The Treasury

Budget 2024 Information Release

September 2024

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[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

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TE TAI ŌHANGA
THE TREASURY

Reference: T2024/590

Date: 7 March 2024

To: Minister of Finance
(Hon Nicola Willis)

Deadline: None
(if any)

Aide Memoire 2023

Purpose

1. This Aide Memoire provides a summary of recent advice on updates to the economic and fiscal outlook and implications for your fiscal strategy, to support engagement with Budget ministers.

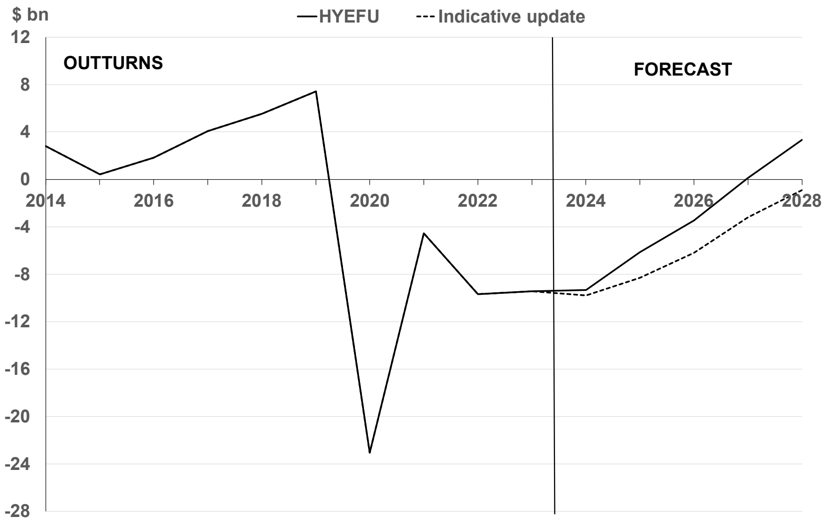
2. The Treasury's latest advice is that the economic and fiscal outlook has deteriorated since the Half Year Economic and Fiscal Update (HYEFU). The Treasury's indicative update of the fiscal outlook shows a fiscal deficit in 2026/27 and in 2027/28, and we have reflected this change in our latest fiscal strategy advice.

The HYEFU forecasts showed a challenging outlook for the fiscal position…

3. The forecasts published at the HYEFU in December showed the Operating Balance Excluding Gains and Losses (OBEGAL) returning to a $0.1 billion surplus in 2026/27 and a $3.4 billion surplus in 2027/28 (figure 1). The Treasury estimates that the deficits since 2020 are largely structural, with temporary spending and the economic cycle accounting for only a quarter of the current year OBEGAL deficit.

4. At the time, the Treasury recommended, on balance, that your fiscal strategy should target a return to operating surplus in 2026/27 at the latest (see T2023/1992). This advice reflected that a credible trajectory towards achieving sustained operating surpluses is required to support confidence in medium-term fiscal sustainability, particularly in light of emerging fiscal pressures associated with an ageing population. From a macroeconomic perspective, tighter fiscal policy also supports monetary policy in reducing inflation back towards the target band.

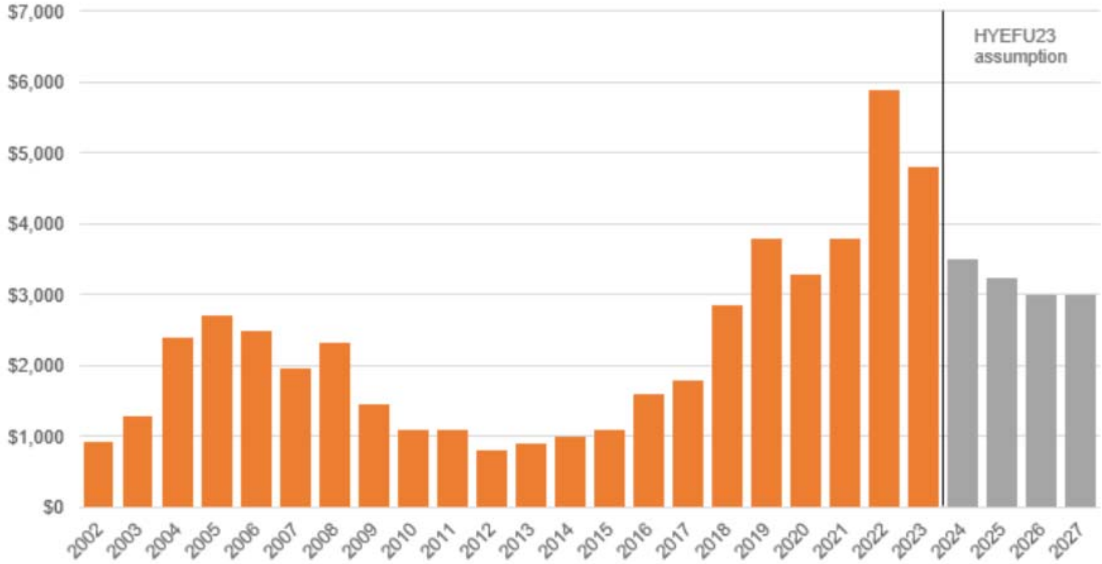
Figure 1: OBEGAL forecasts at HYEFU and indicative update (*June years)*



and difficult trade-offs to achieve the forecast return to operating surplus.

5. Reflecting the structural nature of the forecast deficits, Treasury's advice noted that the fiscal strategy needs to be supported by a deliberate and structured programme of reprioritisation, savings and revenue raising measures. As a result, the HYEFU forecasts assumed smaller operating allowances than recent history (figure 2). In particular, the assumed allowances range between $3-3.5 billion over the forecast period, compared to an average of almost $5 billion between Budgets 2021 to 2023. Large allowances at recent Budgets can only partly be explained higher-than-expected cost pressures associated with elevated inflation, and were accompanied by large increases in expenditure outside allowances.

Figure 2: Historical and HYEFU assumed operating allowances ($ million)

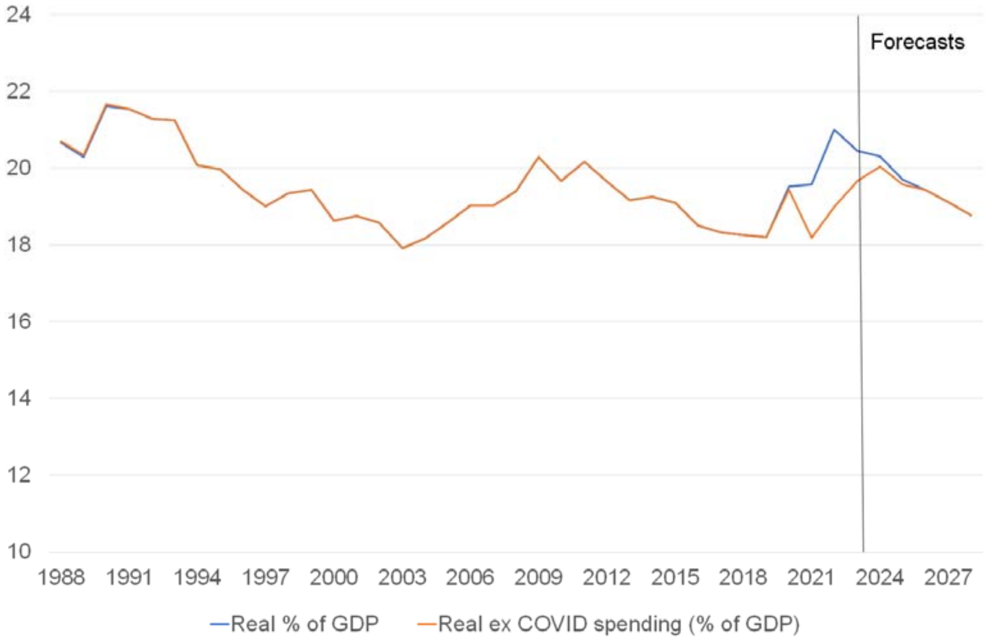


Note: Caution is warranted in comparing nominal allowances over time due to the cumulative effects of inflation.

6. The Government is likely to face significant demands on operating allowances in forthcoming Budgets, as assumed allowances will need to fund cost pressures, ongoing demand for government services, capital-related operating costs and any new initiatives. While the allowances are broadly sufficient to meet critical cost pressures not already funded, the number and complexity of Specific Fiscal Risks has also increased, and programmes with time-limited funding are set to expire.

7. The forecast decline in real government consumption at HYEFU illustrates the extent of fiscal consolidation required to adhere to the currently assumed allowances, with the scale of decline being comparable to the early 1990s but over a more compressed time period (figure 3).[1] Although some of the decline in consumption has already occurred as a result of expiring programmes related to COVID-19, there are material further declines expected in coming years. The HYEFU forecasts do not incorporate the impact of the Government's savings programme.

Figure 3: Real government consumption (HYEFU)



Note: COVID adjustment based on announced spending (not actual). The forecast expenditure is prior to mini-Budget savings and Budget 24 savings.

1 Government consumption measures expenditure required to produce public goods and services. Government consumption does not include a number of categories of core Crown expenditure, such as transfers, subsidies, finance costs, student loan costs. Government consumption as measured in the National Accounts includes both local and central Government.

The updated economic forecasts show a weaker outlook for growth

8. There has been a significant deterioration in the economic and fiscal outlook since HYEFU, due to factors outside of the Government's direct control. Although the Budget 2024 forecasts will not be finalised until April, Treasury has provided a preliminary set of updated economic forecasts.

9. A major driver of the downward revisions to the economic outlook is a lower assumption for productivity growth compared to HYEFU. Recent GDP revisions and data updates from Stats NZ have provided evidence that the burst of strong productivity growth experienced after COVID was temporary. This aligns with global experience of a slowdown in productivity growth, and suggests that the trend of slower productivity growth that New Zealand was experiencing between approximately 2010 and 2020 remains intact.

10. Recent data also suggest a more abrupt slowdown in GDP growth in the near-term and a slightly faster decline in inflationary pressures than anticipated. Nevertheless, high interest rates remain necessary to further restrain demand and to ensure inflation settles at the 2.0 percent mid-point of the target range. Weak GDP growth is expected to see the unemployment rise to around 5 percent. Annual consumer price inflation is forecast to fall from 4.7 percent currently to below 3 percent later this year, before settling around the 2.0 percent mid-point in 2026.

leading to a downward revision to forecast tax revenue...

11. The weaker outlook for real GDP in the preliminary forecasts, combined with the faster pace of disinflation, drives a downgrade in the forecast for nominal GDP of nearly $40 billion over the forecast period compared to the HYEFU, which flows through to forecast tax revenue. Tax revenue is cumulatively $11.7 billion lower in the five years to 2027/28 and $3.6 billion lower in 2027/28, compared to the HYEFU forecast. The downward revision primarily reflects weaker growth in nominal GDP.

12. There remains significant uncertainty about the economic and tax outlook. Further revisions to nominal GDP are possible as we get more information about the economic outlook. In addition, there is uncertainty about the outlook for tax revenue as a share of the economy, and how enduring downward revisions made over successive forecast rounds prove to be. For example, there is ongoing uncertainty associated about how ongoing inflation and shifts in the composition of output (including the outlook for services exports) will affect revenue.

and a delay to the forecast return to surplus, based on current allowances.

13. Assuming the same operating allowances as were used in HYEFU, the downward revision to the revenue forecast and other factors means that the Treasury now expects an OBEGAL deficit in 2026/27 (table 1). The updated indicative OBEGAL track also shows a small deficit in 2027/28. The downward revision in OBEGAL will lead to a higher net debt track compared to HYEFU by potentially $15 billion by the end of the forecast period.

Table 1: OBEGAL – HYEFU and Indicative revised OBEGAL track at 4 March[2]

$billions	**2023/24**	**2024/25**	**2025/26**	**2026/27**	**2027/28**
OBEGAL at HYEFU 2023	**(9.3)**	**(6.1)**	**(3.5)**	**0.1**	**3.4**
Tax revenue (forecast changes only)	(0.9)	(2.4)	(2.3)	(2.8)	(3.6)
Benefit expenses (MSD forecast changes only)	0.2	0.3	0.5	0.6	0.6
NRP funding decision	0.4	0.1	(0.2)	(0.2)	(0.2)
Fiscal sustainability	0.0	(0.4)	(0.5)	(0.5)	(0.5)
[38]					
Net core Crown finance costs	0.4	0.8	0.4	0.2	0.0
Asset impairments	(0.4)	0.0	0.0	0.0	0.0
Total impact to OBEGAL	[38]				
Indicative revised OBEGAL track					

The Treasury's fiscal strategy advice has been updated for the changed outlook

14. The indicative changes to the fiscal outlook will make it even more challenging to return to operating surplus in 2026/27. To show a 2026/27 surplus in BEFU 2024, Treasury estimates a reduction in Budget 2025 and 2026 allowances of at least $1.6 billion each would be required, in the context of high demands on the operating allowances described above. Forecasting such small allowances would require a multi-year plan agreed by Cabinet for identifying and implementing additional savings and revenue to maintain the credibility of the fiscal strategy.

15. As noted above, the HYEFU forecasts already anticipated difficult trade-offs to adhere to the assumed operating allowances. Moreover, there is already significant pressure on the current Budget 2024 operating allowance. Assuming the Coalition Government's tax relief proceeds broadly as publicly indicated, we anticipate that the options for identifying further required savings are likely to become more complex and require harder trade-offs. These trade-offs would be more acute if the forecast operating allowances were to be reduced significantly.

16. The Treasury's updated advice is to target a return to surplus no later than 2027/28 (see T2024/475). This reflects our view that the risks from implementing the savings and revenue programme required to return to surplus in 2026/27,

[2] The preliminary fiscal forecasts will be completed on 18 March 2024, which will provide a clear picture of the updated fiscal outlook.

given the updated outlook, outweighs the macroeconomic and fiscal sustainability benefits. Beyond targeted policy changes previously recommended, it will take time to identify substantial savings and revenue that best balance your broader objectives, including for living standards, more efficient public services, long-term economic prospects, and the durability of spending reductions.

17. We recommend that the Government support its commitment to medium-term sustainability by demonstrating fiscal control through the Budget 2024 process, and emphasising the intention to meet future Budget allowances. In addition, the fiscal strategy announced at Budget Policy Statement (BPS) should commit to using upside revenue surprises to support the return to operating surplus, and set out the limited circumstances where a further deferral in the timeframe for returning to surplus would be considered (see T2024/312).

Next steps

18. We recommend you refer this Aide Memoire to Associate Ministers of Finance to support decision-making at Budget Ministers Meeting 2, including on the short-term intentions and long-term objectives that will anchor the Government's fiscal strategy and operating and capital allowances. Budget Ministers are also expected to provide feedback on the draft Budget package.

19. Decisions on the fiscal strategy will be reflected in the BPS released on 27 March 2024. The Treasury anticipates publishing updated economic and fiscal forecasts alongside BPS, and intends to shortly provide you with more information on the nature of these forecasts.

20. The updated economic forecast and indicative fiscal outlook update discussed in this Aide Memoire will continue to be revised between now and when the economic forecasts are finalised on 5 April, the tax forecasts are finalised on 12 April (with formal advice to the Minister of Finance on 15 April) and the fiscal forecasts are finalised on 9 May 2024. The key factors that may lead to revisions include:

    a. Updating the economic and forecasts for new data releases
    b. Detailed agency-level forecasts for expenditure and other revenue
    c. Government decisions yet to be made and incorporated.

    While many of the revisions will likely be offsetting, the net impact of them could see further material changes to the forecast OBEGAL before they are finalised for publication in Budget 2024.

21. The forecasts for Budget 2024 are made under conditions of significant uncertainty and, over the longer-term, the Treasury will continue to adjust its forecasts based on new information about the economic and fiscal outlook.

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