ECONOMIC BULLETIN

Preview of New Zealand Budget 2024, 30 May 2:00pm.

17 May 2024 | **Darren Gibbs**, Senior Economist | +64 9 367 3368 | +64 21 794 292 | darren.gibbs@westpac.co.nz

Plotting a long and uncertain path back to surplus

- **Budget 2024 on 30 May will provide the first complete official costings of the new Government's spending and revenue initiatives.**
- **A weaker outlook for nominal GDP and thus a smaller tax take will be the key driver of revisions to the OBEGAL balance and the government borrowing programme.**
- **We expect the Treasury to forecast a tiny OBEGAL surplus in '27/28, while net core Crown debt will likely remain above the Government's long-term goal of 20-40% of GDP.**
- **A weaker operating balance and a topped-up capital allowance will likely increase the government's borrowing requirement by about $15bn over the four-year forecast period.**
- **The increase in the borrowing requirement could be smaller if tax cuts have been scaled back or spending control is tighter than we have assumed. But it could also be larger if the Treasury's growth forecasts are revised down more than we have assumed.**
- **Beyond the worse starting point associated with a weaker than expected economy, we think that forecast rate of fiscal consolidation will be similar to that depicted in the HYEFU.**
- **We think that sustained spending restraint may well prove more difficult than is likely to be depicted in Budget 2024. Hence the path to surplus may be longer and more uncertain.**

Budget 2024 – fiscal deterioration to be laid bare.

The Minister of Finance, Nicola Willis, will table her first budget in Parliament at 2pm NZT, Thursday 30 May. The first budget of a new government is always of interest. This occasion will be no different, with Budget 2024 providing the first complete official costings of the various spending and revenue initiatives that were set out in the coalition agreements between the National Party and its coalition partners. That said, the largest driver of revisions to the forecasts contained in the Half-Year Economic and Fiscal Update (HYEFU) will a weaker outlook for the economy, as was already foreshadowed in the Budget Policy Statement (BPS) in late March.

As far as discretionary changes to the fiscal outlook are concerned, the main uncertainties regarding expenditure are the extent of the baseline departmental cost savings that the Minister has been able to achieve and the size of the operating allowances that she will set herself for future budgets. Last week, in her first pre-Budget speech, the Minister stated that Budget 2024 will capture the full $1.5bn of ongoing operating spending reductions that the Government had been seeking. The size of future operating allowances remains uncertain, although for the coming year the Minister has restated that the allowance will be less than the $3.5bn sum specified in the HYEFU.

Regarding revenue, the focus will be on the government's tax cuts; specifically, whether the cost of the tax threshold indexation adjustment will be as large as the $9bn (over four years) that was proposed by the National Party during the election campaign, or whether it has been pruned given the weaker fiscal backdrop that has emerged since the election. On that score, in her pre-Budget speech the Minister indicated that 83% of income earners over the age of 15 would benefit from tax relief, but she did not indicate whether that relief would be exactly as specified during the campaign. Aside from changes to income tax, it seems likely that Budget 2024 will announce some additional minor revenue raising initiatives beyond those foreshadowed in the coalition agreements.

Aside from any announcements that might have implications for specific sectors or regions of the economy, at the macro level financial markets will be focused on two key aspects of the Budget:

- The implication of forecast developments in operating and capital spending, together with revenue, for the Government's bottom line borrowing requirement.
- How the government's spending and revenue plans will likely impact the economy (i.e., the fiscal impulse) and thus the RBNZ's assessment of the degree of support that fiscal policy is providing in quelling inflation pressures.

A weaker nominal economy means less tax revenue.

Given all the moving parts, forecasting the fiscal aggregates is a difficult task at the best of times. Forecasting what the Treasury will forecast is even more fraught with difficulty. Fortunately, the partial economic update published by the Treasury alongside the BPS in late March does provide a relatively recent guide as to how the Treasury is viewing the economy and the outlook for tax revenue. The 'scenario' depicted in that update pointed to a significantly lower track for nominal GDP – and thus a smaller tax base – than forecast in the HYEFU, with core Crown tax revenue likely to be about $14bn lower across the forecast period. It is worth noting that this update was finalised prior to the release of December 2023 quarter GDP data, which were also a little weaker than the Treasury's expectation. And in her pre-Budget speech, the Minister lamented that each successive Treasury update seems worse than the last. This suggests that the Budget 2024 forecast for nominal GDP and tax revenue will be weaker still in the near-term, even before tax cuts are factored. *Table 1* provides an indication of how the revised Treasury forecasts might look.

Given such an economic outlook, *table 2* sets out our best guess as to how the key fiscal metrics will look in Budget 2024. Reflecting forementioned savings, we expect Budget 2024 to reveal a slightly lower track for spending than in the HYEFU. It is worth noting that at the end of the period we expect that core Crown expenses will remain a little above the Government's long-term goal of 30% of GDP. The impact of that favourable revision on the operating balance is more than offset by a lower track for revenue, however. This reflects the combined effect of a downward revision to the tax base and the assumed impact of tax cuts. Given these assumptions, we calculate that the Treasury's forecast for the OBEGAL deficit will be a cumulative $11bn higher than the HYEFU forecast. Such a forecast would mean that OBEGAL would remain in deficit in 2026/27 – as the Minister has already suggested is likely – but would perhaps allow the possibility of a tiny surplus to be projected in 2027/28.

We would be surprised if the fiscal outlook was portrayed more positively than this unless income tax cuts have been pruned significantly compared to what the National Party had proposed and/or future assumed spending allowances are much tighter than we have assumed. It is also worth noting that the government spending forecasts that we expect to see in Budget 2024 are somewhat lower than incorporated in our latest **Economic Overview**. In the latter, we made the judgment that beyond the next year or so, maintaining spending control as strictly has had been forecast in the HYEFU

Table 1: Key Economic Assumptions (June years)

	22/23	23/24f	24/25f	25/26f	26/27f	27/28f
Real GDP growth (ann. avg.)						
HYEFU	3.2	1.5	1.5	2.8	3.0	2.7
Budget 2024 (Westpac f/c)	3.0	-0.1	1.7	3.2	3.1	2.6
Nominal GDP growth						
HYEFU	8.9	6.1	4.7	5.4	5.4	5.0
Budget 2024 (Westpac f/c)	8.7	4.5	4.2	5.2	5.2	4.9
Unemployment (June qtr)						
HYEFU	3.6	4.5	5.2	4.8	4.6	4.4
Budget 2024 (Westpac f/c)	3.6	4.6	5.2	4.8	4.5	4.4
CPI inflation (ann %)						
HYEFU	6.0	4.1	2.5	2.2	2.0	2.0
Budget 2024 (Westpac f/c)	6.0	3.5	2.2	2.1	2.0	2.0

Source: NZ Treasury, Westpac

Table 2: Key Fiscal Metrics (June years)

	22/23	23/24f	24/25f	25/26f	26/27f	27/28f
Total spending $bn						
HYEFU	162	176	181	188	194	199
Budget 2024 (Westpac f/c)	162	176	178	185	191	197
Total revenue $bn						
HYEFU	153	167	175	185	194	203
Budget 2024 (Westpac f/c)	153	165	170	179	189	197
OBEGAL $bn*						
HYEFU	-9.5	-9.3	-6.1	-3.5	0.1	3.4
Budget 2024 (Westpac f/c)	-9.5	-10.9	-8.4	-5.9	-2.6	0.3
OBEGAL % of GDP*						
HYEFU	-2.4	-2.2	-1.4	-0.7	0.0	0.7
Budget 2024 (Westpac f/c)	-2.4	-2.6	-2.0	-1.3	-0.5	0.1
Net core Crown Debt (% of GDP)						
HYEFU	39.2	43.5	42.3	40.7	39.9	37.6
Budget 2024 (Westpac f/c)	39.3	44.6	44.3	43.4	43.3	41.8

Source: NZ Treasury, Westpac

is likely to prove very challenging. So given the balance of risks, our own forecasts project that the OBEGAL will ultimately remain in deficit in 2027/28.

Implications for the bond programme.

Regarding the borrowing programme, our expectations regarding the Treasury's forecast for spending and revenue, together with the funding of the foreshadowed top-up of the multi-year capital allowance (MYCA), imply that the cumulative bond programme over the next four years will be about $15bn greater than assumed in the HYEFU. The deterioration is slightly greater in the second half of the period, reflecting the steadily compounding impact of weaker economic growth. Even so, we expect a $3bn lift in the borrowing requirement for the upcoming '24/25 fiscal year, moving it slightly above the $38bn programme that will be completed in the current fiscal year. New Zealand Debt Management (NZDM) has scope to expand non-NZGB issuance (e.g., T-bills, ECP), so it could use this to smooth the issuance profile somewhat. The increase in the borrowing requirement could be smaller if tax cuts have been scaled back or spending control is assumed to be tighter than we have assumed. But it could also be larger if the Treasury's growth forecasts are revised down more than we have assumed.

Implications for the RBNZ.

The February Monetary Policy Statement included a special topic in which the RBNZ reached a preliminary verdict on the impact of the Government's proposed policies on monetary policy. The RBNZ's analysis concluded that based on available information, uncertainties around the policy outlook appeared at least partially offsetting, so that it was unclear whether the net effect would be inflationary or deflationary. In our own writing ahead and following the General Election, we also concluded that the overall macroeconomic impact of proposed government policy changes was likely to be small, although it would have distributional impacts across the economy. We note that the Minister has said that Treasury modelling indicates that fiscally neutral tax relief – financed through reduced government consumption – reduces inflationary pressure and nominal interest rates. This is mainly because there

Table 3: NZ Government Bond Programme ($bn), June year

	23/24f	24/25f	25/26f	26/27f	27/28f	Cumulative
HYEFU	38	36	34	28	16	152
Budget 2024 (Westpac f/c)	38	39	38	32	20	167
Difference	0	3	4	4	4	15

Source: NZ Treasury, Westpac

is generally a lower multiplier on tax relief than for general government consumption. We agree with that assessment.

On budget day, we expect that financial markets will take note of the Treasury's estimate of the total fiscal impulse (TFI). The TFI is based on a complete cash-based measure of fiscal outlays and revenues, while adjusting for some items that do not directly affect aggregate demand (although the TFI does include financing costs – the returns from which in large part fall to foreign bond holders). That said, the TFI only provides an indication of the first-round impact on the economy of changes in discretionary fiscal policy. Budget decisions – both financial and non-financial – will also have an economic impact to the extent that they change behaviour, including on the supply-side of the economy. And how the economy reacts to a given fiscal impulse – the fiscal multiplier – will depend on factors, such as the state of the economic cycle.

In the HYEFU, the Treasury's estimate of the TFI indicated that the government would subtract from aggregate demand to the tune of 6.3% of nominal potential GDP over the four years from 2024/25 to 2027/28. Given a worse near-term outlook for the economy, the fiscal impulse may be a little less negative in 2024/25 than previously estimated as the automatic stabilisers kick in, while the rate of fiscal consolidation beyond that year will probably be similar to that estimated in the HYEFU. It is also worth noting that estimates of the TFI can be sensitive to assumptions about trend growth in the economy, and that Budget 2024 will likely include a downwardly revised assessment of nominal potential GDP given signs that trend productivity growth has been weaker than expected earlier. We would not be surprised to see the Treasury's estimate of the fiscal impulse in '23/24 revised lower. Indeed, we note that recent IMF estimates contained in the Article IV Staff Report estimate that the fiscal impulse was in fact mildly negative in '23/24, in sharp contrast to the Treasury's HYEFU estimate.

Table 4: Fiscal Impulse (% of Nominal Potential GDP)

	22/23	23/24f	24/25f	25/26f	26/27f	27/28f	Cumulative (24/25-27/28)
HYEFU	-1.28	2.64	-2.37	-1.58	-0.79	-1.52	-6.3

Source: NZ Treasury, Westpac

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