The Treasury

Budget 2024 Information Release

September 2024

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Key to sections of the Act under which information has been withheld:

[1] 6(a) - to avoid prejudice to the security or defence of New Zealand or the international relations of the government

[23] 9(2)(a) - to protect the privacy of natural persons, including deceased people

[25] 9(2)(b)(ii) - to protect the commercial position of the person who supplied the information or who is the subject of the information

[27] 9(2)(ba)(ii) - to protect information which is subject to an obligation of confidence or which any person has been or could be compelled to provide under the authority of any enactment, where the making available of the information would be likely otherwise to damage the public interest

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

[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] 18(c)(i) - that the making available of the information requested would be contrary to the provisions of a specified enactment

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TE TAI ŌHANGA
THE TREASURY

Reference: T2024/1149

Date: 6 May 2024

To: Minister of Finance
(Hon Nicola Willis)

Deadline: None
(if any)

Aide Memoire: further information on the macroeconomic impacts of the personal income tax package

Purpose

On 4 April 2024 the Treasury provided information on the modelled impact of the personal income tax (PIT) package on inflation and interest rates [T2024/717]. You have subsequently asked for further information on the impacts of a fully funded PIT package, where the lost revenue is fully offset by cuts to government consumption. You have also asked for an explanation of the unemployment impacts of the package.

The modelling approach

As set out in our previous aide memoire, the Treasury has used a dynamic stochastic general equilibrium (DSGE) model for this macroeconomic modelling. This is a different approach from the Treasury's EFU forecasts. The model is built on a set of assumptions, some of which are more plausible than others. It is a stylised, simplified version of reality and cannot capture every feature of the economic and policy environments. The interventions discussed have been approximated in the context of the model and the results should be seen as illustrative. The modelled impacts are in percentage point terms, and are independent of the underlying levels of inflation, interest rates, and unemployment (such as the BEFU forecasts).
We have modelled scenarios based on three different assumptions:

1 That the package takes the form of a direct payment to households which is 100% consumed ('Fully Spent').

2 That it takes the form of a direct payment which is 70% saved and 30% consumed ('Partially Spent').

3 That it takes the form of a uniform reduction in their marginal tax rate, rather than a direct payment, ('Marginal Reduction').

None of these assumptions will necessarily be accurate, but serve to approximate the range of results and allow readers to interpolate any intermediate policy responses. The modelling done is near term (over the next 4 years) and shows short run effects. We have not modelled long run effects. Modelled over the longer run we would expect to see interest, inflation and unemployment rates returning to equilibrium.

The inflationary impacts of the PIT package

Generally, we would expect a cut in government consumption to reduce inflationary pressures because it reduces demand in the economy. Whereas tax cuts increase inflationary pressures as households have more wealth, which increases private demand.

However, in the modelled scenarios the increase in private consumption is smaller than the cut to government consumption resulting in a net negative to demand.[1] The net effect will be a reduction in overall demand, which creates disinflationary pressures. Because monetary policy should act to offset this through the OCR, the impact will mostly come through in interest rates rather than inflation. The impacts are quite small in part because the total quantum is small relative to the economy.

Overall then, depending on the assumptions used, our modelling show that a tax package which is fully funded by cuts to government consumption would reduce interest rates, over the modelled period, at the most significant point **from between 0.04 to 0.2 percentage points** during the modelled period.

The unemployment impacts of the PIT package

The modelling shows that the reduction in public consumption – under each of the three sets of assumptions – **will likely lead to an increase in the rate of unemployment in the short term**, which subsequently declines over the longer-term towards trend.

We are less confident in the exact magnitude of impacts on unemployment. Because the model is built primarily to show the impacts on interest rates and inflation, the reported impacts on unemployment are likely overly sensitive, so we have not included the modelled quantitative changes to unemployment. We are confident though in the direction of the impact, which is the flip side of the easing of inflationary pressures due to the reduction in demand.

Jack Starrett Wright, Senior Analyst, Macroeconomic and Fiscal Policy, [39]
Luke Came, Team Leader, Macroeconomic and Fiscal Policy, [39]

1 The reason for each scenario is slightly different. For the Fully Spent case this is due to GST reducing private consumption. In the Partially Spent case it is because some of the tax cut is also saved. In the Marginal Reduction case, the reduction in government consumption has the effect of reducing demand and employment more than the impacts on the labour supply due to the tax cuts.

Annex: modelling outcomes

Modelled impacts on interest rates, in percentage points, largest bolded

	Fully Spent	Partially Spent	Marginal Reduction
2024Q2	0	0	0
2024Q3	-0.009	-0.029	-0.036
2024Q4	-0.016	-0.054	-0.069
2025Q1	-0.022	-0.073	-0.095
2025Q2	-0.025	-0.086	-0.115
2025Q3	-0.030	-0.105	-0.141
2025Q4	-0.034	-0.118	-0.161
2026Q1	-0.036	-0.127	-0.175
2026Q2	-0.037	-0.133	-0.185
2026Q3	**-0.037**	-0.136	-0.192
2026Q4	-0.037	-0.138	-0.196
2027Q1	-0.036	-0.139	-0.198
2027Q2	-0.035	**-0.139**	**-0.199**
2027Q3	-0.034	-0.138	-0.198
2027Q4	-0.033	-0.137	-0.197
2028Q1	-0.032	-0.136	-0.196
2028Q2	-0.032	-0.135	-0.196

Modelled impacts on inflation, in percentage points, largest bolded

	Fully Spent	Partially Spent	Marginal Reduction
2024Q2	0	0	0
2024Q3	-0.008	-0.033	-0.057
2024Q4	**-0.01**	-0.039	-0.072
2025Q1	-0.009	-0.037	-0.075
2025Q2	-0.007	-0.034	-0.072
2025Q3	-0.009	**-0.04**	-0.087
2025Q4	-0.008	-0.039	**-0.088**
2026Q1	-0.006	-0.035	-0.086
2026Q2	-0.005	-0.032	-0.083
2026Q3	-0.004	-0.03	-0.081
2026Q4	-0.003	-0.029	-0.079
2027Q1	-0.003	-0.028	-0.078
2027Q2	-0.003	-0.028	-0.078
2027Q3	-0.002	-0.027	-0.076
2027Q4	-0.003	-0.028	-0.076
2028Q1	-0.003	-0.029	-0.077
2028Q2	-0.003	-0.031	-0.079