# WESTPAC ECONOMIC BULLETIN

## First Impressions: Half-Year Economic and Fiscal Update 2022.

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- The HYEFU painted a relatively benign picture of the Government's books, with less of a change from the May Budget projections than we were expecting.
- Cost pressures still loom large on the fiscal accounts. The Government has chosen to address this through reprioritising spending towards core public services.
- However, the scope for this reprioritisation remains to be worked out in next year's Budget round.
- The outlook for the economy has deteriorated since May, with the Treasury now forecasting a shallow recession next year and a substantial lift in unemployment.
- However, the Government's expected borrowing requirement has not significantly increased, outside of a change to how Kāinga Ora is funded.

| | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 |
|---|---|---|---|---|---|---|
| | Actual | F/cast | F/cast | F/cast | F/cast | F/cast |
| **Economic forecasts (June years, %)** | | | | | | |
| Real GDP growth | 1.0 | 3.5 | -0.3 | 2.1 | 3.3 | 3.0 |
| Unemployment rate | 3.3 | 3.8 | 5.5 | 5.2 | 4.6 | 4.3 |
| CPI inflation | 7.3 | 6.4 | 3.5 | 2.5 | 2.0 | 2.0 |
| **Fiscal forecasts (June years, % of GDP)** | | | | | | |
| Total Crown OBEGAL | -2.7 | -0.9 | -0.1 | 0.4 | 1.4 | 1.9 |
| Net core Crown debt | 17.2 | 19.9 | 21.4 | 19.1 | 17.1 | 14.1 |
| **Debt issuance (June years, $ billion)** | | | | | | |
| Bond programme | - | 28.0 | 30.0 | 30.0 | 20.0 | 20.0 |

The HYEFU paints a relatively benign picture of the Government's books. The Treasury's preferred operating balance measure (OBEGAL) is forecast to return to surplus on schedule in the 2024/25 year, and to increase further to around 1.9% of GDP by 2026/27.

To achieve this, however, the Government has kept its operating allowances for future Budgets unchanged, despite growing cost pressures on the delivery of core public services. We had expected more movement on this front in today's HYEFU, given that the Treasury had already highlighted these pressures back in the May Budget.

The HYEFU continues to highlight that: "The possibility of higher-than-normal cost pressures expected in the 2023/24 year, could make it challenging to meet these costs from the funding remaining in the Budget 2023 operating allowance." It goes on to point out that the options the Government has for closing any funding gap are:

- reprioritising existing services to fund new Budget decisions;

- introducing policy decisions to change revenue settings (e.g. increasing tax revenue) or finding savings in the delivery of existing services; and
- increasing the amount of the Budget operating allowance.

The Government appears to have settled on reprioritisation in order to maintain spending on public services and to hit its fiscal targets. That said, the discussion about whether that degree of reprioritisation is possible won't come until the Budget round next year. And it doesn't entirely rule out a lift in their spending plans come the 2023 Budget, or beyond. To a degree, the relatively benign fiscal outlook does hint at some wiggle room for the Government on this front. For now, though, the Government is keeping its powder dry.

Meanwhile, the net debt outlook looks similarly benign. The Treasury forecasts net debt to peak at 21.4% of GDP in 2023/24 (previously 19.9%) and to then fall to 14.1% by the end of the forecast period.

## Economic outlook.

The Treasury has made a significant downgrade to its growth forecasts. Notably, it also expects a recession in 2023, with an overall contraction in GDP of 0.8% over the three quarters to the end of 2023. This is a larger downturn than we're forecasting, but is similar to the Reserve Bank's projections.

As a result, the Treasury expects the unemployment rate to lift above 5% in 2024. Its forecast of a 5.5% unemployment rate in June 2024 is one percentage point higher than our forecast.

Curiously, and despite its weaker GDP forecasts, the Treasury expects inflation to linger high for longer than we do. Indeed, the Treasury does not forecast inflation to be back inside the Reserve Bank's target range until December 2024 (two quarters later than our forecast) and for it to be back at the midpoint of the range until June 2026.

## Bond programme.

As expected, the Debt Management Office (DMO) has increased its forecast for the bond programme. Forecast issuance for the year to June 2023 has been lifted by $3bn to $28bn, while each of the following years has been increased by $5bn relative to the programme forecast as at the May Budget.

The majority of the increase is due to Kāinga Ora's funding requirements being brought back to within the DMO. That move has contributed to $13.8bn in additional funding requirements across the forecast period, with the remaining $4.2bn reflecting the softer economic outlook.

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