ANZ Research

NZ Budget 2024 Preview

21 May 2024

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Contact

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The big reveal

Summary

- The macroeconomic and fiscal backdrop for Budget 2024 is very challenging: the economy is anaemic and the labour market is loosening, but pro-cyclical fiscal policy in recent years means fiscal consolidation is now desperately overdue.
- The main focus of Budget 2024 will be on delivering key election promises (ie the fiscally neutral tax package), but the real test of the new Government lies ahead: a credible path back to surplus needs to be signalled and the Government needs to stick to it. That implies the Government will probably need to get better at doing more with less and reprioritising from within existing baselines.
- The Treasury's Budget Economic and Fiscal Update is expected to show a deterioration in the economic and tax outlook (similar to that outlined in the Budget Policy Statement), and incorporate the impacts of discretionary fiscal policy changes (ie government spending and tax cuts). We expect the net impact of discretionary fiscal policy changes to be broadly neutral from both a fiscal outlook and an economic outlook perspective.
- On our back-of-the-envelope, a forecast OBEGAL surplus for the 2027/28 fiscal year is achievable despite the weaker economy, but will require lower operating allowances than signalled in the Half-Year Update beyond Budget 2024. And if the Treasury do forecast a surplus in the 2027/28 fiscal year, it'll probably be wafer-thin and therefore vulnerable to being revised away in subsequent forecast updates.
- Net core Crown debt is expected to remain on a clear trajectory to 40% of GDP, but may not hit that milestone over the Treasury's forecast horizon given the outlook for a smaller nominal economy and more debt.
- Speaking of debt, we expect NZDM to lift their bond issuance guidance by $10bn over the forecast horizon.

Year to June	Jun-24	Jun-25	Jun-26	Jun-27	Jun-28	Total (24-28)
2023 Half-Year Update	38	36	34	28	16	152
Budget Update (ANZ expectation)	**40**	**38**	**36**	**30**	**18**	**162**

Source: The Treasury, ANZ Research

- All in all, Budget 2024 is just the beginning of what's likely to be a very challenging few years ahead as the Government focuses on getting the books in order. From a macroeconomic perspective, this could mark the beginning of a new phase in the post-COVID cycle where fiscal policy is set to become a better ally to monetary policy than it's been over the past couple of years.

Overview

On 30 May, the Treasury will open up the Government's books with the publication of the Budget Economic and Fiscal Update (henceforth Budget Update), and the Government will table its first Budget and Fiscal Strategy Report.

The Budget Update will be the first time the Treasury has incorporated the new Government's policies into the economic and fiscal outlook. However, we also know that a downgrade to the Treasury's economic outlook is going to drive a deterioration to the fiscal outlook, and it'll be important to separate that from the impacts of discretionary fiscal policy changes.

We expect the net impact of discretionary fiscal policy changes (tax and spending cuts) to be broadly neutral from a fiscal outlook perspective. Operating allowances are expected to be a little lower than signalled at the Half-Year Update, but capital spending a little higher (note: the operating allowance captures the net impact of the Government's tax and spending cuts but does not incorporate the fiscal impacts of a weaker economy).

In terms of the economic impacts, we expect the new fiscal policy mix to have very little impact on the outlook for headline GDP, as a smaller-than-otherwise government sector is offset by a larger-than-otherwise private sector (this has been in our GDP forecast since shortly after the election). But as we outline in our latest Quarterly Economic Outlook, we think the net impact of tax and spending cuts are likely to be marginally contractionary on balance, insofar as households save a portion of their tax relief or spend a greater proportion on imports than the Government would have. On the other side of the fiscal reshuffle, job cuts will certainly detract from demand and be felt in Wellington. But compared to all the other moving parts in the economy at present, these impacts are small and are unlikely to move the dial for the RBNZ.

Big picture, the new fiscal policy mix outlined in the Budget Update will be of secondary importance to the Government outlining a credible path for fiscal consolidation going forward and sticking to it. Maintaining lower operating allowances in the current inflationary environment won't be easy, but it is possible. To do so, the Budget process will probably need to turn more towards reviewing and reprioritising spending from within existing baselines as new cost pressures arise, as opposed to being centred around additional spending. But if the Government signals lower operating allowances beyond Budget 2024 and then sticks to these, Budget 2024 will mark a turning point in the post-COVID economy where fiscal policy is set to become a better ally to monetary policy than it's been over the past couple of years. In other words, the faster the fiscal consolidation, the sooner the RBNZ can cut the OCR.

The Budget Update will deliver a meaningful downgrade to the Treasury's economic outlook…

The scenario provided in the Budget Policy Statement (BPS) showed a much weaker outlook for the nominal economy compared to the Half-Year Update forecast (table over page). Since that was only published in March, we don't expect to see huge changes to the Treasury's economic forecasts, and we accordingly won't go through all the overs and unders in the economic data flow since the Half-Year Update.

Table 1. Treasury's BPS scenario forecast

June years	2023 Actual	2024 Forecast	2025 Forecast	2026 Forecast	2027 Forecast	2028 Forecast
Real production GDP (annual average % change)						
Budget Policy Statement	3.0	0.1	2.1	3.1	2.8	2.5
Half Year Update 2023	3.2	1.5	1.5	2.8	3.0	2.7
Unemployment rate (June quarter)						
Budget Policy Statement	3.6	4.6	4.9	4.5	4.4	4.4
Half Year Update 2023	3.6	4.5	5.2	4.8	4.6	4.4
CPI inflation (annual % change)						
Budget Policy Statement	6.0	3.3	2.2	2.1	2.0	2.0
Half Year Update 2023	6.0	4.1	2.5	2.2	2.0	2.0
Nominal GDP ($ billion)						
Budget Policy Statement	395.5	414.6	432.6	455.6	478.4	500.9
change from Half Year Update	-0.5	-5.4	-7.1	-8.0	-10.2	-12.1
Core Crown tax revenue ($ billion)						
Budget Policy Statement	112.4	120.8	127.1	135.5	143.0	149.8
change from Half Year Update	0.0	-1.2	-2.6	-2.6	-3.2	-4.2

Sources: Stats NZ, the Treasury

...and that's going to drive a deterioration in the fiscal outlook

The BPS scenario included a near-$14bn downgrade to the tax outlook over the forecast horizon. We're expecting something very close to that in the Budget Update.

On the expenses side, it was interesting to see lower unemployment forecast in the BPS scenario, which all else equal implies lower forecast welfare expenses – which would be a small partial offset to the weaker tax take.

In terms of operating allowances, we don't have a lot to go on from the BPS other than "Budget 2024 will have an operating allowance of less than $3.5 billion, with the exact number to be confirmed in the Budget" and "Operating allowances for Budgets 2025 to 2027 will be set out in the FSR" (Fiscal Strategy Report).

At the Half-Year Update, the operating allowance for Budget 2024 was signalled at $3.5bn. For Budget 2025 it was signalled at $3.25bn, and $3bn for Budgets 2026 and 2027. Assuming the Budget 2024 allowance will be $3.2bn, and all other subsequent Budgets will be $3bn or less, we estimate a small OBEGAL surplus is achievable for the 2027/28 fiscal year. But it'll be wafer thin (less than $1bn), and therefore very vulnerable to another downgrade to the Treasury's economic forecasts further down the track.

Compared to recent Budgets, $3bn allowances (or a little lower) might seem small, but it's certainly achievable provided the Government continues to look for cost savings and reprioritisations from within existing baselines as additional pressures on government services inevitably pop up.

On the capex side, the increase in the multi-year capital envelope signalled in the BPS will add to government debt, but that will likely be offset by lower operating allowances. However, in combination with the weaker economic and tax outlook, net core Crown debt may not fall below 40% of GDP over the Treasury's forecast horizon to June 2028, but it'll come close. In the Half-Year Update, net core Crown debt was forecast to fall below 40% of GDP in the 2026 fiscal year.

The weaker economy will mean more bonds on issue

Table 1 shows our expectation for bond issuance guidance. Compared to the Half-Year Update, we've pencilled in a $10bn increase in issuance guidance to June 2028. To get here, we've:

- plugged in the lower tax outlook provided in the BPS scenario (about $14bn over the forecast horizon);
- assumed the lower unemployment forecast in the BPS scenario will be carried into the Budget Update outlook, lowering forecast expenses a touch (all else equal);
- assumed discretionary fiscal policy changes (lower operating allowances but higher capex) are broadly neutral for debt issuance;
- shaved around $3bn off for the change in yields since the Half-Year Update;
- added $2bn to the current year programme, since that'd be easy to achieve given their current run rate; and
- added a smoothing factor so each year rounds to the nearest $2bn.

Table 2. NZDM bond issuance guidance ($bn)

Year to June	Jun-24	Jun-25	Jun-26	Jun-27	Jun-28	Total (24-28)
2023 Half-Year Update	38	36	34	28	16	152
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We have upped the current fiscal year's guidance by $2bn partly owing to the weaker fiscal starting point and partly because we assume NZDM will get away a $4bn deal when they tap the 28s in June. We estimate a $40bn programme will give NZDM a small headstart when it comes to funding the 2025 fiscal year.

Risks around our expected guidance feel balanced. The Treasury's economic forecasts are always a wild card and often land on the optimistic side of our expectation. But we know a material downgrade is due; we're just not sure how much more this might change (and in which direction) and/or how this will impact their judgements around revenues and expenses.

Regarding the other bits and bobs we often get asked about: we've assumed no change to NZDM's liquidity buffer strategy, no change to Kāinga Ora funding (where maturing bonds over the Treasury's forecast horizon *are* provisioned for in NZDM's bond programme), and no change to the pace of LSAP purchases.

We're not expecting any changes to the fiscal strategy, but can't rule out a tweak

The Government's key short-term fiscal intentions outlined in the Budget Policy Statement were as follows:

- Work towards a surplus via a steadily improving trajectory for the OBEGAL.
- Put net core Crown debt as a percentage of GDP on a downward trajectory towards 40%.

The BPS also noted that a specific timeframe for returning to surplus will be set out in the FSR, when a complete set of updated fiscal forecasts and projections will be available, but it was unclear in the BPS whether the Government was gearing up to announce a *target* surplus date in the FSR or if it will keep this component of their fiscal strategy relatively loose.

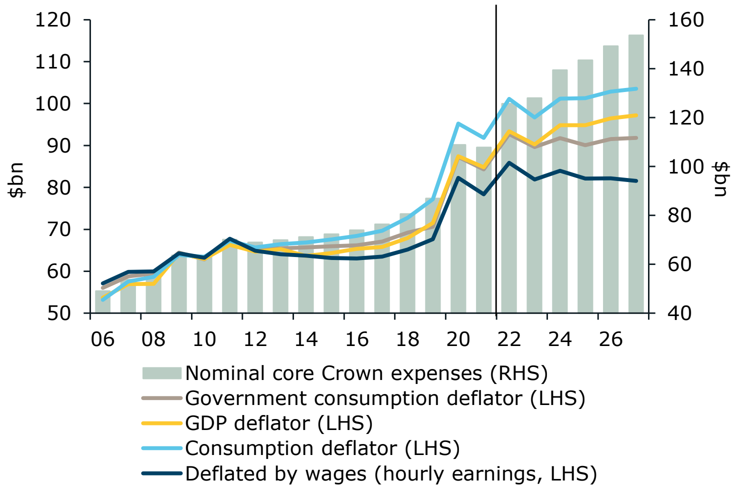
The big missing piece for us in the fiscal strategy was any comment about what the Government might do were the economy and revenues to surprise on the upside (eg use such surprises to strengthen the balance sheet, rather than spending it). Doing so could certainly add some symmetry around debt-issuance risks, and help avoid pro-cyclical fiscal settings in the future (given positive revenue surprises typically result from a stronger-than-expected economy).

All in all, the fiscal strategy may not change in the Fiscal Strategy Report, but the BPS seemed to leave that door at least slightly ajar.

Summary

All up, Budget 2024 is going to be about delivering on election promises (fiscally neutral tax cuts) while credibly setting the books on a path towards surpluses and a shrinking debt ratio. But the big test for this relatively new Government won't just be in signalling an overdue fiscal consolidation; it'll also need to follow through over coming years. While the cupboards may be "bare" from an additional spending perspective, we think there will still be scope for further reprioritisations from within existing baselines as new cost pressures arise. There's also scope to consolidate faster via deeper spending cuts if desired. Indeed, even after proposed tax cuts are delivered, and after we strip out the impact of high inflation on delivering public services, we estimate the public sector will still be meaningfully larger than it was prior to the pandemic. That suggests the Government should be able to find further cost savings to replenish the cupboards over coming years if they so desire. It won't be easy, but we think living within a lower operating allowance is certainly achievable provided a really big shock doesn't come along.

Figure 1. Real core Crown expenses (based on Half-Year Update forecasts)



Source: The Treasury, ANZ Research

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