OPINION:

A holding budget in a changing world

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The budget reminds more of good, tidy management than a forward looking approach

That the government's 8th budget last week was widely seen as dull illustrates the progress made since Bill English's first budget in 2009, when the global financial crisis was causing New Zealand's fiscal position to unravel. Over the past several years, the government has done an excellent job of restoring fiscal health.

But too much of this budget reminds of good, tidy management rather than a forward-looking approach that positions New Zealand for emerging challenges and opportunities. This approach is perhaps understandable when New Zealand's GDP growth has been strong, driven by external demand for dairy (now tourism), by record levels of immigration, and by the wealth effect of strongly rising property prices.

To reinforce this sentiment, the budget was based on an optimistic set of economic forecasts from the Treasury. Growth is forecast at 2.6% for 2016, rising to 2.9% and 3.2% in 2017 and 2018 respectively, for a 2.8% average growth rate over the 2016-2020 period. The Minister noted that 'Only a handful of developed economies enjoy such a positive outlook'.

This is true enough, but caution should be used in interpreting this outlook. Indeed, as an outside observer of New Zealand, the outlook and associated commentary come worryingly close to complacency. New Zealand is a small open economy, and its outlook will be importantly shaped by external events.

To provide a perspective on this, it is instructive to look at the experience of other small advanced economies. From Singapore to Denmark and Switzerland, there is a widely shared sense that serious responses are needed for what is an increasingly challenging global environment for small economies.

In this context, three things struck me from the budget.

First, the positive economic outlook requires a lot of things to go right. The housing market is forecast to slow rather than correct; labour productivity and participation rates are forecast to compensate for a reversion to long-term average immigration rates by 2019; and export growth is forecast to pick up strongly from 2017. These are all possible, but there are other reasonable scenarios.

Although it may be that immigration rates continue to positively surprise, boosting growth, the risks seem tilted to the downside. The 2.8% average growth rate over next 5 years strikes me as unduly optimistic. As Fonterra's lower than expected payout announcement last week reminds, New Zealand is exposed to soft international economic conditions.

To calibrate, growth rates across the small advanced economies group have been drifting down over the past 18 months, as weak global trade and global GDP growth weigh on these countries. The average growth rate across the 15-strong small country group was 2.3% in the year to Q4 2015 (1.8% excluding Ireland), with an outlook of 2.2% over the next few years. And it is the Asia-exposed small advanced economies that have particular softness: in April, the IMF downgraded the 2016 growth outlook for Singapore, Hong Kong and New Zealand by more than for other small advanced economies.

New Zealand's particular dynamics of immigration, tourism and real estate may provide a buffer, but New Zealand cannot completely defy the forces of global economic gravity. The emerging global economic and geopolitical environment will be more challenging for small economies, New Zealand included.

Second, there was little focus on positioning the New Zealand economy to succeed in an intensely competitive global environment with disruptive new technologies and business models. There was some welcome new spending in the budget on science and innovation, although New Zealand remains well behind the small country average on R&D investment and innovation outcomes.

Disruptive change is arriving fast, from the 4th Industrial Revolution to new sources of competition from emerging markets. Small advanced economies are deeply exposed to these changes, which bring major opportunities as well as major challenges. In response, there is intense government and business activity in many small advanced economies, from upgrading innovation, education and social insurance systems to developing new areas of competitive strength. New Zealand should be much more active in this space to ensure it can capture new opportunities and manage new risks, and sustain growth in a more competitive global environment.

The investment in the fibre network, the increased focus on innovation, and more start-ups scaling up, are all encouraging indications of change. But increased intensity is required: New Zealand's export share remains static, successful outward investment is very low, and IPO activity of scaled-up New Zealand firms is rare relative to the experience of other small advanced economies.

Third, the budget commentary signalled the increasingly tough balancing act between debt repayment, infrastructure investment, and tax cuts. The preference for debt repayment over tax cuts is a prudent course of action given the economic and fiscal risks. But substantial infrastructure investments will be required to ensure that growth can be sustained, from roads and rail to housing and hotels. New Zealand will have to pay the bill for growth that has been supported by record levels of immigration and tourism.

There are large pools of capital in Asia and elsewhere that can assist with this, but the government will also need to use its balance sheet to ensure that New Zealand gets ahead of the curve on infrastructure.

Overall, the budget reflected the post-crisis progress that New Zealand has made. But New Zealand is exposed to a rapidly changing and increasingly challenging global environment. Economically at least, New Zealand is not an island. Deliberate, forward-looking action now needs to be taken to prepare New Zealand for emerging challenges and opportunities.

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About the author

Dr David Skilling is the founding Director of Landfall Strategy Group. David advises governments, companies, and financial institutions in several small countries, and writes regularly on global macro, globalisation and geopolitics from a small country perspective. David has recently served as Senior Advisor to the Secretary of Foreign Affairs & Trade in New Zealand, and as a Fellow at Singapore's Civil Service College. Previously, David was an Associate Principal with McKinsey & Company in Singapore, as well as being a Senior Fellow with the McKinsey Global Institute. Before joining McKinsey, David was the founding Chief Executive of the New Zealand Institute, a privately-funded, non-partisan think-tank. Until 2003, David was a Principal Advisor at the New Zealand Treasury. David has a Ph.D. in Public Policy, and a Master in Public Policy degree, from Harvard University, as well as a Master of Commerce degree in Economics from the University of Auckland. David was named as a Young Global Leader by the World Economic Forum in 2008.

About Landfall Strategy Group

Landfall Strategy Group is a Singapore-based research and advisory firm that provides advice on strategic issues to governments, firms, and financial institutions, particularly in small advanced economies. We provide distinctive perspectives on emerging global trends, working with decision-makers to understand key global changes and how governments, firms, and institutions should respond and position themselves in the emerging global economic and political environment.

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