The Treasury

Budget 2021 Information Release

August 2021

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[33] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials

[34] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions

[35] 9(2)(g)(ii) - to maintain the effective conduct of public affairs through protecting ministers, members of government organisations, officers and employees from improper pressure or harassment

[36] 9(2)(h) - to maintain legal professional privilege

[37] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice

[38] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice

[39] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage

[40] Not in scope

[42] 18(d) - information is already publicly available or will be publicly available soon.

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TE TAI ŌHANGA
THE TREASURY

Treasury Report: BEFU 2021 Preliminary Economic and Tax Forecasts

Date:	26 February 2021	**Report No:**	T2021/327
		File Number:	BM-3-6-1

Action sought

	Action sought	Deadline
Hon Grant Robertson **Minister of Finance**	Note preliminary economic forecasts for BEFU show an economic growth outlook that is stronger than in HYEFU, resulting in an upward revision in core Crown tax revenue of nearly $25 billion.	Weekly Agency Meeting, Monday 1 March 2021

Contact for telephone discussion (if required)

Name	Position	Telephone		1st Contact
Melissa van Rensburg	Analyst, Forecasting	[39]	n/a (mob)	✓
Katy Simpson	Team Leader, Forecasting		n/a (mob)	

Minister's Office actions (if required)

Return the signed report to Treasury.

Note any feedback on the quality of the report

Enclosure: No

Treasury Report: BEFU 2021 Preliminary Economic and Tax Forecasts

Executive Summary

The New Zealand economy has been more resilient to the COVID-19 pandemic than previously assumed. Following the June quarter contraction, New Zealand's real GDP is now back to pre-pandemic levels, making it one of only a few OECD countries that have managed this. We expect economic growth to continue over the course of 2021, albeit at a slower pace as border restrictions remain in place, before picking up from 2022 onwards, when the removal of border restrictions is assumed to enable renewed tourism growth.

The swift recovery from the downturn and the cushioning effect of policy support means that the degree of scarring is likely to be lower than previously assumed. However, the pandemic is still expected to have some persistent impact on potential output, for example due to supply chain issues and the re-allocation of labour between sectors. As a result, we have reversed around two-thirds of our previous near 3% downgrade to potential output.

The improved outlook, on top of sizable upward revisions to historical data, results in **nominal expenditure GDP being $100 billion higher by the end of the forecast period**. This is a major driver of the nearly $25 billion increase in core Crown tax revenue forecasts.

The economic forecasts are dependent on some key assumptions. For example, we assume all remaining border restrictions are removed on 1 January 2022, with some easing of restrictions from the middle of this year. If this was delayed, we may see more firm failures, a more pronounced increase in unemployment and lower business investment. These forecasts are also based on no further increases in alert levels.

Uncertainty levels remain heightened and there are measurement challenges in capturing the true state of the economy at present. There are also risks around the global outlook and the effectiveness of vaccines. Our GDP forecasts are now slightly higher than those of the Reserve Bank and most bank forecasts.

However, there is upside risk too. While we have upgraded our nominal GDP forecasts significantly, in the near term this still falls short of the underlying strength that would be suggested by tax outturns alone. If the current strength in tax revenue is sustained, rather than partially unwinding as is currently assumed, not only would tax revenue be higher, but it may mean we have underestimated the strength in the economy too.

The labour market has held up well, with stronger-than-expected employment growth and a fall in the unemployment rate in the December quarter. Employment is expected to continue growing, but at a relatively muted pace in the short term compared to usual, constrained by the absence of the usual seasonal uptick in employment in the tourism industry. As a result, **we forecast a slight increase in the unemployment rate in the near term, but expect it to peak at a much lower 5.4%**, compared to the 6.9% peak forecast in the 2020 Half Year Economic and Fiscal Update (HYEFU).

The stronger domestic recovery results in consumer price inflation being higher across the forecast period compared to HYEFU, although a stronger exchange rate provides some offset. High house price growth is expected to persist in the short term, supported by low interest rates, but is forecast to ease over time due to the reintroduction of loan-to-value ratio restrictions, lower affordability, and rising interest rates. The global economic outlook has improved since HYEFU, and strong momentum in key trading partners and rising commodity prices should support our terms of trade.

Table 1: Forecast summary (Preliminary BEFU vs. HYEFU)

Year to June		2020 Actual	2021 Forecast	2022 Forecast	2023 Forecast	2024 Forecast	2025 Forecast	5yr total
Real GDP (AAPC)	BEFU21	-1.8	4.6	2.6	4.2	3.3	2.9	
	HYEFU20	-2.1	1.5	2.6	3.7	3.8	3.2	
Unemployment rate	BEFU21	4.0	5.3	5.0	4.5	4.2	3.9	
	HYEFU20	4.0	6.6	6.8	5.7	4.7	4.0	
CPI inflation (APC)	BEFU21	1.5	2.0	1.5	1.8	2.0	2.2	
	HYEFU20	1.5	1.4	1.2	1.4	1.8	2.1	
Nominal GDP ($ billion)	BEFU21	316	337	349	371	393	415	
	HYEFU20	308	316	330	351	373	395	
	Change	8	21	18	20	20	21	100
Core Crown tax revenues ($billion)	BEFU21	85.1	92.7	93.9	102.0	107.5	114.0	
	HYEFU20	85.1	88.3	89.1	96.9	102.5	108.8	
	Change	0.0	4.4	4.8	5.1	5.0	5.2	24.5

Recommended Action

We recommend that you:

a **note** the Treasury’s preliminary Budget Economic and Fiscal Update (BEFU) 2021 economic forecasts show an economic growth outlook that is stronger than the Half Year Economic and Fiscal Update (HYEFU) 2020 forecasts. This reflects historical data revisions, the stronger-than-expected recovery to date, and less severe scarring effects on potential output;

b **note** that in line with the economic forecasts, tax revenues are higher than in the HYEFU 2020 forecasts. In total across the five years to June 2025, core Crown tax revenue forecasts are nearly $25 billion higher than in the HYEFU 2020 forecasts; and

c **note** that the uncertainty around the economic outlook is higher than usual and we expect to see larger than normal revisions to the fiscal outlook over the coming years as we update our forecasts.

Katy Simpson
Team Leader, Forecasting

Hon Grant Robertson
Minister of Finance

Treasury Report: BEFU 2021 Preliminary Economic and Tax Forecasts

Purpose and context of report

1. This report provides an **overview of the Treasury's preliminary economic and tax forecasts for BEFU 2021**. These economic and tax forecasts underpin the preliminary fiscal forecasts currently being compiled.

2. You will receive fiscal strategy advice on Thursday, 4 March and advice on Budget 2021 package options (and draft Budget Ministers 2 slides) on Friday, 5 March. **You have a meeting with Treasury officials on Monday, 8 March to discuss our advice on Budget package options**. Budget Ministers 2 is scheduled for Tuesday, 16 March. We will provide you with information on the preliminary fiscal forecasts on 25 March.

3. **The final BEFU forecasts will reflect any fiscal decisions you take following the fiscal strategy advice**. In addition, they will include new economic data, in particular the December quarter GDP outturn that will be released on 18 March, and any other major developments.

4. Annex 1 provides tables with additional details on the economic forecasts, including changes since HYEFU.

Key assumptions underpinning the economic forecasts

5. **COVID-19 continues to materially influence the economic outlook and uncertainty remains high**. A number of assumptions about the impact and likely timing of border restrictions remain necessary.

6. **Border restriction assumptions are unchanged from HYEFU**. The Treasury's working assumption therefore continues to be that border restrictions are removed on 1 January 2022, although an easing is assumed from 1 July 2021 onwards.

7. **We assume there are no further major domestic outbreaks of COVID-19 in the community**, and Alert Level 1 restrictions remain in place for the remainder of 2021. The introduction of higher alert levels during February 2021 are assumed to have had a negligible impact on economic activity given their relatively short-lived nature.

8. **Potential output has been revised higher owing to evidence that the pandemic has caused less severe scarring than previously assumed**. In the 2020 Pre-election Economic and Fiscal Update (PREFU), we assumed that potential output would be nearly 3% lower by the June quarter of 2024. However, the fact that the labour market has held up better than expected suggests that there has been less scarring to the labour input component of potential output (including labour force participation and hours worked). In addition, business investment has not declined by as much as previously forecast, which suggests that the hit to capital accumulation is also likely to be smaller than previously assumed.

9. **It is still too early to say what the true extent of the impact of COVID-19 will be in the long term. However, while there is evidence of less scarring, we still expect that the COVID-19 pandemic will likely have some persistent impact on potential output**, for example due to supply chain disruptions, the re-allocation of labour between sectors, and business failures in tourism-related sectors.

10. Therefore, we have reversed around two-thirds of our previous near 3% downgrade to potential output. When combined with revisions to historical data, in part reflecting upward revisions to the size of the New Zealand population of around 70,000, the potential size of the economy is now forecast to be higher than we expected in HYEFU 2019, our last forecast before the pandemic (Figure 1).[1]

Figure 1: Potential output

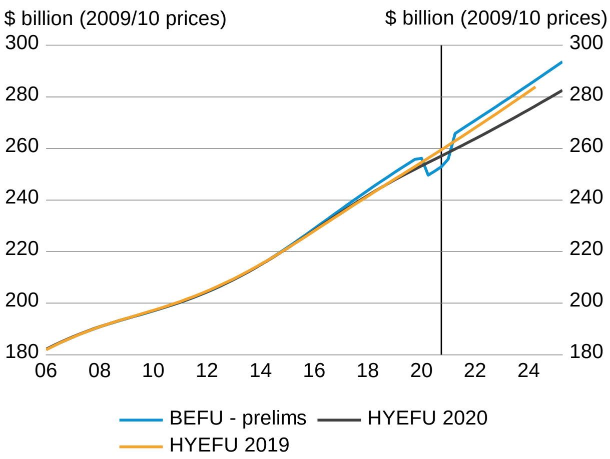
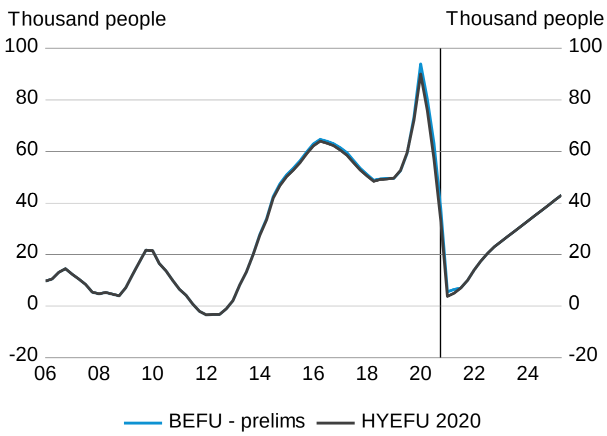


Figure 2: Net migration (annual)



11. Net migration is assumed to start rising gradually from an assumed 1,000 a quarter currently, and to reach just above 40,000 per annum by the end of the forecast period (Figure 2). **Any material changes to government immigration policy can be incorporated into the final forecasts.** We would need details of any changes around the same time you make budget spending decisions.

12. Fiscal support in the economic forecasts are in line with the final HYEFU fiscal forecasts. COVID-19 related fiscal support amounts to $37.2 billion between 2021 and 2025. The profile assumes spending peaks in 2021 before gradually easing.

[1] Note that we have changed the way we measure potential output and the output gap in the June 2020 quarter downturn. Previously, we assumed that there was no material change in potential output during the downturn, which implied that there was a large fall in the output gap (since production could still technically take place but did not because of government regulations). We now instead assume that there was a sharp fall in potential output since, even though the inputs to the production process were still available, the alert level restrictions meant that they could not legally be employed in some sectors, and therefore potential output was lowered temporarily. Note that both outcomes are feasible from a theoretical perspective, but we have decided to change our methodology for presentational purposes.

Economic outlook

Domestic demand has proved more resilient than expected…

13. Since the publication of HYEFU, there has been further evidence that **the New Zealand economy has been more resilient to the COVID-19 pandemic than previously assumed**. In particular, economic growth in the September 2020 quarter was much stronger than forecast, with production GDP growing by 14% (to be 0.2% higher than December 2019), while expenditure GDP growth was even stronger at 15.7% (3.7% higher than in December 2019). In HYEFU, we had forecast growth of 10.5% in production GDP.

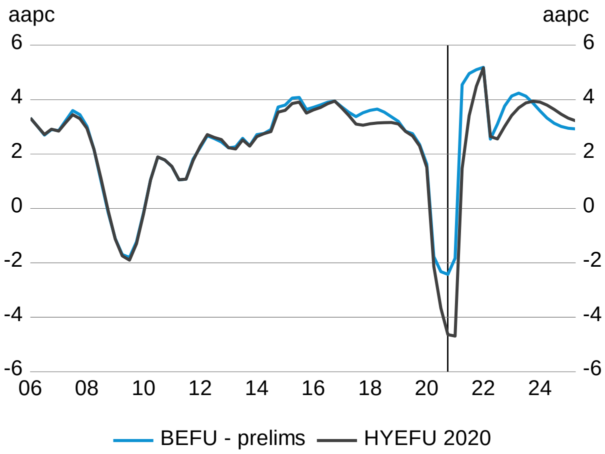
14. Several other indicators suggest that **domestic demand remains fundamentally strong**. Tax outturns have continued to exceed forecasts, the labour market has recovered strongly, house prices and building consents remain elevated, and confidence levels have recovered (though remain below their historical averages).

15. **Despite border restrictions, we expect growth to continue over the course of 2021, albeit at a slower pace.** The impact of border restrictions on the tourism sector will be most acutely felt in the peak summer season. While we expect a slowdown in momentum in the December quarter of 2020 and March quarter of 2021, **we are not forecasting a technical recession**, in contrast to some of the domestic banks. The GDP outlook is also slightly stronger than presented in the Reserve Bank's February Monetary Policy Statement.

16. **Considerable uncertainty remains, both in terms of the evolution of COVID-19 as well as the degree to which pent-up demand contributed to the current strength**. As a result, we expect real GDP growth to remain relatively subdued in the remainder of 2021, before picking up in 2022 as border restrictions are lifted. Real GDP growth is expected to decline towards trend levels thereafter due to lower policy support, although continued above-average growth in tourism-related industries (reflecting catch-up growth) should provide some offset.

17. Annual growth in production GDP is now forecast to reach a trough of -2.4% in the 2020 December quarter, compared to a -4.7% trough forecast in HYEFU in the March 2021 quarter (Figure 3). **The stronger momentum along with upward historic data revisions, stronger potential output, and a positive output gap by the end of the forecast period leaves GDP significantly above HYEFU 2020 forecasts**.

Figure 3: Real GDP growth



18. Following the stronger-than-expected rebound in the September 2020 quarter, **private consumption is expected to remain resilient**, with low interest rates boosting the disposable incomes of households who have bank loans or mortgages, substitution away from spending on international holidays in the earlier part of the forecast period, and the wealth effect of higher house prices. Retail sales volumes – an indicator of real private consumption – declined by 2.7% in the December 2020 quarter, but were still up 4.8% from a year ago after surging by 27.8% in the previous quarter.

19. Business and residential investment levels also bounced back much more strongly than forecast over the September 2020 quarter. **Partial indicators for the December 2020 quarter, such as capital imports and non-residential consents, suggest a slowdown in momentum in business investment**. However, overall confidence levels have improved, and we expect steady growth in 2021 and beyond. Residential investment bounced back 42.0% in the September quarter to be 7.3% higher than a year ago. Although catch-up effects are likely to have played a role, there is evidence that the higher activity levels have persisted. Annual building consents have increased towards the record highs of the 1970s. This implies robust growth in the New Zealand housing stock can be expected, which should over time start contributing to an easing in some of the long-standing supply issues.

…leading to higher inflation…

20. **The stronger domestic recovery results in consumers price index (CPI) inflation being higher across the forecast period compared to HYEFU**, although a higher exchange rate provides some offset (Figure 4). CPI inflation was slightly higher than expected in the December 2020 quarter due to strong domestic demand driving up non-tradables inflation, with higher housing costs and accommodation prices as well as supply chain disruptions contributing to the increase. Inflation expectations have also increased recently, with the Reserve Bank's January survey showing that 2-year inflation expectations reached 1.9%, near the mid-point of the Reserve Bank's target range. These results were in line with other inflation expectation surveys, such as the ANZ Business Outlook (ANZBO).

21. Annual CPI inflation is forecast to increase to just below 2% in the near term, partly due to base effects and higher commodity prices, before trending downwards as momentum in the domestic demand recovery eases somewhat along with an expected easing in the effects of supply chain congestion. Then, as the domestic recovery gathers steam and the lifting of border restrictions support the economy, **CPI inflation is forecast to return to the mid-point of the Reserve Bank's target range by the June quarter of 2024**.

Figure 4: CPI inflation

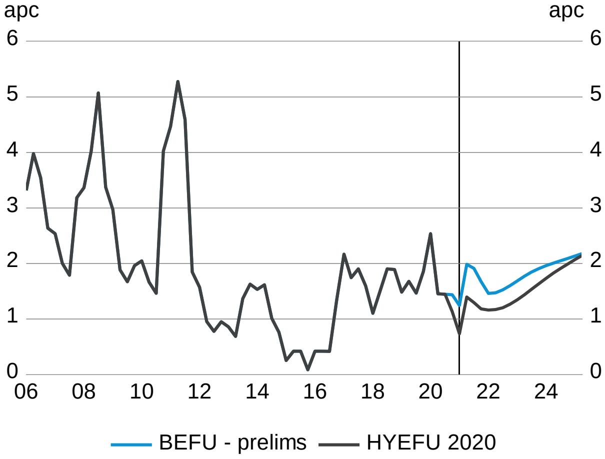
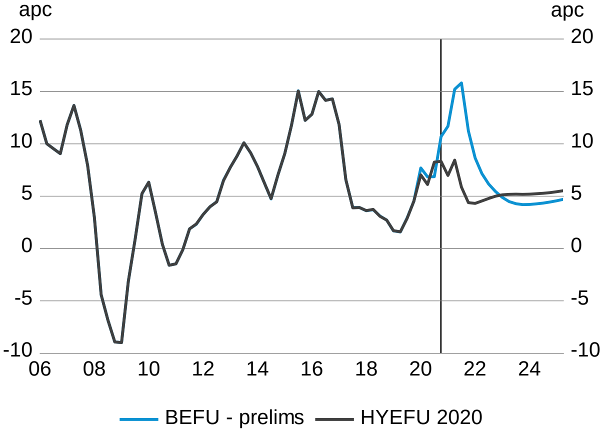


Figure 5: House price inflation

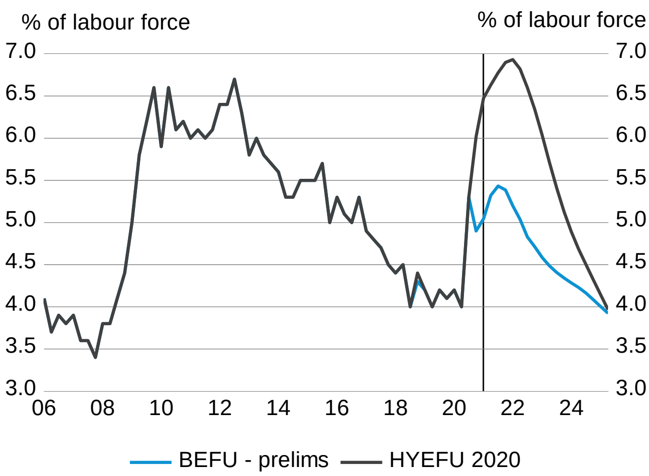


22. House prices have continued increasing rapidly since HYEFU was published, with annual growth in the Real Estate Institute of New Zealand (REINZ) House Price Index reaching 19.2% in January, the highest annual growth rate since June 2004. **High house price growth is expected to persist in the short term, supported by low interest rates, but is forecast to ease over time** as lower affordability and the return of loan-to-value ratio restrictions dampens growth in new lending (Figure 5).

…a lower forecast peak in the unemployment rate…

23. The labour market has held up well, with stronger-than-expected employment growth and a surprise fall in the unemployment rate in the December quarter. There are several reasons this strength may persist: domestic demand has remained resilient, JobSeeker support numbers have declined slightly, monthly job numbers from Stats NZ show a normal pattern of growth compared to previous years, and hiring intentions of businesses have been increasing in recent ANZBO surveys. Therefore, we forecast a much lower and earlier peak in the unemployment rate – at 5.4% in the 2021 September quarter, compared to the 6.9% peak forecast in HYEFU (Figure 6).

Figure 6: Unemployment rate



24. Employment is expected to continue growing, but at a relatively muted pace in the short term compared to usual, due to the border restrictions reducing the usual seasonal uptick in employment in the tourism industry. We also expect the labour force participation rate to recover at a slightly faster rate than forecast in HYEFU, as the resilience of the economy and limited scarring effects encourage more people to return to the labour force.

…and a reduction in monetary policy support

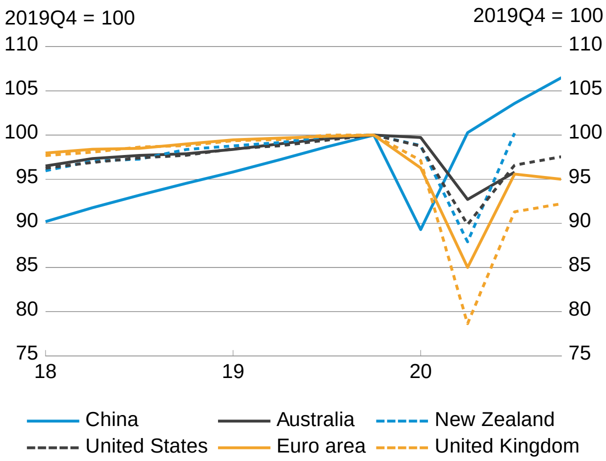
25. **The stronger domestic recovery is expected to result in a gradual reduction in monetary policy support**. Monetary policy is expected to remain relatively accommodative over the forecast period, with the 90-day rate only starting to increase in late-2023 to ensure inflation remains within the targeted range. At its most recent meeting on 24 February, the Reserve Bank's Monetary Policy Committee kept its policy settings unchanged and said that prolonged monetary stimulus will be required due to heightened uncertainty levels.

Improved global outlook and higher terms of trade support the external accounts

26. **The outlook for COVID-19 has improved across the world since HYEFU and this is supporting economic growth prospects in several of our key trading partners**, especially in the United States, China and Australia. While the vaccine rollout has gained pace in several developed markets, how effective they will be (including against new strains) remains a key risk. While developed economies are generally expected to see a widespread deployment of vaccines by late 2021, this is likely to be much later in many emerging economies, including some of our key trading partners in emerging Asia. Vaccination rollouts are currently on track in the United States and the United Kingdom, but supply constraints have limited progress in the euro area.

27. The real GDP performance for selected key trading partners is shown in Figure 7. In the short term, activity in the United Kingdom and the euro area is being dampened by health restrictions, and GDP in the 2021 March quarter is likely to fall following a weak December quarter. Activity should pick up in the second half of the year as restrictions are lifted and vaccine coverage expands. Momentum is stronger in the United States, China, and Australia, New Zealand's largest trading partners.

Figure 7: Real GDP in selected countries



28. Overall, the outlook for trading partner growth has improved since HYEFU. The contraction in 2020 for our top 16 trading partners is now estimated at a less severe -2.2%, compared to -2.8% previously. The recovery in 2021 has also been upgraded from 5.3% to 5.5%. **This improved growth outlook along with an upward trend in commodity prices is expected to support our terms of trade over the forecast period**. In turn, this will support our exports, although a stronger exchange rate provides some offset. The demand fundamentals remain strong for most of our key export products, and while there are some risks with regards to supply chains, this has not yet had a marked impact on primary exporters.

29. **The recovery in imports following the sharp fall in the 2020 June quarter is expected to continue**, supported by the steady recovery in domestic demand, but will be constrained by numerous supply chain issues in the near term, in New Zealand and abroad. Goods import values are forecast to rise gradually towards pre-pandemic levels by the first half of next year, while we have upgraded our medium-term forecasts. Overall, the forecast trade balance is slightly weaker than at HYEFU, due to the upward revisions to imports exceeding that of exports.

30. **Travel services exports held up better than expected in the June and September quarters**, partly because more visitors remained in the country than we had assumed, while non-travel services exports (in particular business and telecommunications services) made a steady recovery in the September quarter. While the actual value of travel services exports may hold up through the first half of 2021, seasonal patterns may result in a fall in the seasonally adjusted values.

31. **The current account balance is forecast to widen over the course of this year**, mainly due a widening goods deficit and with the services balance expected to move into deficit as border restrictions remain in place. The income balance is expected to remain roughly steady as a ratio to GDP throughout the forecast period, with the rise in interest rate payments (due to both higher debt levels and rising interest rates) being in line with the growth in nominal GDP. The current account balance should narrow from 2022 onwards, as the assumed lifting of border restrictions boosts the services balance.

Nominal GDP is higher by a cumulative $100 billion by the end of the forecast period

32. Data revisions mean nominal expenditure GDP is around $8 billion higher in the year to June 2020. The stronger-than-expected GDP outturn in the September 2020 quarter (including higher growth in the expenditure than the production measure) leave nominal GDP close to $7 billion higher in the quarter than previously forecast. **The higher starting point, the expectation of a continued steady recovery in domestic demand, higher inflation and a stronger terms of trade contribute to nominal GDP being $100 billion higher** by the end of the forecast period. Adjusting for the higher starting point owing to historical data revisions gives an underlying increase of around $55 billion to $65 billion.

Tax outlook

33. Higher forecasts of nominal GDP are a major driver of higher forecasts of tax revenues. **Core Crown tax revenue forecasts have been increased by nearly $25 billion compared to HYEFU, across the five years of the forecast period** (Table 2).

Table 2: Estimated[2] change in core Crown tax revenue forecasts

June years, $ billions	2021	2022	2023	2024	2025	Totals
2020 Half-year Update	88.3	89.1	96.9	102.5	108.8	
% of GDP	27.3	26.3	26.9	26.8	26.9	
Forecasting changes by tax type:						
GST	+2.1	+2.1	+2.3	+2.2	+2.1	+10.8
Source deductions	+0.7	+1.6	+1.8	+1.8	+1.7	+7.6
Corporate tax	+1.2	+0.8	+0.8	+0.9	+1.0	+4.7
Net other persons tax	+0.4	+0.5	+0.3	+0.2	+0.2	+1.6
Transport taxes (RUC, MVF)	+0.1	+0.1	+0.1	+0.1	+0.1	+0.5
Resident withholding taxes	+0.1	-	-	+0.1	+0.2	+0.4
Customs & excise duties	-0.3	-0.3	-0.3	-0.2	-0.2	-1.3
All other taxes	+0.1	-	+0.1	-0.1	+0.1	+0.2
Total change	***+4.4***	***+4.8***	***+5.1***	***+5.0***	***+5.2***	***+24.5***
2021 Budget Update (prelim)	**92.7**	**93.9**	**102.0**	**107.5**	**114.0**	
% of GDP	27.5	26.9	27.5	27.3	27.4	
Changes owing to…						
Macroeconomic effects	+2.5	+2.3	+2.7	+2.5	+2.5	+12.5
Interest rates (RWT)	-	+0.1	+0.1	+0.3	+1.1	+1.6
Fiscal drag	+0.1				+0.4	+1.3
Other factors	+1.8				+1.2	+9.1
Total change	*+4.4*	*+4.8*	*+5.1*	*+5.0*	*+5.2*	*+24.5*

34. **Increases in the forecasts for nominal GDP and its components add $2.5 billion to the tax revenue forecasts each year, on average**. However, tax outturns up to the end of January 2021 would be consistent with even larger upgrades to nominal GDP. Core Crown tax revenue for the seven months to January are already $1.8 billion above the HYEFU forecast, and there are five months remaining in the 2020/21 fiscal year.

[2] Unconsolidated tax forecasts were completed on 24 February. The Crown eliminations forecasts used to derive the core Crown and total Crown measures of tax will be calculated as part of the fiscal forecasting process, due for completion on 23 March. Since the Crown eliminations forecasts are not yet available, all numbers in Table 2 should be regarded as approximate.

35. Therefore, **we made upward adjustments to the forecasts of several tax types to bring them in line with the latest outturn data**:

- $2.8 billion was added to the GST forecast in the 2020/21 year, with smaller amounts added in later years.
- Amounts averaging $0.65 billion per annum were added to the corporate tax forecasts. These amounts recognise additional tax revenue in respect of the 2020 tax year that have been seen in terminal tax assessments since HYEFU, thereby increasing the tax base in all forecast years. Portfolio Investment Entity (PIE) tax forecasts have also been revised higher, based on recent investment market returns.
- We added between $0.2 to $0.5 billion each year to the net other persons tax forecasts, to include additional revenue that is evident in the outturns to January.

36. However, some downwards adjustments were included in the resident withholding tax (RWT) and tobacco duty forecasts:

- Small nominal increases in the already-low 90-day interest rate forecasts translated into large increases in the interest-RWT forecasts. To ensure the forecasts are plausible, the RWT forecast was reduced by as much as $0.7 billion in the 2024/25 year alone.
- Total tobacco duty for the six months to December 2020 was down nearly 50% on the same period in 2019 for a variety of reasons including behavioural factors and supply chain difficulties associated with COVID-19, and the absence of foreign tourists in New Zealand. In response to these factors, we have reduced the tobacco duty forecast by around $0.5 billion a year.

37. Inland Revenue was consulted in the preparation of these tax forecasts. Although Inland Revenue's forecasts were generally lower than the Treasury's forecasts, the differences were immaterial.

Comparison to bank forecasts

38. **The Treasury's preliminary BEFU economic forecasts are stronger than the major domestic banks**. Bank forecasters generally expect a slowdown in momentum in the 2020 December and 2021 March quarters, with some forecasting a technical recession. We are putting more emphasis on the continued strong performance of various high-frequency indicators, particularly strong tax returns, and our GDP forecasts are therefore slightly above the median of other forecasters. The BEFU forecast for the unemployment rate to peak at 5.4% is roughly in line with the median of other forecasters.

Risks to our central forecasts

39. **There are several upside and downside risks to our central forecasts that could lead to different outcomes for the economy, with associated implications for tax revenues**. We will once again communicate some of these risks with scenarios in the publication of the BEFU document.

40. **Our central forecasts assume there will be no further material domestic outbreaks of COVID-19 in the community**. Further outbreaks of COVID-19 in the community that necessitate the reinstatement of higher alert levels could lead to further declines in GDP, push up the unemployment rate, and threaten to worsen the scarring effects of the pandemic.

41. Should vaccines turn out to be less effective against the spread of the disease than assumed or the vaccination programme takes longer to reach a sufficient proportion of the population, **border restrictions may be lifted later than assumed in our central forecasts, and trading partner growth may also be lower**. This would mean a later recovery in services exports and could also put downward pressure on the terms of trade and the exchange rate. On the other hand, an easing of border restrictions could happen sooner than assumed in our central forecasts (1 July 2021), which would mean an earlier recovery in services exports.

42. In theory, the different ways of calculating GDP should give the same number, but real expenditure GDP is now an unprecedented 5.8% above the production measure. This illustrates that **capturing the true state of the economy is particularly challenging at present**. In our central forecasts, we assume some unwinding of the strength in expenditure GDP, which results in a decline in the differential with the production measure. Various alternative outcomes are plausible; the differential could narrow by more, stay unchanged, or widen further, and this creates uncertainty about the starting point for GDP. **Each outcome will have different implications for our forecasts for economic output and therefore also tax revenues**. On balance, we are putting considerable weight on the ongoing strength in tax revenue as a signal that much of the greater expenditure GDP strength is warranted.

43. **Another risk is that the near-term recovery we have seen is not sustainable**, merely reflecting catch-up growth, pent-up demand and substantial fiscal and monetary policy support. With border restrictions remaining in place, there is still weakness ahead for the tourism sector, with the most difficult period being the peak summer months. Supply chain issues also have the potential to put pressure on business operations and profit margins.

44. On the other hand, **there is a risk that momentum is even stronger than we are assuming and that there will not be a slowdown in real GDP growth over the course of 2021**. In this case we may see a stabilisation or decline in the unemployment rate instead of an increase. The recent strength in tax data could suggest the economy is performing better than the economic data is suggesting – which may mean the economic data will be revised up in future.

Annex 1: Forecast summary tables

Table A1: Summary of economic forecasts – June years

(Annual average percent change, unless specified otherwise)

June Years	2017	2018	2019	2020	2021 Forecast	2022 Forecast	2023 Forecast	2024 Forecast	2025 Forecast
Private consumption	6.4	4.6	4.2	-0.9	5.2	3.4	3.1	2.5	2.6
Public consumption	2.9	3.8	3.6	6.8	4.1	2.2	1.2	0.8	1.5
TOTAL CONSUMPTION	**5.6**	**4.4**	**4.1**	**0.8**	**4.9**	**3.1**	**2.6**	**2.1**	**2.4**
Residential investment	3.7	-0.1	3.7	-6.1	16.0	3.5	6.3	2.4	2.7
Business investment*	1.7	12.3	4.1	-4.7	1.1	4.6	7.8	5.7	3.9
TOTAL INVESTMENT	**2.2**	**8.9**	**4.0**	**-5.0**	**4.8**	**4.3**	**7.4**	**4.8**	**3.6**
Stocks (contribution to GDP growth)	0.4	0.2	-0.5	-0.5	0.5	0.2	0.1	0.0	-0.2
GROSS NATIONAL EXPENDITURE	**5.2**	**5.8**	**3.4**	**-1.1**	**5.6**	**3.5**	**3.8**	**2.7**	**2.5**
Exports	0.6	4.0	3.2	-5.5	-10.8	4.2	8.0	6.2	5.0
Imports	6.7	8.4	2.4	-6.0	-7.9	11.7	7.3	4.6	3.9
EXPENDITURE ON GDP	**3.5**	**4.6**	**3.7**	**-1.1**	**5.7**	**1.2**	**3.7**	**3.0**	**2.7**
GDP (PRODUCTION MEASURE)	**3.5**	**3.7**	**2.8**	**-1.8**	**4.6**	**2.6**	**4.2**	**3.3**	**2.9**
- annual % change, June quarter	3.5	3.6	2.2	-11.3	15.5	3.6	4.1	3.0	2.9
Other Output Measures									
Real Gross National Disposable Income	4.4	3.9	2.6	0.1	4.2	2.4	4.6	3.6	3.0
Nominal GDP (Expenditure Basis)	6.6	7.4	4.8	2.0	6.5	3.5	6.5	6.0	5.6
Potential GDP	3.2	3.1	2.8	-1.1	6.5	2.6	2.5	2.5	2.5
Output gap (June qtr,% of potential)	0.4	1.1	0.5	-0.7	-2.2	-1.1	0.4	0.8	1.3
Total Population (thousands, mean quarter ended)	4,805	4,893	4,972	5,090	5,125	5,167	5,219	5,279	5,347
Real GDP per capita (Production basis)	1.3	1.7	1.1	-3.7	3.1	1.8	3.3	2.2	1.7
Labour Market									
Employment	5.3	3.6	1.9	1.7	0.3	1.3	2.4	2.0	1.9
Unemployment Rate (June quarter)	4.8	4.5	4.0	4.0	5.3	5.0	4.5	4.2	3.9
Labour Productivity (Hours worked basis)	-1.6	-0.6	0.3	-0.7	1.3	2.2	1.9	1.4	1.0
Wages (QES average hourly ord time earnings, APC)	1.5	3.0	4.4	3.0	3.6	2.7	2.6	3.2	3.4
Monetary Conditions									
90-day Bank Bill Rate (June quarter ave)	2.0	2.0	1.7	0.3	0.3	0.3	0.3	0.9	1.9
10-year Bond Rate (June quarter ave)	2.9	2.8	1.8	0.8	1.4	1.8	2.1	2.4	2.6
TWI (June quarter ave)	76.5	73.8	72.7	69.7	75.0	75.0	75.0	75.3	75.7
- annual % change (June quarter)	3.9	-3.5	-1.5	-4.1	7.6	0.0	0.0	0.4	0.5
Price Measures									
CPI Inflation (ann % change, June quarter)	1.7	1.5	1.7	1.5	2.0	1.5	1.8	2.0	2.2
Consumption Deflator	1.1	1.3	1.6	2.0	0.8	1.3	2.0	2.4	2.5
GDP Deflator	2.9	2.6	1.1	3.1	0.7	2.3	2.7	2.9	2.8
House Price Inflation (ann % change, June qtr)	6.5	3.6	1.5	6.8	15.2	7.2	4.5	4.3	4.7
Key Balances									
Current account balance ($ million)	-7,739	-10,692	-11,657	-5,643	-7,821	-13,666	-13,786	-12,932	-12,508
Current account balance (% of GDP)	-2.8	-3.6	-3.8	-1.8	-2.3	-3.9	-3.7	-3.3	-3.0
Terms of Trade (goods) - SNA Basis	4.9	4.6	-3.5	4.6	-0.6	-0.3	0.5	0.2	0.0
Net International Investment Position (%GDP)	-54.3	-51.9	-54.0	-57.0	-55.0	-57.1	-57.3	-57.4	-57.3

* Total investment excluding residential

Table A2: Change in economic forecasts from HYEFU – June years

(Annual average percent change, unless specified otherwise)

June Years	2017	2018	2019	2020	2021 Forecast	2022 Forecast	2023 Forecast	2024 Forecast	2025 Forecast
Private consumption	0.1	0.6	1.1	0.3	3.9	0.3	-0.1	-0.7	-0.4
Public consumption	0.1	0.2	0.1	1.5	-0.8	-0.2	-0.7	-0.6	-0.3
TOTAL CONSUMPTION	**0.1**	**0.5**	**0.8**	**0.6**	**2.7**	**0.2**	**-0.2**	**-0.7**	**-0.4**
Residential investment	-0.2	-0.2	1.5	0.5	12.2	2.0	0.5	-4.6	-3.4
Business investment*	-0.4	1.1	1.5	0.5	6.5	0.9	0.7	-2.5	-2.0
TOTAL INVESTMENT	**-0.3**	**0.7**	**1.5**	**0.5**	**7.9**	**1.2**	**0.7**	**-3.0**	**-2.3**
Stocks (contribution to GDP growth)	-0.0	0.1	0.1	-0.1	-0.3	-0.1	0.4	-0.0	-0.0
GROSS NATIONAL EXPENDITURE	**0.0**	**0.7**	**1.1**	**0.5**	**3.7**	**0.3**	**0.4**	**-1.2**	**-0.9**
Exports	0.0	0.0	-0.0	0.1	1.6	-0.8	0.2	0.3	0.6
Imports	0.0	0.0	0.0	-0.0	1.2	3.9	1.1	-1.4	-0.9
EXPENDITURE ON GDP	**0.0**	**0.6**	**1.1**	**0.5**	**4.0**	**-0.9**	**0.1**	**-0.8**	**-0.5**
GDP (PRODUCTION MEASURE)	**0.1**	**0.5**	**0.0**	**0.4**	**3.1**	**-0.1**	**0.5**	**-0.5**	**-0.3**
- annual % change, June quarter	*0.4*	*0.4*	*0.1*	*1.1*	*1.6*	*0.8*	*0.1*	*-0.5*	*-0.2*
Other Output Measures									
Real Gross National Disposable Income	0.1	0.5	0.0	0.3	3.3	0.1	0.6	-0.5	-0.3
Nominal GDP (Expenditure Basis)	0.0	0.7	1.2	0.5	4.0	-1.1	0.3	-0.4	-0.2
Per Capita Output Measures									
Real GDP per capita (Production basis)	-0.1	0.3	-0.1	0.3	4.1	-0.1	0.5	-0.5	-0.3
Real Gross Nat. Disp Income per capita	-0.1	0.3	-0.1	0.3	4.4	0.1	0.6	-0.5	-0.2
Nominal GDP per capita (Expenditure basis)	0.0	0.7	1.2	0.4	3.8	-1.1	0.3	-0.4	-0.1
Labour Market									
Employment	0.0	-0.0	-0.0	0.1	1.2	0.7	-0.1	-1.0	-0.6
Unemployment Rate (June quarter)	0.0	0.0	0.0	0.0	-1.3	-1.8	-1.2	-0.5	-0.0
Labour Productivity (Hours worked basis)	0.1	0.5	0.0	0.3	0.5	-0.3	0.5	0.6	0.4
Wages (QES average hourly ord time earnings, APC)	-0.0	-0.0	-0.0	-0.0	1.4	0.6	0.3	0.4	0.1
Unit Labour Costs (Hours worked basis)	-0.1	-0.5	-0.0	-0.3	0.3	1.1	-0.2	-0.3	-0.2
Monetary Conditions									
90-day Bank Bill Rate (June quarter ave)	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.7	1.7
10-year Bond Rate (June quarter ave)	0.0	0.0	0.0	0.0	0.9	1.2	1.0	0.7	0.6
TWI (June quarter ave)	0.0	0.0	0.0	0.0	4.0	4.0	3.4	2.7	2.2
- annual % change, June quarter	0.0	0.0	0.0	0.0	5.7	0.0	-0.8	-1.0	-0.6
Price Measures									
CPI Inflation (ann % change, June quarter)	0.0	0.0	0.0	0.0	0.6	0.3	0.3	0.2	0.0
Consumption Deflator	0.1	0.1	0.1	0.1	-0.6	-0.7	0.2	0.5	0.4
GDP Deflator	0.0	0.0	0.1	-0.1	-0.1	-0.2	0.2	0.3	0.3
House Price Inflation (ann % change, June quarter)	0.0	0.0	0.0	0.8	6.8	2.6	-0.7	-1.0	-0.8
Key Balances									
Current account balance ($ million)	4	3	4	83	980	-1,174	-2,030	-925	215
Current account balance (% of GDP)	0.0	0.0	0.1	0.1	0.5	-0.1	-0.4	-0.1	0.2
Terms of Trade - SNA Basis	0.0	0.0	-0.0	-0.0	0.7	1.4	-0.1	-0.6	0.0

* Total investment excluding residential