The role of forecasts in fiscal management

Q 6-01. Why should one do cash flow forecasting?

Although the most commonly cited reason for forecasting cash flows might be to anticipate better the need for debt issuance, many aspects of cash management and control are strengthened with more accurate cash forecasts. More generally, projections of funds or cash flows support budget execution and management, financial control, treasury control, capital budgeting, and liquidity management.

In the end, the reason for committing resources to cash forecasting or cash management or debt management is so that a public official or a citizen can get a quick and simple answer to questions such as,

- How much debt or cash do we have and where is it?
- How much more debt can we afford?
- Will we sufficient enough fiscal resources to pay for all the promises made by our government?

Q 6-01.01. How do cash forecasts improve debt management?

Having a forecast of the trajectory of the treasury's cash position in the coming months is essential to managing maturities and issuance of investments and debt. A detailed forecast of cash balances guides decisions on the timing and amounts of borrowing and helps avoid financing when cash is available or running out of cash because of a failure to finance in time.[1]

Q 6-01.02. How do cash forecasts support liquidity management?

A forecast of the government's cash position is essential to choosing the term and timing of investments of available cash. In the absence of a forecast, unanticipated cash may be available yet not invested. Idle balances bear an opportunity cost equal to the earnings forgone. If under a too optimistic forecast, cash is tied up in an illiquid investment and is needed, borrowing the equivalent funds may cost more than the investment earns.

Q 6-01.03. How are forecasts used in budget execution management?

Budget formulation and execution management should not be undertaken without reference to credible projections of funds flows. The synchronization of revenue estimates and spending plans forms the core of the budget. The picture of net cash

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[1]Note also that good debt management practice can strengthen the cash forecasting function; maintaining a schedule maturing debt is essential to preparing the cash projection. An efficient debt office will maintains such information; it should freely share it with the cash forecasting staff.

flows that results in the budget plan is needed to manage execution of the budget over the budget period. Adjustments to the forecast as warranted by events would increase the likelihood that needed financial resources will be available as needed to execute properly the budget.

If the budget execution process relies on spending controls, including allotments and apportionments, using a cash flow forecast to set the size and timing of these controls will provide a more realistic basis for managing budget execution.

Q 6-01.04.   How are forecasts used in capital budgeting?

Extended period forecasts of revenues and expenditures, including borrowing costs, are essential tools for capital budgeting and evaluating competing projects.

A forecast of cash flows is the basis for evaluating alternative strategic financial policy objectives. In addition, cash flow forecasting helps in analyzing options for financing operating and capital budgets so that costs will be minimized. In evaluating individual projects, the net present value of long-term costs and benefits tied to each approach can be the basis for selecting among proposals and financing options.