The Treasury

Budget 2024 Information Release

September 2024

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FEC briefing notes for BPS hearing – 11 April 2024

Fiscal Strategy

Key talking points

- The economic outlook has deteriorated significantly since the Half Year Economic and Fiscal update (HYEFU). Economic activity has been weaker than previously thought and inflation has eased more quickly. As a result, we expect a weaker economic and tax outlook.
- OBEGAL has been in deficit since 2019/20, driven by an increase in core Crown expenses. While some spending was temporary, other was structural.
- A structural deficit is not sustainable. Fiscal consolidation is required over time to bring revenue and expenses back into balance. Tight fiscal policy in the near term will also support monetary policy to bring inflation within target, and maintain it there.
- The Government is changing the headline net debt indicator back to the 2009 definition of net core Crown debt to remove volatility introduced by including NZSF assets and to improve historic comparability by providing more clarity over how the current size of debt and the Government's debt objectives fit into a historic context.
- The Government has introduced new short-term intentions and long-term objectives:
  - the Government's intention is to reduce core Crown expenditure as a proportion of the overall economy. In the longer term, the Government's objective is to reduce core Crown expenses towards 30% of GDP.
  - An operating surplus will be achieved via a steadily improving OBEGAL trajectory. A specific timeframe for returning to surplus will be set out in the Fiscal Strategy Report (FSR), when a complete set of updated fiscal forecasts and projections will be available.
  - The Government intends to put net core Crown debt on a downward trajectory. Once it is below 40% of GDP, the Government intends to maintain net core Crown debt within a band of 20 to 40% of GDP.
- Budget 2024 will have an operating allowance of less than $3.5 billion, with the exact number to be confirmed in the Budget. Operating allowances for Budgets 2025 to 2027 will be set out in the FSR.
- In Budget 2024, the Government will top up the multi-year capital allowance (MYCA) by up to $7 billion, with the final number to be confirmed in the Budget.

Key facts & figures

Economic outlook

- Since presenting the HYEFU, real GDP for the September quarter showed a contraction and downward revision in several previous quarters. Following finalisation of the BPS scenario, real GDP for the December quarter showed another 0.1% contraction – consistent the expectation in the scenario – resulting in a technical recession.

- By the end of the forecast period, the cumulative level of nominal GDP in Treasury's economic scenario is $42.8 billion lower than forecast at the HYEFU and core Crown tax revenue is $13.9 billion lower.
- These revisions to the economic outlook will have a negative impact on the Government's fiscal position. Preliminary forecasts suggest that revisions to forecast tax revenue will reduce the HYEFU balances by around $3 billion in 2026/27 and around $4 billion in 2027/28.

Operating balance and government spending

- Over the forecast period, Crown Entities are expected to make a significant negative contribution to OBEGAL. For example, the HYEFU showed deficits from the Accident Compensation Corporation (ACC) of $3.3 billion per annum on average over the 2024–2028 period, flowing straight into the OBEGAL.
- Budget 2024 will have an operating allowance of less than $3.5 billion, with the exact number to be confirmed in the Budget. $3.5 billion was the size of the Budget 2024 operating allowance at HYEFU.

Debt

- New Zealand's debt has increased rapidly in recent years. Some, but not all, of this increase was due to COVID-19. The International Monetary Fund estimated that debt in New Zealand rose more than all 33 countries in its advanced economy grouping over the COVID-19 period, apart from the United Kingdom and Malta.
- In 2009, the Government adopted net core Crown debt as its headline indicator and specified its long-term debt objective in these net debt terms. Net debt includes financial assets as well as financial liabilities.
- In 2022, the previous Government revised this measure by adding the assets of the New Zealand Superannuation Fund (NZSF), core Crown advances and Crown Entity borrowing.
- The Government is changing the headline net debt indicator back to the established, 2009 definition of net core Crown debt. This removes volatility introduced by including NZSF funds and supports historic comparability.
- Net core Crown debt is currently 44% of GDP – around the same as it was in the mid-1990s.
- The Government intends to put net core Crown debt on a downward trajectory. Once it is below 40% of GDP, the Government intends to maintain net core Crown debt within a band of 20 to 40% of GDP.
- This is a lower level relative to the previous Government's 50% ceiling. It is intended to reduce risks of debt ratcheting up following future shocks, while recognising that pursuing very low levels of public debt can involve forgoing opportunities for productive investment.

Table 1: The Government's short-term intentions and long-term objectives

Indicator	**Short-term intention (next 4 years)**	**Long-term objective (next 15 years)**
Debt	Maintain total debt at prudent levels. Put net core Crown debt as a percentage of GDP on a downward trajectory towards 40 per cent.	Maintain total debt at prudent levels. Once net core Crown debt is below 40 per cent of GDP, maintain it within a range of 20 per cent to 40 per cent of GDP, subject to economic shocks
Operating Balance	Work towards a surplus via a steadily improving trajectory for the operating balance (before gains and losses). Ensure consistency with the short-term intention for debt	Maintain operating surpluses sufficient to ensure consistency with the debt objective. This will ensure that, on average, over a reasonable period of time, operating expenses are funded from operating revenues and not from debt.
Expenses	Reduce core Crown expenses as a percentage of GDP. Ensure expenses are consistent with the operating balance intention	Control growth in government spending so that, over time, core Crown expenses reduce towards 30 per cent of GDP
Revenue	Ensure revenue is consistent with the operating balance intention.	Ensure the level of operating revenues is consistent with the operating balance objective and supports long-term productive economic growth
Net Worth	Maintain net worth at around 40 per cent of GDP.	Ensure net worth remains at a level sufficient to act as a buffer to economic shocks

Capital expenditure

- In Budget 2024, the Government will top up the multi-year capital allowance (MYCA) by up to $7 billion, with the final number to be confirmed in the Budget.
- $7 billion is the amount assumed in each projection year (in real terms) in the Treasury's fiscal strategy model. At present, there is only $3.45 billion in the MYCA, which is intended to be a multi-year allocation. A MYCA top-up of up to $7 billion supports the Government's investment objectives while recognising market capacity.

Q&A

Economic outlook / scenario

What has changed with the economic outlook since Treasury presented HYEFU?

- The anticipated slowdown in economic activity came sooner than previously thought.
- Since presenting the HYEFU, real GDP for the September quarter showed a contraction and downward revision in several previous quarters. Following finalisation of the BPS scenario, real GDP for the December quarter showed another 0.1% contraction – consistent with the expectation in the scenario – resulting in a technical recession.
- Sentiment, card spending, and housing data through late-2023 and early-2024 showed ongoing weakness in our economy.
- On the other hand, labour conditions eased less than expected in December 2023 and wage growth remains high.
- Inflation has eased more than expected. Headline CPI inflation slowed to 4.7% in the December 2023 quarter, weaker than expected due to falls in petrol and food prices.
- Core inflation has slowed, but is still some distance from the inflation target. These developments have led us to conclude that aggregate demand in the economy is now broadly in line with the economy's capacity to supply goods and services.

What recent Government announcements does this scenario take into account?

- We have updated the multi-year capital allowance (MYCA), but no other decision has been reflected in the BPS scenario.
- The Treasury will publish our next Economic and Fiscal Update alongside the Budget, which will fully incorporate all Budget 2024 decisions.

Why haven't you updated fiscal forecasts?

- The purpose of the BPS scenario is to provide an update on how the economic outlook has further deteriorated since the Half-Year Update. Doing so provides a greater picture on how this impacts our tax forecasts.
- We are mindful about the additional work and pressure that updating the fiscal forecasts for the BPS would put on agencies at the same time that they are preparing information to feed into the Budget Update.
- Therefore, a full set of economic and fiscal forecasts will be published alongside the Budget in May.

The BPS talks about preliminary economic forecasts in advance of the Budget, do you expect what you've presented today to change by 30 May?

- Our economic forecasts will be updated for the May Budget to incorporate additional economic data and the final package.

Economy

Why is unemployment lower relative to HYEFU, when growth is also lower?

- The relationship between unemployment and GDP has changed. In many countries around the world, we have observed weak or falling GDP, but unemployment has stayed surprisingly low. We have taken this dynamic on board in our forecasts. This is also consistent with our projection of lower productivity.

What are the implications of the GDP outturn and our forecasts? How does the recent GDP data affect your forecasts?

- GDP data for the 2024 December quarter released on 21 March was broadly in-line with our BPS outlook and other forecasters (although slightly weaker than we and other forecasters expected).
- We are still assessing the details and implications of the latest GDP release and other economic data on the economic outlook.
- Our economic forecasts will be updated for the May Budget to incorporate additional economic data and the final budget package.

What has contributed to a weakening economy? Why is it weaker than previously predicted?

- Restrictive interest rates necessary to address high inflation have slowed economic activity. Recently released GDP data revealed that growth has been weaker – and the slowdown began sooner – than previously understood.
- Domestic demand has softened, particularly in interest rate sensitive sectors, although this has been masked to some extent by high population growth and overseas spending by New Zealanders.

Do you agree with the latest IMF and OECD reports on the NZ economy?

- The IMF's latest report on the NZ economy was released last week on 19 March.
- The IMF's preliminary outlook is very similar to the Treasury's BPS scenario. We both show slow growth over 2024 at around 1.1% year-on-year, before picking up in 2025, while also showing annual inflation easing to within the Reserve Bank's inflation target band in the September quarter of this year.
- The OECD hasn't released an updated outlook since November 2023. While the HYEFU forecasts were slightly stronger than the OECD's, this BPS scenario now shows a weaker outlook.

Real GDP growth forecasts (annual average % change)

December year	**2023**	**2024**	**2025**	**2026**
IMF (Mar 24)	-	1.1	-	-
OECD (Nov 23)	1.6	1.3	1.9	-
TSY **(BPS Mar 24)**	0.7	1.2	2.7	3.1

Information was released last week on GDP. What does this scenario assume and what does the market expect?

- As expected in our preview, real GDP fell 0.1% in the December quarter, the fifth contraction in two years and the average annual rate falling to just 0.7%. Real GDP is now 0.7% lower than its peak in the September 2022 quarter.
- The BPS scenario incorporated our latest estimate of –0.1% for the December quarter. The market range was –0.2% - 0.3%

Is Treasury concerned about persistently high rates of inflation?

- It is important to reduce inflation.
- We would be concerned about prolonged high inflation.
- The Treasury continues to be focused on raising living standards for all New Zealanders.
- High interest rates combined with tightening fiscal policy are forecast to reduce inflation over time.
- We note that similar levels of inflation are being seen in other advanced economies, and that inflation has been falling in recent quarters.

Why is New Zealand inflation taking longer to fall compared to some other countries?

- CPI inflation has broadly followed global trends, and most advanced economies including New Zealand have headline inflation rates above their targets. Inflation is easing slower than some countries, but faster than others.
- New Zealand's core inflation rate (that excludes volatile components) is performing relatively better than other economies.
- Differences can be attributed to monetary policy tightening cycles (other central banks were more gradual), the significant rise in house prices following low interest rates, government interventions, geographic isolation, vulnerability to high global rates and access to global credit markets, and responses to COVID-19 including the timing of border re-openings to tourists and to migrants who had been granted work visas immediately prior to the lockdown.

Where is inflation pressure coming from?

- In February, the Reserve Bank acknowledged that interest-rate sensitive sectors are responding to tighter monetary conditions, but high net migration remains an upside risk meaning interest rates need to be higher for longer.
- Throughout 2023 businesses have faced resistance from consumers to pay ever increasing prices from higher input costs, and profit margins have been squeezed.
- The cumulative effect of a 525 basis point increase in the OCR between October 2021 and May 2023 has led to mortgage rates roughly doubling in that time. Currently, almost one-quarter of fixed-rate mortgage holders are still yet to roll over.
- The impact of higher prices and higher interest rates has curbed domestic demand more recently. As acute labour market shortages have been met with net migration, wage inflation has slowed. CPI inflation eased in the last quarter of 2023 mainly due to an anticipated drop in tradable inflation, specifically from lower petrol and food prices compared to the September quarter.

What is the impact of recent government decisions (e.g. 100-day Plan announcements, mini-Budget decisions) on this economic scenario?

- As highlighted in the Economic and Tax Outlook – BPS 2024 document, the BPS scenario has made two specific assumptions regarding recent Government decisions:
    - The scenario does incorporate the higher multi-year capital allowance (MYCA). This reflects the Government's decisions to top up the MYCA as described in the BPS.
    - Apart from the change above, the scenario does not incorporate announced or proposed Government policy changes made since the HYEFU as information on changes will be presented alongside the Budget on 30 May 2024.

How big is the fiscal consolidation? How does it compare to previous consolidations?

- The BPS scenario includes government spending figures based on the fiscal forecasts in the *Half-Year update* but updated for recent economic data. The policy intentions of the new Government will be included in the 2024 Budget, including the impact on government consumption of the various savings initiatives that are underway.
- Real government consumption in the scenario is similar to that presented at the Half-year Update. With GDP growth expected to average around 1.5% per year over the forecast period, government spending is projected to decline as a share of GDP. This represents a significant departure from recent upward trends. In an environment of relatively high population growth, a flat-to-falling government consumption implies declining government consumption on a per-capita basis.

What is Treasury's expectation of the impact of fiscal consolidation on the economy?

- The impact will depend on the design and implementation of the fiscal consolidation, including scale, timing and design choices.

Does Treasury see the economy at risk of stagflation?

- High inflation has required a period of high interest rates and slow economic growth in order to address imbalances within the economy. This is associated with our forecasts of rising unemployment.
- The BPS scenario shows inflation falling below 3% in the September quarter 2024, and continuing to ease back towards 2% over the forecast period.

Tax revenue

What is Treasury's view/advice about the impacts of the Government's tax package in light of the current economic outlook?

- The current economic outlook is challenging and means we are expecting lower tax revenues.
- A structural deficit is not sustainable. Fiscal consolidation is required over time to bring revenue and expenses back into balance. Tight fiscal policy in the near term will also support monetary policy to bring inflation within target, and maintain it there.

- Governments have a range of choices around spending and revenue measures, which we are currently advising on ahead of the Budget in May.

Why is tax revenue lower than the Treasury forecast at HYEFU?

- Softer economic activity and faster decline in inflation leads to weaker growth in nominal GDP across the period to June 2028, which drives the change in tax revenue.
- Core Crown tax revenue is expected to be weaker in all years, and is cumulatively $13.9 billion lower over the forecast period, compared to the Half-Year Update.

What has been happening in recent tax outturns?

- Core Crown tax revenue for the seven months to January 2024 was $0.8 billion (1.1%) below the 2023 HYEFU forecast. Corporate tax, other individuals' tax and GST revenue were all below forecast (-$0.5 billion, -$0.3 billion and -$0.2 billion respectively), but these were offset a little by above-forecast PAYE and resident withholding taxes.
- Recent weakness relative to forecast in taxpayers' provisional tax payments for the 2024 tax year suggests that both corporate tax and other individuals' tax revenue will deteriorate further vs HYEFU23 over the remainder of the 2023/24 fiscal year. Labour market data for the December 2023 quarter was stronger than forecast, in both employment and wage growth, supporting the above-forecast January PAYE outturn.
- February 2024 tax data will be published on 4 April.

Fiscal strategy and operating allowances

What did Treasury advise about the return to surplus?

- It is a challenging economic environment.
- A structural deficit is not sustainable. Fiscal consolidation is required over time to bring revenue and expenses back into balance. Tight fiscal policy in the near term will also support monetary policy to bring inflation within target, and maintain it there.
- There are a range of trade-offs between the macroeconomic benefits of returning to surplus quickly and the risks associated with rapid fiscal consolidation.
- International evidence is that reducing deficits is best done over the course of several years and should be focused on structural reforms to expenditure and revenue settings.

What did Treasury advise about the operating allowance?

- There are significant demands on the operating allowances expected across the forecast period.
- The Treasury is advising the Government on allowances for Budget 2024 and beyond to support the government's fiscal strategy.
- A combination of savings and revenue measures will be required to provide headroom in future allowances and support the return to surplus.

Did Treasury advise the Minister not to publish outyear allowances? Is this PFA compliant?

- We are currently advising the Government on outyear allowances.
- As the Minister said at the BPS release, she will make decisions on outyear allowance once she has received final economic and fiscal forecasts.
- The PFA does not require publishing allowances in the BPS.

How big is the fiscal consolidation? How does it compare to previous fiscal consolidation?

- The BPS scenario includes government spending figures based on the fiscal forecasts in the *Half-Year update* but updated for recent economic data. The policy intentions of the new Government will be included in the 2024 Budget, including the impact on government consumption of the various savings initiatives that are underway.
- Real government consumption in the scenario is similar to that presented at the Half-year Update. With GDP growth expected to average around 1.5% per year over the forecast period, government spending is projected to decline as a share of GDP. This represents a significant departure from recent upward trends. In an environment of relatively high population growth, a flat-to-falling government consumption implies declining government consumption on a per-capita basis.

When do you expect the NZ Government to get back into surplus?

- The Government has communicated its short-term intention that an operating surplus will be achieved via a steadily improving OBEGAL trajectory. The Government has indicated that a specific timeframe for returning to surplus will be set out in the FSR, when a complete set of updated fiscal forecasts and projections will be available.

What does the BPS announcement indicate about return to surplus?

- The Treasury's preliminary economic forecast today highlights that the economy has slowed faster than expected.
- It also indicates that tax revenue will be affected beyond what we anticipated in December.
- These revisions to forecast tax revenue will reduce what we previously anticipated at Half-Year Update for the operating balance before gains and losses by $3 billion in 2026/27 and $4 billion in 2027/28.

What has changed for allowances for Budget 2024?

- Treasury's forecast scenario assumes the same operating allowances as were in HYEFU. Operating allowances will be confirmed on Budget Day. The Government has communicated in the BPS that the operating allowances will be smaller or no larger than set out at HYEFU.

MYCA

When does the multi-year capital allowance top up take effect?

- The Government has decided to top up the MYCA by up to $7 billion in Budget 2024.
- This will be allocated over the next three Budgets (2025 to 2027).

What will almost doubling the MYCA do? In real terms, what will that fund? Projects, examples?

- The MYCA reflects funding the Government has set aside to meet the costs of future capital investments.
- This funding will cover cost of new investments and any cost escalations in existing projects for the next four Budgets.

Debt

What was Treasury's advice about the net debt ceiling? What is Treasury's view about the new 20-40% range?

- Treasury has done extensive analysis on the maximum sustainable debt level in 2022 and considers that a net core Crown debt level of up to 50% of GDP is prudent.
- Maintaining net debt between 20-40% of GDP will result in greater certainty that the government will have sufficient balance sheet capacity to increase debt in response to significant economic shocks.
- A more binding debt objective is also more likely to constrain the Government's future fiscal decisions. The increased emphasis on the debt objective may result in sharper trade-offs between the Government's fiscal strategy and the objective of increasing the stability of the capital investment pipeline.

What are the implications of the change in the net debt ceiling?

- The Government is lowering the debt ceiling to 40% of GDP as a long-term objective.
- Higher debt levels have led to higher finance costs. The Government aims to put debt on a downward trajectory to below 40% of GDP and from there maintain it in the band of 20-40% of GDP.
- A lower debt ceiling will strengthen incentives to reduce debt levels. It will lower the risk that future shocks could rachet up debt to a level at which severe corrective action is required.

What was the previous debt ceiling?

- The previous ceiling was equivalent to approximately 50% of GDP for the net core Crown debt measure that the Government has changed back to in this BPS.

Will the new debt objective mean that there is less room to borrow to undertake capital investments?

- Having a range for debt levels recognises that pursuing very low levels of debt can involve reducing capital investment and passing up on productivity and growth enhancing investments.
- Prioritising investments is necessary to deliver better value for money, especially given current capacity and fiscal constraints.
- The Government has communicated the intention to take a deliberate approach to building a sustainable pipeline of investments.
- Returning to surplus will create additional space for investment while bringing debt down as a share of the economy.

What did Treasury advise about the change in the net debt measure?

- There are finely balanced considerations around the choice of the net debt measure. There are advantages and disadvantages to both.
- The choice of debt indicator should balance principles of international comparability, accuracy in reflecting fiscal sustainability trends, suitability for use in fiscal management, and ease of communication.
- The 2022 measure included Crown entity liabilities such as those from Kainga Ora. Bringing those in helped highlight the performance of Crown entities and more accurately reflected the liabilities of the Crown. It also avoided creating incentives for Crown Entities to seek Ministerial permission to borrow against their own balance sheet.
- However, introducing NZSF asset into the measure introduced a significant amount of volatility, and would require the debt objective to be amended periodically to account for rises and falls in the value of the NZSF fund.
- The proposed change supports the Government's objective to have a consistent measure over time that provides clarity about how the current size of debt, and the Government's objectives, fits into a historical perspective.
- We will continue to publish both measures – the 2022 net debt measure and the 2009 net core Crown debt measure.

What are the implications of the change in the net debt measure?

- The 2022 measure introduced New Zealand superfund assets into the measure which introduced a significant amount of volatility.
- Moving back to the net core Crown debt supports a more consistent long-term approach to measuring debt levels and removes volatility introduced by the NZSF.

Does this take us out of step with the international norm? Why/why not?

- This change does move New Zealand's debt indicator away from the measure used by the IMF.
- However, both this debt measure and the one introduced by the previous Government are not fully comparable to other countries for a variety of factors (such as the treatment of local government and central banks).

The BPS mentioned there were some 'good reasons' for introducing the previous measure in 2022, can you name some of those reasons? Do you agree with those?

- The 2022 measure included Crown entity liabilities such as those from Kainga Ora. Bringing those in helped highlight the performance of Crown entities.
- However, introducing NZSF asset into the measure introduced a significant amount of volatility.