The Treasury

Budget 2024 Information Release

September 2024

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[31] 9(2)(f)(ii) - to maintain the current constitutional conventions protecting collective and individual ministerial responsibility

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

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

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TE TAI ŌHANGA
THE TREASURY

Treasury Report: Initial decisions for your fiscal strategy

Date:	27 November 2023	**Report No:**	T2023/1992
		File Number:	MC-1-5-2-2024

Action sought

	Action sought	Deadline
Nicola Willis **Minister of Finance**	**Agree** to aim to return OBEGAL to surplus in 2026/27 at the latest, and lift the 2027/28 surplus to 1% of GDP. **Agree** any mini-Budget is at least fiscally neutral in every year of the forecast period. **Discuss or indicate** your preferences for further analysis and advice on fiscal rules and fiscal strategy.	29 November 2023

Contact for telephone discussion (if required)

Name	Position	Telephone		1st Contact
Rosalinda Pierce	Analyst, Macroeconomic and Fiscal Policy	[39]	[35]	
Simon McLoughlin	Manager, Macroeconomic and Fiscal Policy			
Ben Gaukrodger	Acting Director, Economic System			✓

Minister's Office actions (if required)

Return the signed report to the Treasury.

Note any feedback on the quality of the report	

Enclosure: No

Treasury Report: Initial decisions for your fiscal strategy

Executive Summary

This report seeks initial decisions on key elements of your fiscal strategy, including a target for the Operating Balance Before Gains and Losses (OBEGAL) and when you intend for this to be shown in the Treasury's forecasts. Treasury supports your publicly stated objective of returning OBEGAL to surplus by 2026/27. Your early decisions on the fiscal strategy will help us to provide advice on the mini-Budget, Budget Policy Statement 2024 and Budget 2024 strategy that supports your objectives.

To support medium-term fiscal sustainability and macroeconomic stability, we recommend that you target an OBEGAL surplus in 2026/27 at the latest and aim to show this, and a 1% of GDP surplus in 2027/28, by the Budget Economic and Fiscal Update (BEFU) 2024 at the latest. Delivering a steadily improving OBEGAL trajectory through your fiscal decisions in the near-term is on-balance more important for supporting the credibility of your fiscal strategy than committing to a point target over three years away. Further, to support macroeconomic stability and the achievability of our recommended fiscal strategy, **any mini-Budget should be at least fiscally neutral in every year of the forecast period**. These recommendations are because:

- **The fiscal position is currently structurally weak and faces medium term (next 15 years) challenges**. While temporary factors such as COVID-19 and the North Island Weather Events response have contributed to a weaker fiscal position, the structural increase in expenses over recent years has exceeded growth in revenue. The fiscal position also faces significant challenges over the medium term, which means that structural policy changes are likely to be required to support fiscal sustainability. Although net debt remains low by international standards the Crown's stock of debt has been rising, with associated increases in debt servicing costs expected over the forecast period.
- **Tight fiscal policy will support monetary policy to bring inflation down in the earlier years of the forecast period.** Although slow economic growth is expected over 2024, setting tight fiscal policy would support monetary policy and the forecast moderation of the current account deficit. Not tightening fiscal policy in line with the draft Half Year Economic and Fiscal Update (HYEFU) 2023 forecasts would likely mean higher-for-longer interest rates. At a minimum, maintaining the forecast tightening of fiscal policy would be particularly important in a scenario where inflationary pressures are more persistent than expected.

Achieving this recommended OBEGAL trajectory while delivering on the Coalition Government's other commitments will be challenging. It will require a deliberate and structured programme of reprioritisation, savings and revenue raising measures over successive Budgets while adhering to the allowances set out in the National Fiscal Plan to deliver enduring improvements in the OBEGAL position. As such, you have an option to use your communications alongside HYEFU as an opportunity to signal your direction of travel and show this forecast trajectory in BEFU 2024.

Beyond your surplus target date, we seek direction from you on your preferences for further analysis and advice on fiscal rules to guide your broader fiscal strategy. Fiscal rules are an effective way to signal commitment to responsible fiscal policy, with a need to do so at the Budget Policy Statement (BPS) 2024. In line with the principles of responsible fiscal management in the Public Finance Act 1989, rules to deliver sustained operating surpluses over time and maintain prudent levels of debt would be broadly appropriate. We seek a discussion with you to understand your preferences for further advice ahead of decisions and publication of the BPS. We suggest you signal your direction of travel at the mini-Budget ahead of setting out your short-term intentions and long-term objectives at the BPS in line with the requirements set out in the Public Finance Act 1989.

Recommended Action

We recommend that you:

a **Note** that as the Minister of Finance you are responsible for setting and adhering to the Government's fiscal strategy, which should accord with the principles of responsible fiscal management set out in the Public Finance Act 1989

Noted

b **Note** that the fiscal position is currently in structural deficit, and tighter fiscal policy would further support monetary policy to bring inflation down

Noted

c **Agree** to aim to return the Operating Balance Before Gains and Losses (OBEGAL) to surplus in 2026/27 at the latest

Agree / Disagree

d **Agree** any mini-Budget is at least fiscally neutral in every year of the forecast period (to 2027/28)

Agree / Disagree

e **Agree** to aim to increase the size of the OBEGAL surpluses that are forecast beyond 2026/27, including aiming for a 1% of GDP surplus in 2027/28, to be forecast by the Budget Economic and Fiscal Update 2024 at the latest

Agree / Disagree

f **Note** that Treasury recommends any positive revenue surprises should be saved to increase the size of the forecast surplus in 2026/27

Noted

g **Discuss or indicate** your preferences for further analysis and advice on fiscal rules and fiscal strategy.

Simon McLoughlin
Manager, Macroeconomic and Fiscal Policy

Nicola Willis
Minister of Finance

Treasury Report: Initial decisions for your fiscal strategy

Purpose of Report

1. This report seeks initial decisions on key elements of your fiscal strategy, including a target for the Operating Balance Before Gains and Losses (OBEGAL) and when you intend for this to be shown in the Treasury's forecasts. Early decisions on key elements of your fiscal strategy will set the framework to support your upcoming decisions on:

    - the overall fiscal parameters for any mini-Budget (i.e. whether it is fiscally neutral or aims to deliver net savings),
    - your strategy for Budgets 2024 – 2027 (i.e. the size of your operating and capital allowances, and setting targets for savings, new revenue, and reprioritisation to achieve your fiscal targets at Budget 2024); and
    - further advice you would like on the details of your fiscal strategy (i.e. short-term intentions, long-term objectives, and any fiscal rules to be published in the Budget Policy Statement (BPS) by 31 March 2024 and the Fiscal Strategy Report at Budget 2024).

Background

2. The fiscal strategy is the Government's plan to manage its revenue, expenses, and balance sheet position over time. Under the Public Finance Act 1989 (the PFA) you are required to set out your fiscal strategy through short-term fiscal intentions and long-term fiscal objectives in accordance with the principles of responsible fiscal management. It is common practice for some of these intentions and objectives to be expressed as fiscal rules. Any fiscal rules are set by the government of the day.

3. The principles of responsible fiscal management aim to capture the dimensions of good fiscal policy, which we typically categorise as:

    - **Sustainability**: Are sound public finances, stable and predictable taxation rates, and expenditure programs effectively supporting higher living standards?
    - **Structure**: How does the composition of expenditure and taxation impact living standards?
    - **Stability**: Is the fiscal strategy helping to make economic cycles less pronounced, where appropriate?

4. Your consideration of the fiscal strategy comes in the context of current structural deficits, elevated inflation and global economic headwinds that will continue to challenge the fiscal position over the forecast period. A successful fiscal strategy will enable the Government to deliver on its objectives, support macroeconomic stability and resilience, and raise living standards for New Zealanders.

Considerations when setting your fiscal strategy

The fiscal position is currently in structural deficit and faces medium-term challenges

5. From the perspective of sustainable debt levels, we do not expect the net debt position to be a binding fiscal constraint. The current net debt levels remain low by international standards and there is space between the forecast level of net debt (a peak of 23.3% of GDP in 2024/25 in the draft Half Year Economic and Fiscal Update (HYEFU) 2023 fiscal forecasts) and the previous Government's 30% of GDP net debt ceiling. This ceiling was based on conservative assumptions in Treasury's 2022 debt sustainability analysis.[1] In principle, this fiscal space could be used to fund high-value investments, or to respond to unexpected shocks while remaining within prudent levels of debt.

6. However, OBEGAL has been in deficit since 2019/20 and the fiscal position and outlook has deteriorated even as the economy recovered from COVID-19, both in terms of OBEGAL and net debt. The draft HYEFU 2023 forecasts show a return to surplus in 2026/27, as with the Pre-election Economic and Fiscal Update (PREFU) 2023 (see figure 1), but at a lower level. You will receive further advice on the HYEFU forecasts shortly.

7. The current OBEGAL deficit is largely structural, meaning temporary spending (e.g. COVID-19 and the North Island Weather Events response) and the economic cycle account for about a quarter of the total OBEGAL deficit. Deficits in the structural balance mean that even if the economy was operating at full capacity, government expenditure would be higher than revenue.[2] Consistent with the principles of responsible fiscal management, we would typically expect a strengthening of fiscal buffers during the recent expansion in the business cycle through the automatic stabilisers (i.e. welfare spending decreases and tax revenue increases).

8. Growth in government expenditure has been the main factor behind the deteriorating OBEGAL position since 2021. Although higher-than-expected inflation and wage pressures contributed to increased expenditure, there was additional new spending. More recently, downward revisions to the tax revenue forecasts have contributed to the deterioration in the fiscal outlook since Budget 2023. This reflects our assessment that the relatively high revenue-to-GDP ratio over recent years was more temporary than previously thought, highlighting the uncertainty inherent in revenue forecasts.

9. Over the forecast period, economic headwinds will continue to challenge the fiscal position. Global growth is expected to be slower in 2023 and 2024 compared to 2022 amid expectations that global interest rates will be higher-for-longer. Economic fragmentation and heightened geopolitical tensions add uncertainties to the outlook and reinforce slower growth prospects. These external headwinds are weighing on New Zealand's export prices and the terms of trade, supressing income growth. While we do not expect a recession, these external factors, together with high inflation eroding consumers' spending power and higher domestic interest rates, mean that growth is expected to remain slow through 2024. This is despite a continued recovery in tourism. Slow growth and high inflation mean lower tax revenues and higher cost pressures faced by the public sector, putting pressure on the forecast OBEGAL track.

10. Additionally, Government debt issuance is forecast to be elevated by historical standards over the forecast period, and there are signs that the pace of issuance is starting to put upward pressure on the cost of borrowing (in addition to rising bond yields globally). Core Crown finance costs are expected to increase over the forecast period, rising from around $8.8 billion (c.2.1% of GDP) in the current fiscal year to a forecast (based on draft HYEFU

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[1] The 30% net debt ceiling was calibrated by our 2022 debt sustainability analysis to be a prudent level of net debt whilst still providing headroom to respond to shocks. It is based on conservative assumptions about the maximum level of net debt as a share of GDP at which it is still plausible to stabilise and reduce net debt to GDP back to a level that restores the Crown's fiscal buffers to respond to a large economic and fiscal shock.
[2] Over 2021 and 2022, the output gap was positive, indicating an economy operating above its capacity.

forecasts) of approximately $11.9 billion (c.2.3% of GDP) in 2027/28. This reflects both growing debt and higher interest rates. This will make finance costs the fourth-highest area of core Crown spending by functional classification, after social security and welfare, health, and education.

11. The fiscal position also faces significant challenges over the medium term (next 15 years) and beyond. Consistent with the principles of responsible fiscal management, surpluses on average across the medium term are required to enable a strengthening of fiscal buffers to enable governments to respond to future economic downturns or shocks without posing a risk to fiscal sustainability. However, low productivity growth combined with pre-existing challenges to the fiscal outlook could threaten the ability of the Government to achieve sustained operating surpluses and maintain sufficient balance sheet capacity due to:

- **Pressures on expenditure**: Demographic change will mean increased pressures on expenditure in policy areas that are hard to change such as superannuation and health. Approximate demand-led modelling,[3] which shows the effect of meeting pre-existing demographic change and cost pressures in full, suggests that Core Crown Expenses could be around $20 billion higher than the PREFU 2023 expenditure projection in 2037, which would cause the OBEGAL to average a deficit of approximately 1.5% of GDP over the projection period.

- **Investment programmes**: Available estimates point to the presence of an infrastructure gap in New Zealand. However, there are constraints on the pace and scale of investment that can be delivered by both the public and private sectors. The current pipeline of public investment exceeds our estimates of market capacity and may not represent the best value for money. Funding the full pipeline would lead to a significant reduction in the Government's debt fiscal space available to respond to the impact of future economic shocks and would add further pressure on OBEGAL due to associated operating costs such as maintenance and interest on debt. As such, we recommend the Government's investment pipeline is reprioritised. We will provide more advice on this shortly.

- **Climate change**: Mitigating greenhouse gas emissions and adapting to the physical impacts of climate change will have large fiscal costs. The approach to meeting these costs at Budgets 2022 and 2023 has been to size available funding proportionally to cash proceeds from the Emissions Trading Scheme and to spend these through the Climate Emergency Response Fund. Adaptation costs have also been managed with funding from the Multi-Year Capital Allowance and National Resilience Plan. These sources of funding will very likely be insufficient to meet the full costs of climate change over time. The broader challenges for the fiscal outlook heighten the importance of integrating your fiscal and climate strategies to better manage future climate costs. We will provide early advice on your approach to climate spending as part of the forthcoming Budget 2024 Strategy advice and can provide further advice on the management of climate change related costs in due course.

- **Specific fiscal risks**: Government decisions and other circumstances known to the Government that may have a material effect on the fiscal outlook, but which are uncertain in timing or quantum, have grown in scale and complexity in recent years, creating additional downside risk to the fiscal outlook.

12. The PREFU fiscal projections showed OBEGAL averaging just 0.1% of GDP over the 2026/27 – 2036/37 period. While the addition of the 2027/28 fiscal year at HYEFU to the fiscal forecasts is likely to marginally improve this average projection, structural changes are likely to be required to deliver fiscal sustainability over the medium term.

[3] This modelling is based on the PREFU forecast with a similar methodology to the Long-Term Fiscal Model.

Tight fiscal policy will support monetary policy to bring inflation down in the earlier years of the forecast period

13. From a macroeconomic perspective, the fiscal stance has been procyclical during the recent period of elevated inflation and strong domestic demand.[4] This has likely contributed to inflationary pressures at the margin. Published Treasury analysis shows supply and demand drivers contributed roughly equal amounts to inflation in the year ending March 2023, although different models give different estimations. The surge in inflation from 2021 was initially demand driven by stimulatory monetary and fiscal policy (in response to the pandemic), and rapidly increasing house prices. However, from the second half of 2021, supply-side factors (specifically pandemic related disruptions to labour supply, bottlenecks in production, and later the war in Ukraine) drove the continued accelerated in inflation. The relative contributions of supply and demand side drivers became stable across 2022.

14. The Monetary Policy Committee (MPC) has stated that the Official Cash Rate needs to stay at restrictive levels for the foreseeable future to ensure annual consumer price inflation returns to the 1 to 3% target range. Our draft HYEFU economic forecasts show interest rates remaining at their current level before gradually falling from the second half of 2024. Although there are risks that inflation may be more persistent than anticipated, due to factors such as higher net migration inflows supporting demand and providing additional inflationary pressure. We provide more advice on the economic outlook in T2023/1962.

15. The MPC takes fiscal policy into account when setting monetary policy, meaning changes in the stance of fiscal policy are likely to be reflected in the level of interest rates over the forecast period, rather than in changes to medium-term inflation or output forecasts. As such, not tightening fiscal policy broadly in line with the draft HYEFU forecasts would, all else equal, likely mean higher-for-longer interest rates. At a minimum, maintaining the forecast tightening of policy would be particularly important in a scenario where inflationary pressures are more persistent than expected. If slowing demand warrants more stimulatory macroeconomic policy, there is now significant headroom for monetary policy to be eased.

16. New Zealand has been running elevated current account deficits over the past two years which have largely been driven by the effects of COVID-19, including from the increase in government borrowing to support the response. While the current account is forecast to return to near its long-run average, not tightening fiscal policy consistent with the draft HYEFU forecast would push against this and potentially make New Zealand's debt increasingly costly to finance**.** This reinforces the desirability of a tight fiscal stance, and of economic policy reforms to lift productivity and competitiveness, supporting the ability of New Zealand to service and repay its debt over time.

To support macroeconomic stability and medium-term fiscal sustainability, we recommend that OBEGAL returns to surplus in 2026/27 at the latest

17. You have publicly stated your objective is to return OBEGAL to surplus in 2026/27 and we support this. Delivering a trajectory towards surplus in 2026/27 through your fiscal decisions in the near-term is on-balance more important to supporting the credibility of your fiscal strategy and your commitment to achieving sustainable surpluses over the medium-term than committing to a point target over three years away. We therefore recommend you commit to return to surplus in 2026/27 at the latest. As noted above, tightening fiscal policy to help meet this objective, particularly early in the forecast period, will help reduce inflationary pressures and the current account deficit.

18. Macroeconomic and fiscal sustainability objectives suggest that the date for returning to surplus should be brought forward if there are upside surprises to the forecast fiscal outlook. The draft HYEFU 2023 forecasts assume that the recent run of lower-than-expected tax

[4] At PREFU we estimated the output gap for 2021/22 was positive 2.6% of GDP, and the total fiscal impulse was positive 2% of GDP. This implies that, while the economy was generating excess demand, fiscal policy was contributing more to aggregate demand that year relative to the 2020/21 year.

outturns is largely carried through to later years of the forecast. While there is uncertainty regarding tax forecasts in years ahead, our assumptions reflect a balanced assessment of the upside and downside risks and we recommend you formulate the fiscal strategy on these central forecasts. However, if revenue comes in higher than forecast, we recommend using this to increase the size of the surplus forecast in 2026/27, rather than allocating upside revenue surprises to new expenditure. Conversely, if revenue comes in lower than forecast, we would likely recommend you find additional savings or revenue to at least partially offset the deterioration to the OBEGAL outlook. We would, however, recommend considering delaying the forecast return to surplus if a significant economic shock were to occur.

19. We therefore recommend you adopt the framing of the surplus target as in 2026/27 "at the latest", which could be further supported by commitments in the short-term intentions that you are required to publish in the Budget Policy Statement 2024.

20. Alternatively, you could choose to delay the return to surplus but doing so may risk negative ratings action by credit rating agencies. The New Zealand sovereign is highly rated by the three main internationally recognised credit rating agencies, and rating agencies tend to prefer holding ratings steady. However, recent commentary on New Zealand from credit rating agencies has had a more negative tone, owing to the return to OBEGAL surplus being delayed in multiple Economic and Fiscal Updates since late 2021 and the record high current account deficit.

21. While short term deteriorations in the fiscal outlook and a one-notch downgrade in the credit rating would not be expected to generate a noticeable increase in the cost of debt, it is important to bear in mind that confidence is difficult to build and easy to lose. Repeated delays in returning to operating surplus could undermine confidence in the Government's commitment to fiscal sustainability and more persistent external imbalances could result in increased concerns about the high current account deficit.[5] This provides a further rationale to a new Government returning to and maintaining sustained operating surpluses, and ensuring debt levels remain at prudent levels.

22. It is important that the timeframe for returning to surplus is supported by a realistic plan for achieving it. Achieving the return to surplus in 2026/27 at the latest will be contingent on managing within much smaller operating allowances than recent history and exercising fiscal restraint by limiting net new spending. Delivering on the Government's commitments while achieving the return to surplus by 2026/27 will require a deliberate and structured programme of a combination of reprioritisation, savings and revenue raising measures. These measures should deliver enduring improvements in the OBEGAL position and put New Zealand on a path to addressing the medium-term fiscal sustainability challenge. Such a programme will require the Government to make trade-offs over successive Budgets.

23. We recommend phasing savings activities over your term, beginning with pursuing targeted policy savings. Identifying specific targeted savings (e.g. by stopping or scaling programmes that are not well aligned with the Coalition Government's objectives) is more likely to be enduring than untargeted spending reductions. Targeted policy savings could be supplemented by baseline reductions which create a focus on efficiencies within agencies and provide Ministers with the flexibility to make trade-offs within their portfolios. We provide more advice on this in T2023/1987: Implementing the fiscal strategy.

24. Your revenue strategy can also be reviewed to support medium-term fiscal sustainability. Structural revenue increases can be pursued through tax policy changes, or by letting fiscal drag continue to increase revenue raised through personal income tax. We consider structural reform the most effective way to raise significant revenue, while having the ability to ensure this does not undermine distributional and economic objectives for the tax system.

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[5] No material impact on New Zealand Government bond yields was observed when Fitch and S&P upgraded New Zealand's credit ratings in 2021 and 2022 respectively. A one notch downgrade to New Zealand's credit rating would return New Zealand's foreign currency credit rating back to 'AA' (for S&P and Fitch).

Implementing your fiscal strategy

We recommend that your mini-Budget be fiscally neutral or positive over the forecast period

25. You have indicated that you wish to deliver a package of immediate tax and spending priorities though a mini-Budget before the end of 2023. To support the forecast OBEGAL surplus in 2026/27, we recommend your mini-Budget be at least fiscally neutral every year over the forecast period (to 2027/28). This approach would demonstrate your commitment to the 2026/27 surplus target and would also help limit any near-term inflationary pressure.

26. Alternatively, you could deliver a fiscally positive mini-Budget that results in a larger forecast surplus in 2026/27. This would send a strong signal to financial markets and credit rating agencies about your commitment to your fiscal strategy.

27. If the mini-Budget is fiscally negative, it is possible that there would be some market reaction to this, including expectations for a higher than otherwise Official Cash Rate and higher yields on New Zealand Government Bonds. As noted above, failing to narrow the fiscal deficit as expected could result in a reaction by credit rating agencies.

28. Identifying options for savings or revenue changes in short timeframes limits your choices and the quality of information available for decision making. While we have identified savings and revenue options you could take in the time available, there are risks around the associated trade-offs and the implementation design decisions necessary to incorporate those options in the HYEFU 2023 forecasts. While our advice on operating and capital allowance settings is forthcoming, we do not recommend setting these at levels lower that you intend to maintain for future Budgets.

We recommend you aim for an improving OBEGAL track year on year to be forecast by Budget 2024, showing a surplus in 2026/27 at the latest and a 1% of GDP surplus no later than 2027/28

29. Alongside a 2026/27 surplus, we also recommend you aim to forecast a surplus of 1% of GDP no later than 2027/28. This will provide increased confidence that a surplus will be delivered, supporting the credibility of your fiscal strategy. This will also help to demonstrate a clear trajectory towards surpluses over the medium term, in line with the principles of responsible fiscal management. This is particularly important in the context of the challenging 2026/27 surplus target and the risks to this from forecast variations and other potentially fiscally-negative surprises.

30. We recommend you work towards increasing the size of the forecast 2026/27 surplus at Budget 2024. Recent surplus targets have proven insufficiently robust to deviations from forecast, and the deterioration in the tax revenue-to-GDP ratio (in PREFU 2023 relative to BEFU 2023) demonstrates the difficulty of differentiating temporary from permanent revenue surprises in forecasts. Increasing the ambition of the savings or revenue policy options for consideration at Budget 2024 would mean you are better prepared to maintain a forecast surplus in the face of an unexpected deterioration in the fiscal outlook.

31. For perspective, the operating allowances set out in the National Party Fiscal Plan are close to allowances that could meet our recommended OEBGAL track. Reducing net new spending by a further $200 million over the forecast period would deliver on our recommended OBEGAL track. This could be achieved for example by reducing Budgets 2026 and 2027 operating allowances by $50 million and $100 million respectively.

32. As noted above our advice on allowances is forthcoming. Allowances are net concepts as delivering on coalition Government commitments through savings and reprioritisation will be key. Changes to allowances can also be phased to deliver different OBEGAL tracks depending on your fiscal strategy and government objectives.

Communicating your fiscal strategy

At the Budget Policy Statement you will communicate the priorities that will guide the Government in preparing Budget 2024, including your intentions for fiscal policy

33. Budgets and Budget Policy Statements are the formal process for how the Government communicates its fiscal strategy, by twice-yearly publishing the short-term intentions (including any targets for returning to surplus) and long-term objectives for fiscal policy. These must be consistent with the principles of responsible fiscal management set out in the PFA.

34. The PFA requires that you table the Budget Policy Statement (BPS) in the House by 31 March of each financial year. The BPS is typically delivered on the same day as HYEFU in December but in years with a general election it is often deferred to February. The next BPS will set the operating and capital allowances for Budgets 2024 – 2027. You will receive further advice on the timing and options for the BPS 2024.

35. While the focus of the BPS is generally on the priorities for the upcoming Budget, the PFA also requires the BPS to set out your short-term intentions and long-term objectives for fiscal policy. If these are different from those communicated by the Government at Budget 2023, you will need to explain how the amended intentions and objectives accord with the principles of responsible fiscal management. For example, we expect you will want to amend the short-term intention for the operating balance to reflect your fiscal strategy. Ahead of the BPS we suggest you signal the direction of travel at the mini-Budget.

36. It is common practice for some of these intentions and objectives to be expressed as fiscal rules. Fiscal rules are set by the Government of the day and are not legally binding. Fiscal rules may therefore be seen as a device for the effective communication of the Government's fiscal strategy, as well a self-imposed constraint on decision making.

We can provide further advice on fiscal rules to communicate your fiscal strategy

37. We seek a discussion with you to understand your preferences for any fiscal rules and whether you would like further advice, so that any new or amended fiscal rules can be communicated in the BPS 2024 and Budget 2024.

38. The Treasury provided advice in 2022 on fiscal rules that, when adhered to, would support a fiscal position that is sustainable over time. We recommended:

    - an operating rule as the main fiscal rule – to bring the operating balance before gains and losses (OBEGAL) back to surplus and then to maintain small surpluses on average over time, and

    - a debt ceiling – to maintain net debt as a share of GDP at a prudent level whilst still providing headroom to respond to shocks.

39. These rules were designed to provide buffers to respond to economic shocks and crises and enable the Government to use fiscal policy to support long-run economic growth (e.g. by being sufficiently flexible to respond to the business cycle, deliver government priorities, and enable high-value public investment).

40. We consider that our 2022 recommendations for fiscal rules remain broadly appropriate, but that there is scope to review or recalibrate these rules depending on your preferences (e.g. we can provide advice on the underlying indicators used to anchor the rules, and options to strengthen the rules to better support fiscal sustainability).

Next steps

41. The decisions we are seeking from you through this report will form the basis of your fiscal strategy for this term of Government. We will use this as direction for developing options on how to begin implementing your fiscal strategy through the mini-Budget and Budget Policy Statement 2024.

42. We will then provide advice on the fiscal strategy for Budget 2024. This advice will seek your decisions on short-term intentions for fiscal policy and the size of operating and capital allowances for Budgets 2024 – 2027.

43. We are available to discuss your preferences for fiscal rules and the fiscal strategy to be reflected in the Budget Policy Statement 2024.