WESTPAC ECONOMIC BULLETIN

New Zealand Half-Year Economic and Fiscal Update 2021.

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Having your fiscal cake and eating it too.

- The Half-Year Economic and Fiscal Update (HYEFU) shows material improvement in the Government's books.
- Interestingly, the improvement is mainly due to the Treasury realising that the tax take is structurally higher than it had previously forecast.
- That realisation has resulted in an earlier forecast return to surpluses and lower net debt.
- It has also given the Government room to increase its spending allowance for upcoming Budgets.

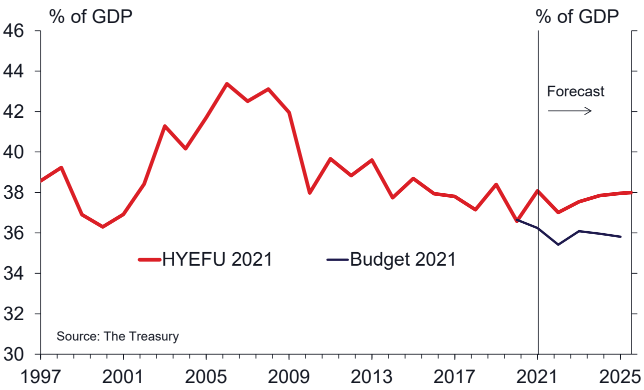
	2021	2022	2023	2024	2025	2026
	Actual	F/cast	F/cast	F/cast	F/cast	F/cast
GDP growth, ann ave % (June year)						
HYEFU	5.1	0.8	4.9	2.2	2.3	2.3
Changes since Budget Update	2.2	-2.4	0.5	-1.1	-0.6	-
Total Crown OBEGAL, $bn (June year)						
HYEFU	-4.6	-20.8	-0.8	2.1	5.9	8.2
Changes since Budget Update	10.5	-2.4	8.7	7.8	8.2	-
Net debt, % of GDP (June year)						
HYEFU	30.1	37.6	40.1	39.9	34.6	30.2
Changes since Budget Update	-3.9	-6.2	-7.9	-7.0	-9.0	-
Bond programme, $bn (June year)						
HYEFU	45.0	20.0	18.0	18.0	18.0	10.0
Changes since Budget Update	0.0	-10.0	-7.0	-7.0	-7.0	-

Treasury delivers fiscal surprise.

The Treasury has incorporated big upgrades into its fiscal forecasts at this Half-Year Update (HYEFU). The key change is a realisation that the tax take is structurally higher than it had previously forecast.

We had been pointing this out over the previous few fiscal and economic updates, highlighting the fact that the Treasury's tax rate assumption was too low. That said, we thought that the Treasury would upgrade its tax and thus fiscal forecasts in gradual steps, rather than in one big hit in this HYEFU. As it turned out the Treasury has been bolder than we expected, so that its fiscal forecasts now line up better with our own.

Total revenue as a % of GDP

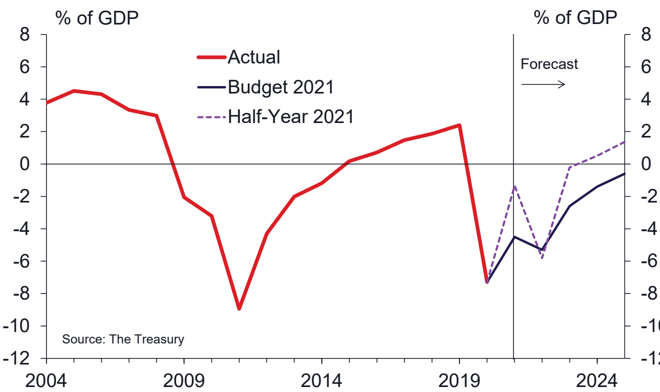


The change in the revenue projections has provided room for both additional spending and an earlier return to surpluses. Indeed, the Government has moved quickly on this basis, increasing the size of both the operating allowances for the 2022 and 2023 Budgets. We also anticipated such a move – if not this early – and our economic forecasts already incorporated a higher ongoing level of Government spending.

Fiscal projections.

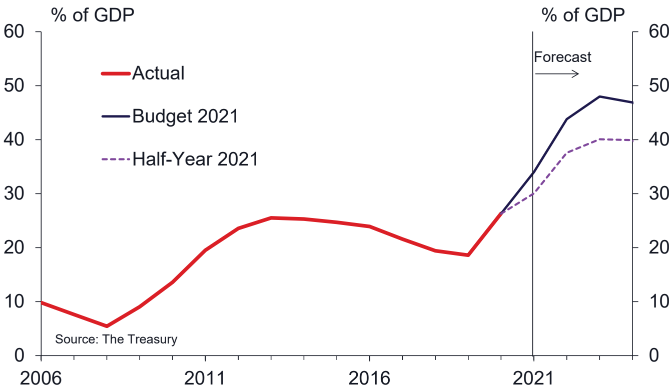
At this HYEFU, the Government's books have a decidedly healthy tinge to them. Indeed, the Treasury now expects the OBEGAL to move into surplus by 2024, even going close to a surplus in 2023. In comparison, at the Budget the OBEGAL was in deficit for the entire forecast period.

Operating balance (OBEGAL) as a % of GDP



Similarly, the net debt track peaks at a much lower level at 40.1% of GDP in 2023, almost eight percentage points lower than forecast in the Budget. And by 2026, Treasury's net debt forecast sits at 30.1% of GDP, a near 10 percentage point reversal over the space of three years. Recall that it was not too long ago (in the Pre-Election Update last year) that the Treasury forecast net debt to hit over 55% of GDP.

Net core Crown debt as a % of GDP



The significantly smaller projected deficits have also meant a considerable reduction in the funding requirement. The bond tender programme has been reduced by $10bn in 2022 and then $7bn per year in each of the next three years.

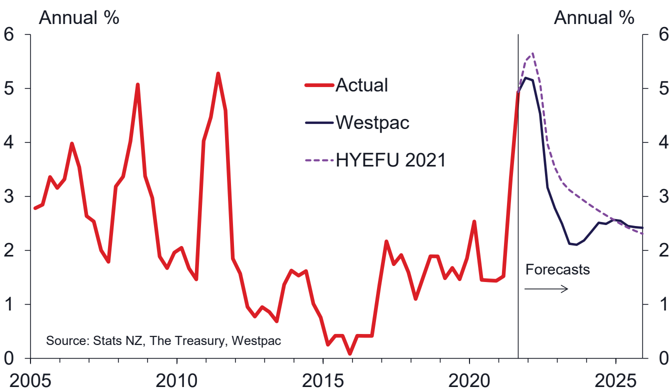
The Covid Response and Recovery Fund (CRRF) is now assumed to reach $69.1bn, compared to $62.1bn in the Budget. The net spending decisions over recent months means there remains $4.3bn of funding unallocated at the HYEFU.

While the CRRF has played a vital role in supporting the economy via fiscal stimulus in the short term, we note that future Budget operating allowances have been re-set at historically high levels. Indeed, these increased allowances have little to do with economic factors and are more of a reflection of the revenue surprise effectively granted by the Treasury forecasts. For the record, the operating allowances have been set at $6bn and $4bn for Budget 2022 and Budget 2023 compared to $2.7bn allocations included in the Budget.

Comparison of economic forecasts.

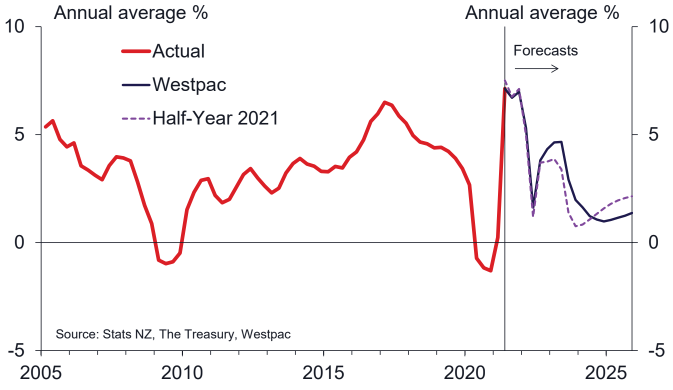
While the Treasury has allowed for some near-term Delta disruptions in its economic forecasts, it has revised up its longer-term forecasts for nominal GDP growth. That's in large part due to the stronger outlook for inflation, with more moderate changes to their forecasts for real economic activity. We generally agree with the direction of these changes.

Inflation



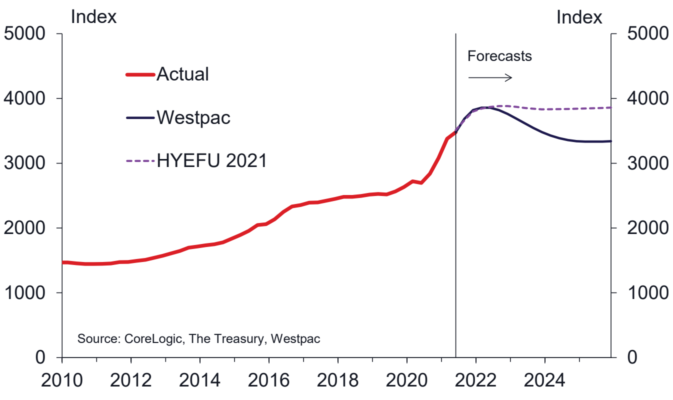
With regards to inflation, we've already seen price pressures bubbling over in recent months and, like the Treasury, we expect that those pressures will remain strong over the coming years. Importantly, much of the strength in inflation is due to firmness in domestic demand. Indeed, despite rising interest rates, the Treasury is still forecasting firm levels of demand over the next few years (while there are some under and overs, the Treasury's forecasts for real household consumption, investment spending and government expenditure are actually fairly close to our own). Combined, that firm outlook for demand and inflation has underpinned the Treasury's upwards revision to the tax take, leaving their tax forecasts closer to our own.

Household consumption



However, there are a couple of areas where we see some risks around the Treasury's forecasts. First is house prices. Like us, the Treasury is forecasting a series of rapid interest rate hikes from the RBNZ. However, the resulting slowdown in house price growth that the Treasury has assumed looks quite modest to us, with the HYEFU forecast only assuming that prices flatten off. But with interest rates set to rise from their recent record lows into tight territory, we think that the risks are tilted towards a more of an easing in house prices over the next few years. But while that would affect the contours of economic growth, we don't think that signals a material risk to the Treasury's revenue forecasts, with firmness in income growth and balance sheets still supporting spending growth.

House price forecasts



The other area where we have a difference of views is migration. The Treasury is forecasting that net migration will rise back to around 40,000 people per annum by 2026 (noting that Treasury assumptions are not an expression of official policy!). Although we do expect net migration to pick up when the borders reopen, we see the risk of lower net migration inflows (around 30,000 per annum) and population growth. That would have important implications for the labour market, spending and housing demand. This is ultimately a political decision, and we'll be watching for news about migration policy over the coming year as the opening of the international border comes into clearer focus.

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