

# Budget Economic and Fiscal Update 2024 Projections

## Budget Economic and Fiscal Update 2024 of the Fiscal Strategy Model (FSM)

30 May 2024

This version of the Fiscal Strategy Model uses economic and fiscal forecasts prepared for the *Budget Economic and Fiscal Update 2024* (BEFU). The projection period begins in 2028/29 and extends a decade to 2037/38. These post-forecast fiscal projections are based on the long-run technical and policy assumptions outlined below.

The Fiscal Strategy Model (sometimes referred to by the acronym FSM) that produces the projections can be found on the Treasury website at <https://treasury.govt.nz/government/fiscalstrategy/model>

Forecasts attempt to predict future outcomes by using wide-ranging resources, comprehensive modelling and expert opinion and knowledge. Projections, which arise from and are heavily influenced by their forecast base, are potential paths. These paths are based on trends or long-run averages for growth rates or levels of key economic, fiscal, and demographic variables, and generally assume no policy changes beyond those built into their forecast base.

### Economic projections and assumptions

Table 1 displays the economic projections from the Budget EFU 2024 Fiscal Strategy Model

**Table 1** – Summary of economic projections<sup>1</sup>

Year ending 30 June	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	.....	2038
	Forecasts					Projections						
Labour force	2.5	1.5	1.6	1.4	1.3	1.1	1.1	1.0	0.9	0.9	...	0.6
Unemployment rate <sup>2</sup>	4.3	5.3	4.9	4.6	4.4	4.4	4.3	4.3	4.3	4.3	...	4.3
Average weekly hours worked <sup>3</sup>	33.6	33.6	33.7	33.7	33.7	33.7	33.7	33.7	33.7	33.7	...	33.7
Labour productivity growth <sup>4</sup>	-1.4	1.1	1.0	1.2	1.3	1.2	1.1	1.0	1.0	1.0	...	1.0
Real GDP <sup>5</sup>	-0.2	1.7	3.2	2.9	2.7	2.5	2.3	2.1	1.9	1.9	...	1.6
Nominal GDP <sup>6</sup>	4.4	4.2	5.6	5.3	5.0	4.6	4.4	4.1	4.0	3.9	...	3.6
Consumers Price Index	3.4	2.2	2.1	2.0	2.0	2.0	2.0	2.0	2.0	2.0	...	2.0
Government 10-year bonds	4.8	4.4	4.3	4.2	4.1	4.3	4.3	4.3	4.3	4.3	...	4.3
Average hourly wage	6.5	4.5	3.3	3.0	3.0	3.2	3.1	3.0	3.0	3.0	...	3.0

Notes:

- 1 Annual average percentage change unless otherwise stated
- 2 Total unemployed as a percentage of the labour force (annual average)
- 3 Average weekly hours worked (total hours worked ÷ total employed labour force)
- 4 Average annual growth in real GDP divided by total hours worked
- 5 Production measure, 2009/10 base
- 6 Expenditure measure

Sources: The Treasury, Stats NZ

Most economic variables are close to their assumed long-run trend growth rates or levels by the end of the forecast. If they differ from this assumption by the final forecast year, then they are transitioned to attain it over the early projected years. The annual convergence rate assumed is based on recent actual and forecast performance. Table 2 reports the five economic variables for which stable assumptions are made and the projected year in which they attain these in the Budget EFU 2024 Fiscal Strategy Model.

**Table 2** – Economic variables with long-run stable assumptions and year of attainment

Economic variable	Stable assumption	End-of-forecast value	Attained in projected year
Unemployment rate	4.25%	4.44%	2030/31
Average weekly hours worked	33.70	33.65	2030/31
Labour productivity annual growth	1.0%	1.33%	2030/31
Consumers Price Index (CPI) annual growth (inflation measure)	2.0%	2.00%	2028/29
Government 10-year bond annual return rate	4.3%	4.05%	2028/29

Source: The Treasury

Projected real gross domestic product (GDP) grows from its forecast base via the annual combined change in the size of the employed labour force, the average hours they work and their productivity. Once the latter two variables, as well as the unemployment rate, stabilise in projected years the only variation in projected real GDP arises from that of the labour force. Statistics New Zealand’s population and labour force projections are used in projecting out the labour force’s size and annual growth.

Growth in nominal GDP in each projected year is achieved by adding inflation, as measured by the Consumers Price Index (CPI), to the real GDP growth. The long-run stable assumption for CPI inflation of 2 per cent per year matches the midpoint of the band set in the remit for the Reserve Bank of New Zealand’s Monetary Policy Committee. Nominal GDP growth is used to project many fiscal variables, including tax revenue. It is also the denominator for most major fiscal indicators, such as net core Crown debt to GDP.

## Fiscal projections and assumptions

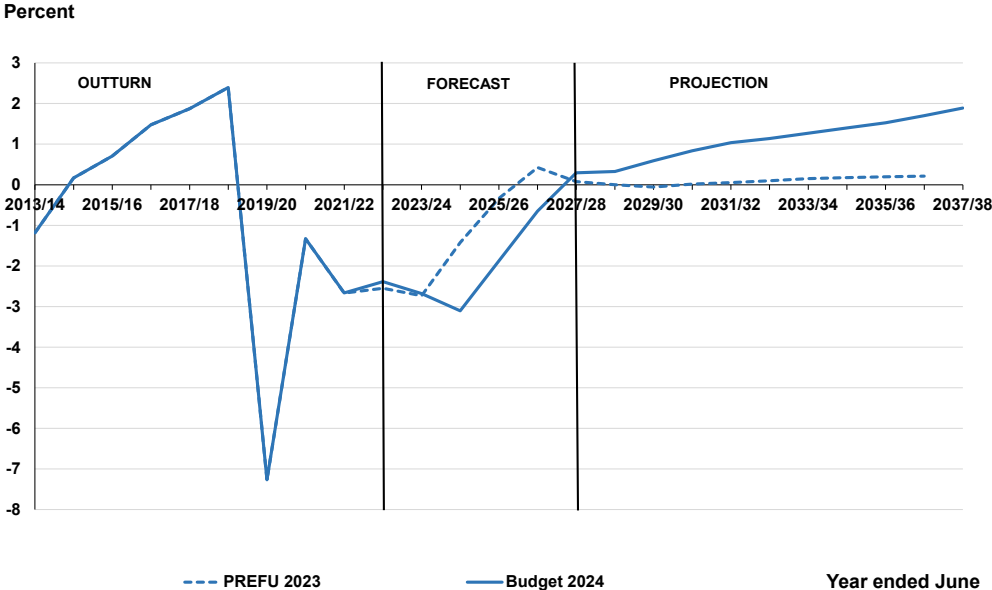
Fiscal projections have changed from those published as part of the *Pre-Election Economic and Fiscal Update 2023* (PREFU) version of the Fiscal Strategy Model. This reflects changes in the economic and fiscal forecast bases of the projections, as well as some changes in the policies modelled, assumptions used to project variables and the logic applied in formulae.

The key fiscal indicator of financial performance, the total Crown operating balance before gains and losses (OBEGAL), is lower as a percentage of nominal GDP than it is in the PREFU 2023 track over most of the forecast years. However, as is shown in Chart 1 below, the Budget 2024 OBEGAL track steadily rises above the PREFU 2023 version across the projected years.

Revenue, as a percentage of nominal GDP, is lower for Budget 2024 relative to PREFU 2023 for all forecast years. This leads to a lower starting point for the revenue projections, although tax revenue converges towards its long-run average more slowly than in the PREFU 2023 projections because tax brackets are adjusted more slowly in the early projected years. This reflects the personal income tax changes announced at Budget 2024.

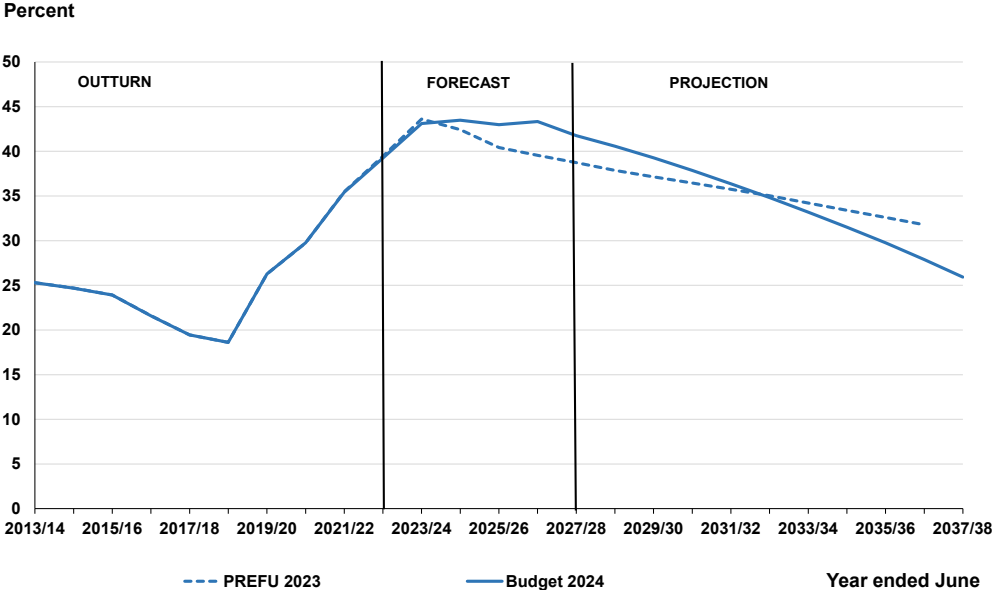
However, the Budget 2024 OBEGAL track is still above that of PREFU 2023 in projected years because the revenue reduction is more than compensated for by lower expenses, not only as a percentage of GDP but in nominal dollar terms too. The biggest contribution to the expenditure reduction comes from lower operating allowances in both forecast and projected years. From 2026/27 onwards the PREFU 2023 forecasts applied \$3.0 billion operating allowances per annum, growing this starting amount at 2% per year over projections. The Budget 2024 forecasts used \$2.4 billion operating allowances in these years, with the same 2% annual growth applied. The cumulative nature of the operating allowance reductions increases the gap between the two expense tracks over the projections, while the revenue gap stays relatively stable. As a result, the Budget 2024 OBEGAL track widens the positive gap with the PREFU 2023 one over the projected years, as illustrated in Chart 1.

**Chart 1** – Total Crown OBEGAL as a percentage of nominal GDP, Budget 2024 and PREFU 2023



Net core Crown debt, excluding the NZSF and advances, plateaus over most of the Budget 2024 forecast years at higher percentages of GDP than the PREFU 2023 track in these years. However, with growing OBEGAL surpluses generated from 2027/28 onwards the net core Crown track steadily declines over the projected years. Stronger surpluses than in the PREFU 2023 projections result in the Budget 2024 net core Crown debt track reducing below that of the PREFU from 2032/33 onwards.

**Chart 2** – Net core Crown debt as a percentage of nominal GDP, Budget 2024 and PREFU 2023



The Government's long-term fiscal objectives are being met in the Budget 2024 projections. These objectives are to:

- reduce net core Crown debt below 40 per cent of GDP and then maintain it within a range of 20 per cent to 40 per cent of GDP, subject to economic shocks
- maintain operating surpluses sufficient to ensure consistency with the debt objective
- over time reduce core Crown expenses towards 30 per cent of GDP
- ensure operating revenue levels are consistent with the operating balance objective, and
- ensure net worth remains at a level sufficient to act as a buffer to economic shocks.

Table 3 reports the fiscal projections from the updated Fiscal Strategy Model, projecting onward from the fiscal forecasts for 2022/23 to 2026/27.

**Table 3** – Summary of fiscal projections, as percentages of nominal GDP

Year ending 30 June	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	.....	2038
	Forecasts					Projections						
Core Crown revenue	32.0	31.6	31.7	32.0	32.2	32.1	32.1	32.0	31.9	31.8	...	31.2
Core Crown expenses	33.5	33.4	32.5	31.6	31.1	31.0	30.7	30.5	30.3	30.1	...	29.0
Core Crown residual cash	-5.3	-2.1	-1.7	-2.3	-0.2	-0.7	-0.4	-0.2	0.0	0.1	...	1.0
Total Crown revenue	40.0	39.0	39.0	39.0	39.1	39.1	39.1	39.0	38.9	38.8	...	38.2
Total Crown expenses	42.5	42.0	40.8	39.6	38.7	38.6	38.4	38.1	37.8	37.5	...	36.2
Total Crown OBEGAL <sup>1</sup>	-2.7	-3.1	-1.9	-0.6	0.3	0.3	0.6	0.8	1.0	1.1	...	1.9
Total Crown operating balance <sup>2</sup>	-0.7	-1.7	-0.4	0.8	1.8	1.8	2.1	2.4	2.6	2.8	...	3.6
Net debt <sup>3</sup>	20.9	23.1	24.1	23.9	21.9	20.4	18.7	16.9	15.1	13.2	...	2.6
Net core Crown debt <sup>4</sup>	43.1	43.5	43.0	43.3	41.8	40.6	39.3	37.9	36.4	34.8	...	25.9
Gross debt (core Crown)	42.3	45.7	48.3	49.9	48.4	46.9	45.2	43.4	41.6	39.8	...	29.6
Total Crown net worth	45.8	42.3	39.6	38.5	38.5	38.8	39.4	40.4	41.7	43.0	...	51.7
Net worth attributable to the Crown <sup>5</sup>	43.8	40.3	37.8	36.7	36.8	36.9	37.5	38.5	39.7	41.1	...	49.8

Notes:

- 1 Operating balance before gains/(losses)
- 2 Excludes minority interests
- 3 Includes Crown entity borrowings and financial assets of the New Zealand Superannuation Fund (NZSF) and core Crown advances
- 4 Excludes financial assets of the NZSF and core Crown advances and excludes Crown entity borrowings
- 5 Excludes assets and liabilities belonging to minority interests

The assumptions underpinning the projections are reported in Table 4.

**Table 4** – Summary of fiscal assumptions

Tax revenue	<p>Linked to growth in nominal GDP. Each of the six major tax types, as well as the inter-segment elimination between core Crown and total Crown tax, moves from its end-of-forecast percentage of GDP towards a stable percentage of GDP, based on the average for the tax type over the five forecast years and the previous five outturn (historical) years. A transition rate of 0.05 percentage points of GDP is used for all of the tax types.</p> <p>However, overriding any transition up or down for overall total Crown tax revenue is modelling that retains this aggregate tax measure at its end-of-forecast percentage of nominal GDP until net core Crown debt has reduced below a targeted percentage of nominal GDP. In the BEFU 2024 FSM that targeted percentage is 40 per cent of GDP. This adjustment has been made to reflect the tax reductions incorporated in the forecast base of source deductions and other personal income tax types. Due to these, tax brackets require less adjustment to address fiscal drag, which by the early projected years has had less time to build up than if there were no tax cuts.</p> <p>Once net core Crown debt has reduced below 40 per cent of GDP all tax types are then projected in ensuing years as described in the first paragraph.</p>
New Zealand Superannuation (NZS)	<p>Demographically adjusted and linked to net wage growth, via the “wage floor.” The latter refers to the net (after-tax) weekly NZS rate for a couple as set in legislation to lie between 66 per cent and 72.5 per cent of net (after tax) average ordinary time weekly earnings (AOTWE).</p>
Jobseeker Support (JSS), Supported Living Payment (SLP), Sole Parent Support (SPS) and Student Allowances	<p>The three main working-age benefits JSS, SLP and SPS, as well as Student Allowances, are grown via demographic adjustment of recipient numbers and annual growth in the projected Consumers Price Index for payment rate indexation. For JSS, which is the most sensitive in terms of recipient numbers to economic conditions, recipient growth is also influenced by projected growth in the size of the unemployed section of the labour force.</p>
Other transfers	<p>There are four transfer types, including Accommodation Assistance and Working for Families tax credits, which are projected in the same way as tax revenue types. A transition rate of 0.05 percentage points of GDP is applied for each of the transfer categories.</p>
Other expenditure	<p>Most expense categories, such as health, education, core government services, etc, are held constant in projected years at their end-of-forecast values. This is because their growth is assumed to come from a share of the projected Operating Allowance annual increment. A notable exception is transport expenditure, which is funded from hypothecated transport taxes and hence is projected in line with that tax type's growth. A few small components of various expense categories in this grouping, like Student allowances in Education and KiwiSaver subsidies in Economic and Industrial Services, are projected by some form of growth driver, rather than kept constant, because they are not funded from the Operating Allowances.</p>
Finance costs	<p>A function of debt levels and interest rates.</p>
Operating allowance	<p>\$2.4 billion in 2028/29. Operating Allowances continue to grow at 2 per cent per year from this value in later projected years.</p>
Capital allowance	<p>\$7.0 billion in 2028/29. Capital Allowances continue to grow at 2 per cent per year from this value in later projected years.</p>
New Zealand Superannuation Fund (NZSF)	<p>Contributions to the NZSF follow the legislated formula and are calculated by the Treasury's NZSF model using BEFU 2024 economic and fiscal forecast inputs, in particular nominal GDP and aggregate net NZS expenses.</p>