ECONOMIC BULLETIN

2023 Half-Year Economic and Fiscal Update.

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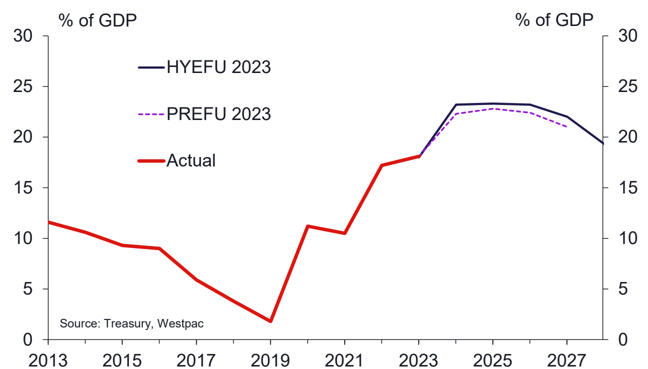
Clearing the fiscal snails off the path

- **A weaker economy and population pressures have led to a weaker fiscal outlook.**
- **Tax revenues are lower, while expenses are higher due to rapid population growth.**
- **Larger fiscal deficits in 2024 and 2025 means less money in the kitty.**
- **Interest rates are expected to be higher for longer, increasing financing costs.**
- **More debt issuance is required as a result – $7 billion more bonds.**
- **Marginally greater inflation pressures coming from fiscal policy.**
- **Achieving the Government's debt aims will require fiscal restraint in Budget 2024.**
- **The new coalition policies have not yet been reflected, but will be broadly fiscal neutral.**

Fiscal outlook, strategy, and monetary policy implications.

The HYEFU presented a partial view of the fiscal outlook as the forecasts were completed ahead of the final coalition agreement and the announcement of the Government's 100-day Action Plan. This outlook was weaker than presented in PREFU. The OBEGAL is $2.1 billion higher (i.e., a smaller deficit) in 23/24 at a deficit of $9.3 billion (2.2 % GDP). But over the whole forecast period, the OBEGAL has been reduced (higher deficits/smaller surpluses) by $4 billion in the 2026/27 and 2027/28 financial years. Hence in aggregate the cumulative fiscal deficit is around $2 billion larger than shown in PREFU.

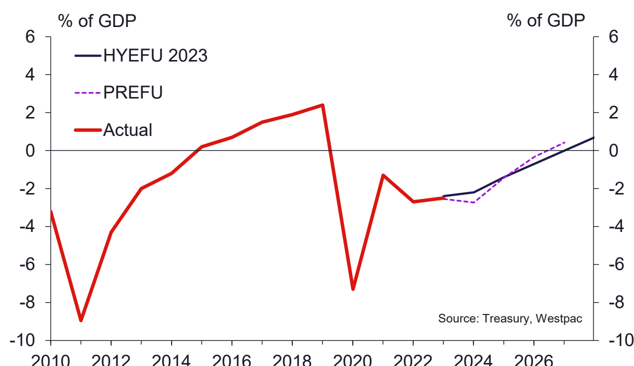
Net core Crown debt as a % of GDP



Key drivers of the weaker profile are assumptions of higher for longer interest rates (required to control inflation) and associated increased financing costs, as well as stronger population growth (that will boost tax revenues through source deductions but also generate larger ongoing operating expenses).

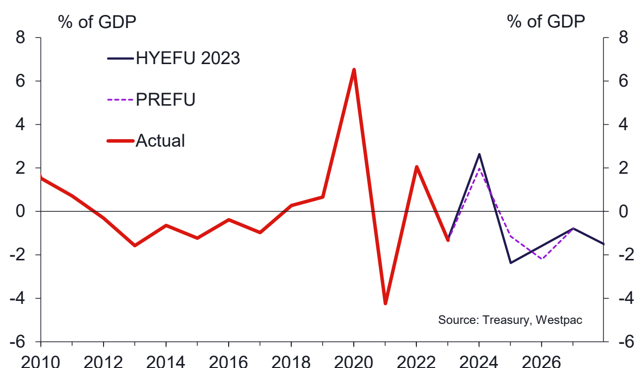
The budget is still projected to return to surplus in 2026/27 but that surplus is now wafer thin at $0.1 billion. A larger $3.4 billion surplus is forecast in the 2028/29 year.

Operating balance (OBEGAL) as a % of GDP



The Treasury's Fiscal Impulse indicator shows a slightly more expansionary impact of fiscal policy on growth over the entire forecast horizon. In the current 2023/24 year, the fiscal impulse is 0.7% of GDP stronger than indicated in PREFU. However, from 2024 onwards the fiscal stance tightens such that in aggregate the forecasts imply a more expansionary fiscal impact of around 0.1% GDP.

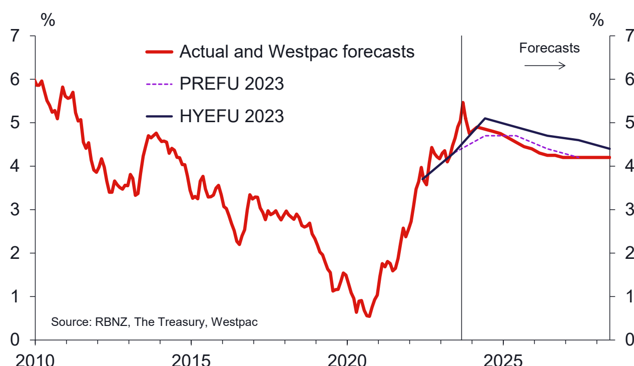
Fiscal impulse as a % of nominal GDP



It's important to understand that these forecasts incorporate little of the new Government's fiscal policies outlined in their 100-day action plan. The forecasts were finalised on 24 November and hence couldn't include the coalition Government's policy platform. The Treasury provides some rough estimates of the direct impact of the new Government's policies on the fiscal outlook. Announced spending cuts (for example associated with the reduced rate of indexation of benefits from June 2024) are expected to improve the OBEGAL by around $7.5 billion over the forecast horizon starting in the 2024/25 fiscal year. However, these gains will be balanced by coalition spending commitments (including tax cuts) such that the overall impact would be broadly neutral over the forecast period.

Hence, the fiscal position remains weak and there is little in the kitty for future initiatives. Indeed, as it stands, significantly more government bond issuance is required. The borrowing requirement has been revised up by $7 billion over the forecast period. Net debt rises by more than in PREFU to a peak of 23.3% of GDP and is well within limits. There could be some downside risk for Crown financing costs given that interest rates have fallen significantly in the last six weeks and markets have come to the view that the RBNZ might be able to reduce interest rates sooner than perhaps is consistent with the Treasury's assumptions in HYEFU.

10 year bond rate



The overall picture is one where fiscal policy is not helping the RBNZ relative to PREFU. The total fiscal impulse is, if anything, more expansionary than shown in PREFU. As we indicated in our pre-election analysis of National's policies, we see a slightly more contractionary impact of the full package of the coalition Government's policy platform on growth (and hence inflation) on the view that the stimulatory impact of tax cuts will be more than balanced by the contractionary impact of spending cuts. But the impact here is very marginal and will not significantly shift the underlying weak fiscal position.

Budget 2024 will be key. Much of the reduced stimulus coming from fiscal policy after this year reflects an assumption of well controlled government spending in the face of strong population growth pressures. The extent to which the coalition Government delivers on their rhetoric of fiscal austerity will be key in determining the ultimate fiscal impact on growth and the inflation outlook. The Government has a lot of work to do to flesh out their policy program and then implement it in a substantive way. Action will be required.

Bottom line: if you were expecting the HYEFU to deliver significant fiscal contraction that would reduce the RBNZ's need to keep interest rates at current levels, then you didn't see that today. Maybe things didn't get harder for the RBNZ, but they didn't get easier either.

HYEFU 2023 forecasts

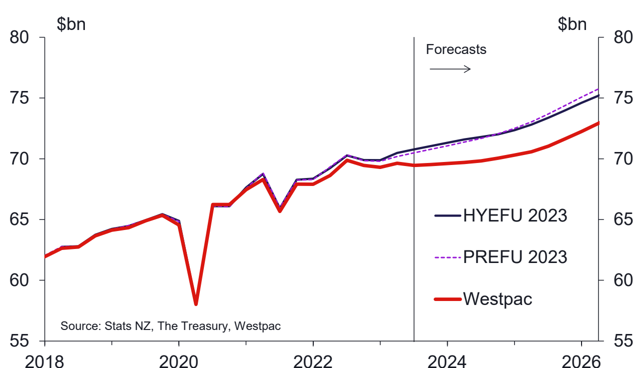
	Actual	Forecast				
	2023	2024	2025	2026	2027	2028
Net debt, % of GDP (June year)						
Half-Year Update	18.0	23.2	23.3	23.2	22.0	19.3
Changes since Budget Update	-0.1	0.9	0.5	0.8	1.0	-
Total Crown OBEGAL, $bn (June year)						
Half-Year Update	-9.4	-9.3	-6.1	-3.5	0.1	3.4
Changes since Budget Update	0.6	2.1	0.1	-2.0	-2.0	-
Fiscal impulse, % Nominal potential GDP (June year)						
Half-Year Update	-1.3	2.6	-2.4	-1.6	-0.8	-1.5
Changes since Budget Update	0.1	0.7	-1.2	0.6	n/c	-
Bond programme, $bn (June year)						
Half-Year Update	-	38.0	36.0	34.0	28.0	16.0
Changes since Budget Update	-	2.0	1.0	4.0	n/c	-

Macroeconomic outlook.

Looking at the details of the forecasts that underlie the updated fiscal projections, we agree with the broad thrust of the Treasury's numbers. Like ourselves, the Treasury is forecasting a period of subdued economic growth, with the combination of high inflation and interest rates, as well as challenging external conditions, weighing on activity.

However, we think there are risks around the Treasury's forecasts and that nominal revenue could fall short of their assumptions. Data released since the Treasury finalised their forecasts in early November indicate that the economy is starting from a weaker position than anticipated and inflation appears to be dropping back. Combined, these point to lower nominal GDP and slower

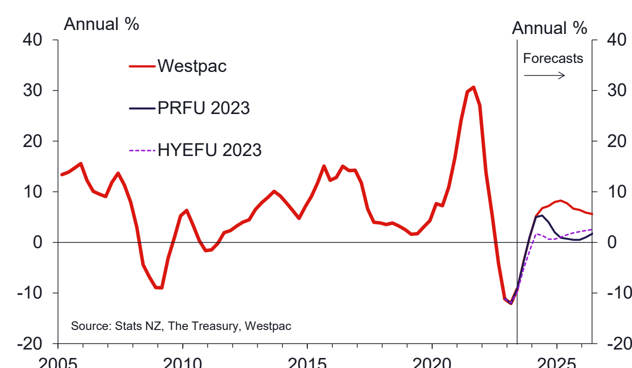
Real quarterly GDP



We also see risks that GDP growth over the next few years is lower than the Treasury expects. In particular, the Treasury's forecast for residential and business investment spending look optimistic. Given the headwinds confronting the economy, we see clear downside risks for spending in both areas.

One notable feature of the Treasury's forecasts is the assumption for house prices which has been revised higher as population growth has continued to climb. The Treasury currently expects that house price growth will rise to 5% over the year ahead. But the Treasury's forecasts have not incorporated the policy changes that were announced in today's mini-Budget, which include the winding back of the 'Brightline' holding period for taxing capital gains and plans to fully reinstate interest deductibility for property investors. We expect that those changes will boost investor demand, supporting an even stronger pick up in the housing market. We're forecasting that house prices will rise 8% over 2024.

House price forecasts



HYEFU 2023 economic forecasts

	Actual	Forecast				
	2023	2024	2025	2026	2027	2028
Real GDP growth, ann ave % (June year)						
Half-Year Update	3.2	1.5	1.5	2.8	3.0	2.7
Changes since Budget Update	0.1	0.2	-0.5	-0.5	-0.2	-
Nominal GDP growth, ann ave % (June year)						
Half-Year Update	8.9	6.1	4.7	5.4	5.4	5.0
Changes since Budget Update	0.6	0.2	-0.4	-0.4	-0.1	-
Unemployment rate (June quarter)						
Half-Year Update	3.6	4.5	5.2	4.8	4.6	4.4
Changes since Budget Update	0.0	-0.3	-0.2	0.0	0.0	-
Annual CPI inflation (June year)						
Half-Year Update	6.0	4.1	2.5	2.2	2.0	2.0
Changes since Budget Update	0.0	0.3	0.0	0.1	0.0	-
90-day interest rate						
Half-Year Update	5.6	5.7	4.9	3.6	2.9	2.6
Changes since Budget Update	0.0	0.1	1.0	0.2	-0.2	-

Key policy announcements in HYEFU.

The Government announced the following policy initiatives alongside the HYEFU:

- To bring the Brightline test for residential property back to two years, effective from 1 July 2024
- Fully restoring interest deductibility for rental properties, with details of the phasing of this commitment to be the subject of an announcement in the New Year.
- Indexation of main benefits to CPI inflation from 1 April 2024.
- Progression of work to deliver meaningful income tax reduction in the 2024/25 Budget.

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