all goods and services produced in New Zealand; changes in GDP measure growth in economic activity or output. GDP can be measured as the actual dollar value of goods and services measured at today's prices (nominal GDP), or excluding the effects of price changes over time (real GDP).

Gross domestic product (expenditure)

This is the sum of total final expenditures on goods and services in the economy.

Gross national expenditure (GNE)

Measures total expenditure on goods and services by New Zealand residents.

Gross Sovereign-Issued Debt (GSID)

Debt issued by the sovereign (ie, Core Crown) and includes Government stock held by the NZS Fund, ACC or EQC. The gross sovereign-issued debt indicator does not eliminate any internal cross-holdings.

Labour force participation rate

Measures the percentage of the working-age population in work or actively looking for and available for work.

Labour productivity

Measures output per input of labour (where labour inputs might be measured as hours worked or people).

Line-by-line consolidation

This is a term used to refer to the general approach to the presentation of the Crown financial statements. It means that the revenues, expenses, assets and liabilities of all departments, Offices of Parliament, the Reserve Bank, SOEs, Crown entities, and other entities controlled by the Government are included in the Crown financial statements.

Marketable securities

Assets held with financial institutions. These assets are held for both cash flow and investment purposes, and include any funds the Government has invested in the International Monetary Fund.

Monetary conditions

The combination of interest rates and the exchange rate.

Monetary policy

Action taken by the Reserve Bank to affect interest rates and the exchange rate in order to control inflation. Tightening monetary policy refers to actions taken by the Reserve Bank to raise interest rates (which can influence the exchange rate) in order to moderate aggregate demand pressures and so reduce inflationary pressures.

Net Core Crown debt

Debt after deducting financial assets of the Core Crown (comprising cash equivalents, marketable securities, derivatives in gain, advances and some share investments) from gross sovereign-issued debt. Share investments in supranational organisations, such as the International Bank for Reconstruction and Development & Bank for International Settlements, are excluded from the net Core Crown debt measure.

Net worth

Total assets less total liabilities (also referred to as Crown balance).

NZ IFRS

New Zealand equivalents to International Financial Reporting Standards. These standards are approved by the Accounting Standards Review Board in New Zealand and are based on the requirements of the internal financial reporting standards issued by the International Accounting Standards Board.

Operating allowance

The amount included in the *Fiscal Strategy Report* projections for new initiatives, including spending and cost pressures. The allowance is a projection assumption. The projections in the *Fiscal Strategy Report* also include an allowance for capital spending.

Operating balance

The operating balance is the residual of revenues less expenses plus surpluses from state-owned enterprises and Crown entities. It includes gains and losses.

Operating balance excluding revaluation and accounting policy changes (OBERAC)

The OBERAC is the operating balance adjusted for revaluation movements and accounting policy changes. It provides a measure of underlying stewardship. As a result of the change to New GAAP this fiscal indicator is being replaced by OBEGAL (refer below).

Operating balance before gains and losses (OBEGAL)

The OBEGAL is the operating balance excluding gains and losses. It replaces OBERAC under New GAAP.

Projections

Projections of the key fiscal indicators beyond the five-year forecast period. The projections are based on long-run economic and fiscal assumptions. For example, the projections assume no economic cycle and constant long-run interest, inflation and unemployment rates.

Provisional tax

A thrice-yearly payment of tax on income that has not been taxed, or been under-taxed, at source (relates only to company tax and other persons' tax).

Source deductions

Tax withheld on wages, salaries, social welfare benefits, bonuses, lump-sum payments and superannuation fund contributions. About 80% of source deductions come from PAYE on wages and salaries. Source deductions is the biggest single tax type.

Specific fiscal risks

These are a category of Government decisions or circumstances which may have a material impact on the fiscal position (excluding contingent liabilities). They are not included in the main forecasts because their fiscal impact cannot be reasonably quantified, the likelihood of realisation is uncertain and/or the timing is uncertain.

Stock change

The change in the value of stocks (raw materials, work in progress, and finished goods) during a given period.

System of National Accounts (SNA)

SNA is a comprehensive, consistent and flexible set of macroeconomic accounts to meet the needs of government and private sector analysts, policy-makers, and decision-takers.

Tax revenue

The accrual, rather than the cash (“tax receipts”) measure of taxation. It is a measure of tax due, regardless of whether or not it has actually been paid.

Trade weighted index (TWI)

A measure of movements in the New Zealand dollar against the currencies of our major trading partners. The currencies comprise the US dollar, the Australian dollar, the Japanese yen, the euro and the UK pound.

Unit labour costs

The wages and other costs associated with employment per unit of output.

Year ended

Graphs and tables use different expressions of the timeframe. For example, 2007/08 or 2008 will generally mean “year ended 30 June” unless otherwise stated.