ECONOMIC BULLETIN

Preview of Half-Year Economic and Fiscal Update and Budget Policy Statement – 1pm Tuesday 17 Dec 2024.

9 Dec 2024 | **Darren Gibbs**, Senior Economist | +64 9 367 3368 | +64 21 794 292 | darren.gibbs@westpac.co.nz

- **On 17 December the Government will provide an update on the state of its books. Information to date already points to some slippage relative to Budget 2024 forecasts.**
- **In addition, comments made by the Treasury suggest that the near-term outlook for growth, and thus tax revenue, is subject to some downside risk relative to Budget forecasts.**
- **As a result, we suspect that the NZDM will continue to issue a minimum of $38bn of bonds this year, despite the partial prefunding of this year's programme undertaken back in June.**
- **Treasury comments also suggest that revised forecasts will factor weaker trend productivity growth than in Budget 2024, leading to slower medium-term growth in tax revenue.**
- **This means that the forecast return to an OBEGAL surplus will likely be deferred until 2028/29, bringing the Government's forecast into line with our own.**
- **Consequently, the forecast bond programme will need to be raised beyond this year, with a weaker trend growth assumption having a compounding impact over time.**
- **Overall, we expect the programme for the four years to 2027/28 to be lifted by around $6bn. We anticipate a $20bn programme to be forecast in 2028/29.**
- **The Government will also provide an update of its priorities for Budget 2025, which will need to be funded within a very tight operating spending allowance.**

On Wednesday 17 December, the Treasury will release the Half-Year Economic and Fiscal Update (HYEFU) alongside the Budget Policy Statement (BPS). The HYEFU will provide an update on the economic and fiscal forecasts in Budget 2024, including the addition of a first forecast for the 2028/29 fiscal year. The BPS will set out the Government's priorities for Budget 2025 and provide an update on the Government's long-term fiscal objectives (the latter originally set in the Government's first BPS back in March).

A slightly worse starting point.

Audited figures for the 2023/24 fiscal year revealed an OBEGAL deficit that was $1.8bn worse than forecast in Budget 2024, largely due to higher spending outside of the core Crown sector i.e., SoE's and other state entities. Indeed, core Crown tax revenue was higher than expected, with high interest rates boosting withholding tax revenue. That slightly worse starting point appears to have continued into the new fiscal year, with the Treasury reporting an OBEGAL deficit (excluding minority holdings) that was $0.8bn larger than expected for the four months to October.

Focusing on the core Crown residual cash position – which drives the Government's borrowing programme – the deficit in the four months to October was $3.0bn larger than forecast in Budget 2024. However, this followed an audited deficit in the 2023/24 year that was $2.6bn smaller than forecast. These discrepancies largely reflect the earlier-than-expected receipt of corporate tax payments, which appears to have been influenced by the timing of the Matariki holiday. But New Zealand Debt Management (NZDM) also partially prefunded this year's borrowing requirement (to the tune of $1.3bn) when it conducted the $3.5bn tap of the 2028 bond back in June, thus contributing to the stronger cash position in 2023/24. So, in underlying terms, the cash accounts also suggest that the fiscal position is a little weaker than envisaged in Budget 2024.

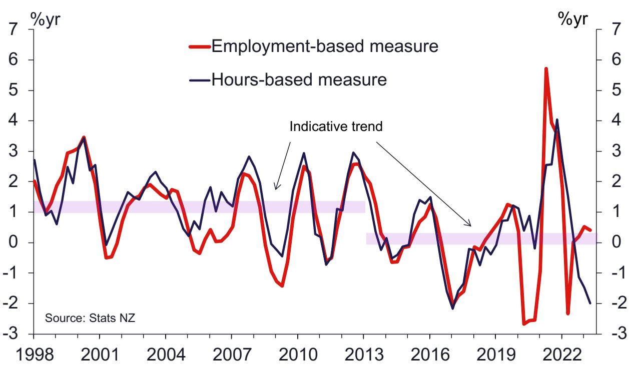
Looking towards the remainder of this fiscal year, in a recent speech the Treasury's Chief Economic Advisor appeared to indicate that the Treasury will revise down its near-term outlook for GDP growth in the HYEFU (notwithstanding a more rapid easing of monetary policy than had been assumed in Budget 2024). All else equal, this will lead the Treasury to project a shortfall of tax revenue compared with Budget forecasts, although the recent lift in key export commodity prices might reasonably be expected to provide at least a partially offsetting boost to tax revenue forecasts over the coming year or so.

On balance, we think that the forecast OBEGAL deficit for this year could be revised up to around $15bn, compared with the Budget forecast of $13.4bn. As a result, notwithstanding the partial pre-funding of this year's original forecast requirement conducted back in June, we think it is likely that NZDM will still issue $38bn of bonds this year. Some additional short-term funding (Treasury bills or ECP) might be required too if NZDM wants to avoid modestly lifting this year's programme. Alternatively, despite maintaining a notional $38bn programme for this year, NZDM might choose to partially prefund the 2025/26 borrowing requirement in this year's remaining syndication (if required and market conditions allow).

Medium-term outlook likely to be impacted by weaker assumption for trend economic growth.

Looking beyond this year, additional comments made by the Treasury's Chief Economic Advisor suggest that the Treasury will revise down its estimate of trend productivity growth. This reflects the fact that productivity growth over the past decade or so has been much weaker than the Treasury's long-term assumption of around 1% (recent news of impending upward revisions to GDP growth over the past couple of years, notwithstanding). Once the cyclical upswing in the economy is complete, GDP growth will settle at a slower long-term pace than assumed in Budget 2024.

Labour productivity



Slower growth in nominal GDP will imply a smaller future tax base than assumed in Budget 2024, with the impact compounding over time. The impact on the Treasury's tax revenue forecasts will depend on the size of the downgrade that the Treasury choose to make. Given an average tax-to-GDP ratio of about 30%, even a 0.25% reduction in assumed trend labour productivity growth (from 1% to 0.75%) would lower revenue in the first year by a little over $300m, and by a further $300m or so in each subsequent year as the impact of slower growth compounds. The impact would be twice as large if the Treasury were to reduce its assumption from 1% to 0.5%. We note that the latter years of the projections in the RBNZ's November Monetary Policy Statement (MPS) imply a trend labour productivity growth rate of around 0.5% - about half of the growth rate that had been assumed in the August MPS. It is quite possible that the Treasury makes a similar revision to its own forecast.

Given the worse starting point and the likelihood of some downward revision to trend productivity growth, it seems reasonable to expect an underlying $1-3bn lift in the annual borrowing requirement compared to that depicted in Budget 2024. Revisions towards the top end of that range would be likely later in the forecast period due to the compounding effect of a lower trend productivity growth assumption. But given NZDM's tendency to smooth the funding profile (more recently in $2bn increments), we think that the revised programme could look like that in *table 1*, with the issuance task raised by $2bn in all years from 2025/26 onwards. In 2028/29 – entering the forecast horizon for the first time – we expect a forecast programme of around $20bn.

Table 1: NZ Government Bond Programme ($bn)

	24/25	25/26f	26/27f	27/28f	28/29f
Budget 2024	38	36	32	20	n/a
HYEFU 2024 (Westpac f/c)	38	38	34	22	20
Difference	0	2	2	2	n/a

Source: NZ Treasury

Government's Budget goals and long-term fiscal objectives likely unchanged.

The BPS will set out the Government's priorities for Budget 2025 and the Government's long-term fiscal objectives. The priorities for the Budget will continue to reflect the same overarching goals as articulated previously: building a stronger and more productive economy, the delivery of more efficient and effective public services, and getting the public finances back in order.

We expect that the BPS will indicate an intention to continue to pursue those goals while still working within the very tight $2.4bn operating allowance assumption that was made in Budget 2024. But there may be some risks to this assumption now inflation has fallen, and the government is keen to pivot to a growth focused agenda. Revisions to the outlook for OBEGAL and the bond programme would be larger if the Government was to relax this assumption.

A significant relaxation of the operating allowance assumption would also be noted by the RBNZ and factored into its next forecast update in the February Monetary Policy Statement. It may also be viewed negatively by the credit rating agencies if the commitment to return net debt to the government's 20-40% range comes into question.

The Government's long-term objectives are likely to be unchanged: (1) reduce core Crown spending towards 30% of GDP, so as to eventually achieve an OBEGAL surplus; and (2) put net core Crown debt on a downward trajectory to below 40% of GDP, and thereafter maintain it within a band of 20 to 40% of GDP (but with no prospect of actually achieving that goal within the forecast horizon). The BPS will likely also indicate an intention to top up the multi-year capital allowance (MYCA), perhaps by as much as $7bn, reflecting the additional year added to the Treasury's forecast horizon.

CONTACT

Westpac Economics Team | **westpac.co.nz/economics** | economics@westpac.co.nz

Kelly Eckhold, Chief Economist | +64 9 348 9382 | +64 21 786 758 | kelly.eckhold@westpac.co.nz

Satish Ranchhod, Senior Economist | +64 9 336 5668 | +64 21 710 852 | satish.ranchhod@westpac.co.nz

Darren Gibbs, Senior Economist | +64 9 367 3368 | +64 21 794 292 | darren.gibbs@westpac.co.nz

Michael Gordon, Senior Economist | +64 9 336 5670 | +64 21 749 506 | michael.gordon@westpac.co.nz

Paul Clark, Industry Economist | +64 9 336 5656 | +64 21 713 704 | paul.clark@westpac.co.nz

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