

# The Treasury

## Budget 2024 Information Release

### September 2024

This document has been proactively released and is available on:

- The Budget website from September 2024 to May 2025 only at: <https://budget.govt.nz/information-release/2024>, and on
- The Treasury website from later in 2024 at: <https://www.treasury.govt.nz/publications/information-release/budget-2024-information-release>

#### Information Withheld

Some parts of this information release would not be appropriate to release and, if requested, would be withheld under the Official Information Act 1982 (the Act).

Where this is the case, the relevant sections of the Act that would apply have been identified.

Where information has been withheld, no public interest has been identified that would outweigh the reasons for withholding it.

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

Where information has been withheld, a numbered reference to the applicable section of the Act has been made, as listed above. For example, a [23] appearing where information has been withheld in a release document refers to section 9(2)(a).

## **Copyright and Licensing**

Cabinet material and advice to Ministers from the Treasury and other public service departments are © **Crown copyright** but are licensed for re-use under **Creative Commons Attribution 4.0 International (CC BY 4.0)** [<https://creativecommons.org/licenses/by/4.0/>].

For material created by other parties, copyright is held by them and they must be consulted on the licensing terms that they apply to their material.

## **Accessibility**

The Treasury can provide an alternate HTML version of this material if requested. Please cite this document's title or PDF file name when you email a request to [information@treasury.govt.nz](mailto:information@treasury.govt.nz).

Reference: T2024/717

Date: 4 April 2024

To: Minister of Finance  
(Hon Nicola Willis)

Deadline: None  
(if any)

## **Aide Memoire: The impact of the personal income tax package on inflation and interest rates**

You have asked for information on the impact of the Personal Income Tax (PIT) package on inflationary pressures and interest rates. This aide memoire provides modelling of the impacts of the PIT package in different scenarios and under different assumptions. These show scenarios where tax cuts are financed through government consumption cuts,<sup>1</sup> debt, revenue funded, and various combinations thereof.

### **The macroeconomic context**

Modelling of the fiscal impulse using the preliminary forecasts shows fiscal policy is subtracting from aggregate demand from 2024/25 relative to the previous year. This is broadly consistent with fiscal policy supporting monetary policy to bring down inflation. While the fiscal impulse from 2024/25 is less negative than forecast at HYEPU, any relative stimulatory impact is lessened by the economy's increasing capacity to absorb fiscal spend, as indicated by the negative output gap from 2024 (indicating the economy is operating below potential capacity).

Figures 1 and 2 set out the present state of fiscal policy, ahead of Budget 2024 decisions. These indicators are based on preliminary economic and tax forecasts, with more recent preliminary fiscal forecasts that assume a \$3.5 billion increase in allowances at Budget 2024 and a \$7 billion increase in the MYCA at Budget 2024. Outyear allowances are assumed to be \$3.25 billion for Budget 2025 and \$3 billion thereafter. You have indicated that future outyear allowances are likely to be lower than assumed. These forecasts assumed that of the remaining \$2.7 billion Budget 2024 allowance available, a portion will be used to fund the tax package, with the remaining used to fund additional operating expenses.

---

General government final consumption expenditure includes all government current expenditures for purchases of goods and services (including compensation of employees). It also includes most expenditures on national defence and security, but excludes government military expenditures that are part of government capital formation.

Figure 1: The operating balance before gains and losses (OBEGAL), the Cyclically-adjusted Balance (CAB) and the Structural Balance

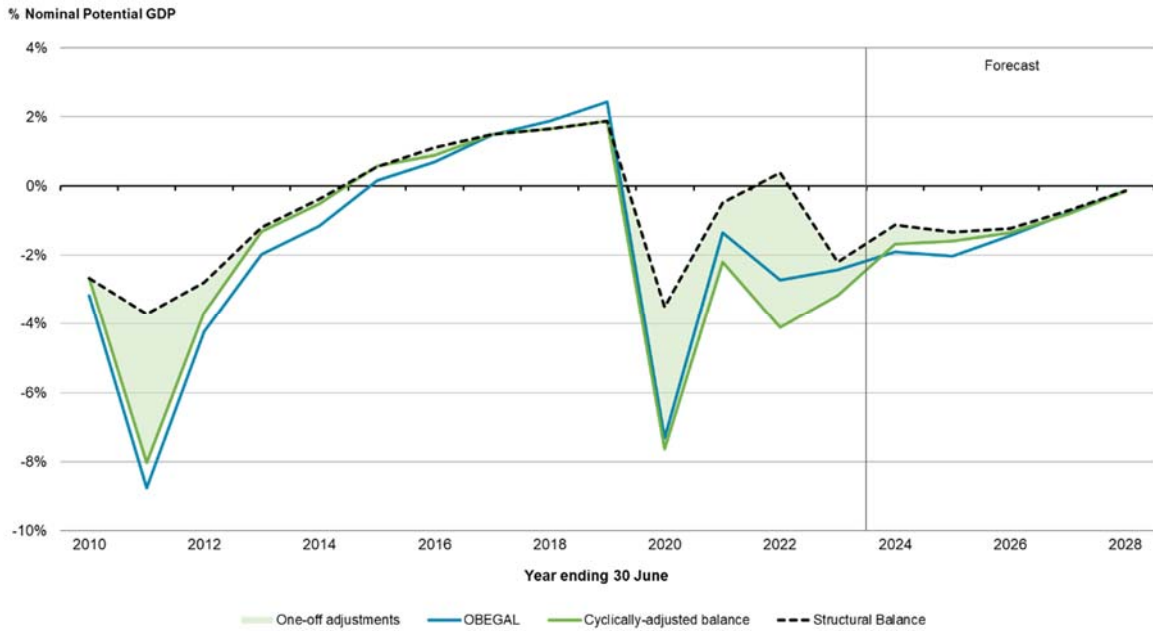
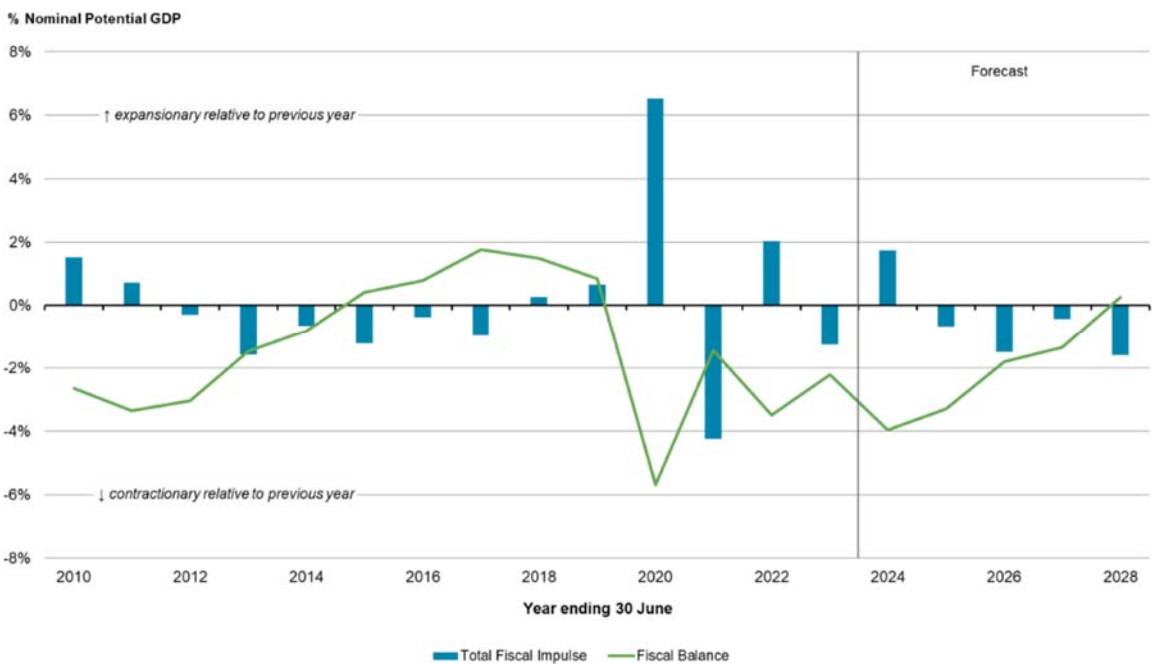


Figure 2: Total Fiscal Impulse



All three indicators of fiscal sustainability – the operating balance before gains and losses (OBEGAL), the cyclically-adjusted balance (CAB) and the structural balance – are currently not forecast to return to surplus within the next four years, with the OBEGAL deficit expected to be \$0.7 billion (0.1% of GDP) in 2027/28. Downward revisions to the tax revenue forecasts by an average of \$5.7 billion each year between 2024/25 to 2027/28 are the key driver for the weaker outlook, and more than offset the reductions in total expenditure in each year of the forecast period relative to HYEUFU 2023.

While the fiscal sustainability indicators show a narrowing in their deficits over time, the OBEGAL deficit is expected to widen slightly to 2.0% of GDP in 2024/25 before narrowing thereafter. The widening deficit in 2024/25 reflects a rise in JobSeeker support consistent with the expected rise in the unemployment rate. The CAB shows a steady recovery throughout the forecast period.

Over the remainder of the forecast period from 2024/25, the total fiscal impulse is forecast to be less negative on average in each year than expected at HYEPU 2023. Fiscal policy under current settings therefore is expected to be subtracting less from inflationary pressures than previously expected.

### **Scenario modelling**

The macroeconomic modelling analysis is carried out using a dynamic stochastic general equilibrium (DSGE) model. DSGE models incorporate behavioural responses from firms and households to changes in both monetary and fiscal policy, making them well suited for policy analysis. DSGE models are used by both academia and policy institutions, including the IMF and the European Commission, to investigate monetary and fiscal policy issues. The model takes the government's long-run budget constraint seriously. In the long-run the present value of government expenditure is expected to equal the present value of taxes, so any change in expenditure plans must also entail changes to taxation (and vice-versa). The DSGE model used for this policy analysis is distinct from Matai, the semi-structural model that the Treasury uses to forecast the macro economy.

The DSGE model is estimated using New Zealand data from 1994 to 2019. This means the model responses will reflect the economic circumstances that underpin the New Zealand economy, which may differ from responses obtained from models of larger, closed economies. The model has been estimated on pre-COVID data, due to the extreme volatility in gross domestic product during the COVID lockdowns. Note that data limitations result in uncertainty about the parameter values, which will have implications for the responses that are reported here.

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. Inflation over the last few years has been more volatile than previously, so it is possible that the analysis underestimates the inflation response of these experiments, given the model was estimated on data where inflation was more stable. Matai, the Treasury's economic forecast model, tends to be more sensitive to fiscal policy and therefore predicts larger interest rate responses to tax cuts or spending changes, although this depends on the nature and timing of fiscal policy changes.

## The Treasury modelled scenarios showing different funding options

All the scenarios modelled increased personal income tax brackets (as set out in the table); increasing the Independent Earner Tax Credit threshold to \$70,000; and increasing the In-Work Tax Credit to \$5,070 per annum. The total cost over the forecast period is \$10.751b. The changes take effect 1 July 2024.

### Modelled tax thresholds

	Current upper threshold	Modelled threshold
10.5% rate	\$14,000	\$15,600
17.5% rate	\$48,000	\$53,500
30% rate	\$70,000	\$78,100
33% rate	\$180,000	\$180,000

Treasury modelled four scenarios to illustrate the impacts of different funding options for the PIT package.

- The first scenario shows the impact of government consumptions cuts with no PIT package.
- The second scenario shows if government consumption falls by the same amount as the fall in PIT revenue, so the package is approximately fiscally neutral.
- The third shows PIT package funded through increased debt, with no cuts to government consumption.
- The fourth shows the PIT package funded half through debt and half through additional taxes (an illustrative combination of increased consumption taxes and increased capital income taxes).

The tables below show the timing and quantum of the maximum impact on inflation and interest rates over the next four years. This was done under three sets of assumptions: that the tax cuts are a lump sum fully spent by recipients; that they are partially spent and 30% is saved; and that the marginal tax rate on labour faced by all workers falls, leading to an increase in the labour supply. The debt and additional tax model is only shown under the fully spent assumption. The different assumptions were used to show the range of possible outcomes.

Generally, the more the tax cuts are funded through debt the greater the impact on inflationary pressures. These increased inflationary pressures are offset by the central bank, meaning the net result is higher interest rates and a similar inflation profile than under the status quo. Tax cuts financed through cuts to government consumption reduce nominal interest rates – this is fundamentally because there is a lower fiscal multiplier on tax cuts than for general government consumption. Funding through consumption taxes tends to offset the impact of the PIT package cuts, whereas funding through increased tax on capital income increases inflation due the negative impact on the total supply of goods and services.

While the scenario modelling shows some impact on macroeconomic variables such as nominal interest rates, the absolute magnitude of these impacts is relatively small.

***Impacts of tax package on interest rates in percentage points***

	Fully spent	Partially spent	Impact on labour supply
Government consumption cuts with no tax reduction	<b>-0.19%pt</b> Q2 2028		
Government consumption cut with tax reduction	<b>-0.03%pt</b> Q3 2026	<b>-0.13%pt</b> Q2 2027	<b>-0.19%pt</b> Q2 2027
Debt funded tax reduction	<b>0.16%pt</b> Q2 2028	<b>0.05%pt</b> Q2 2028	<b>0%pt</b>
Tax reduction funded through debt, and additional taxes	<b>0.02%pt</b> Q4 2025		

**Impacts of tax package on inflation in percentage points**

	Fully spent	Partially spent	Impact on labour supply
Government consumption cuts with no tax reduction	<b>-0.05%pt</b> Q2 2028		
Government consumption cuts with tax reduction	<b>-0.01%pt</b> Q4 2024	<b>-0.04%pt</b> Q3 2025	<b>-0.08%pt</b> Q4 2025
Debt funded tax reduction	<b>0.05 %pt</b> Q2 2028	<b>0.02%pt</b> Q2 2028	<b>-0.04%pt</b> Q4 2025
Tax reduction funded through debt, and additional taxes	<b>0.02%pt</b> Q4 2025		

Jack Starrett Wright, Senior Analyst, Macroeconomic and Fiscal Policy, <sup>[39]</sup>

Luke Came, Team Leader, Macroeconomic and Fiscal Policy, Macroeconomic and Fiscal Policy, <sup>[39]</sup>