ANZ Research

Half-Year Economic and Fiscal Update 2024 Preview

6 December 2024

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Contact

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Walking the talk

Summary

- 17 December brings the Treasury's Half-Year Economic and Fiscal Update (HYEFU) and the Government's Budget Policy Statement (BPS).
- The Treasury has signalled that its activity outlook is in for a downgrade as it dials back optimistic productivity assumptions underpinning prior forecasts and incorporates a little more near-term weakness. That's set to weigh on their outlook for nominal GDP and the tax take.
- That likely means a delay in the forecast return to OBEGAL surplus (from the year to June 2028 to the year to June 2029), wider-for-longer cash deficits, a higher debt projection, and more bonds for NZDM to issue and the (somewhat fatigued) market to absorb.
- In terms of discretionary fiscal policy, we expect the Government to stick to previously signalled allowances and continue to reprioritise spending from within existing baselines as they pursue the long overdue fiscal consolidation. More broadly, we'd be surprised to see any major changes to the Government's fiscal strategy (outlined in the BPS).
- As always, there are lots of moving parts to consider when trying to estimate what this could all mean for NZDM's bond issuance guidance. Our expectation is for a cumulative rise of $4-6bn over the four years to June 2028. The table below shows our upper estimate.

Year to June	Jun-25	Jun-26	Jun-27	Jun-28	Jun-29	Total (25-28)
2024 Budget Update	38	36	32	20	NA	126
HYEFU (ANZ expectation)	**40**	**36**	**34**	**22**	**18**	**132**

Source: The Treasury, ANZ Research

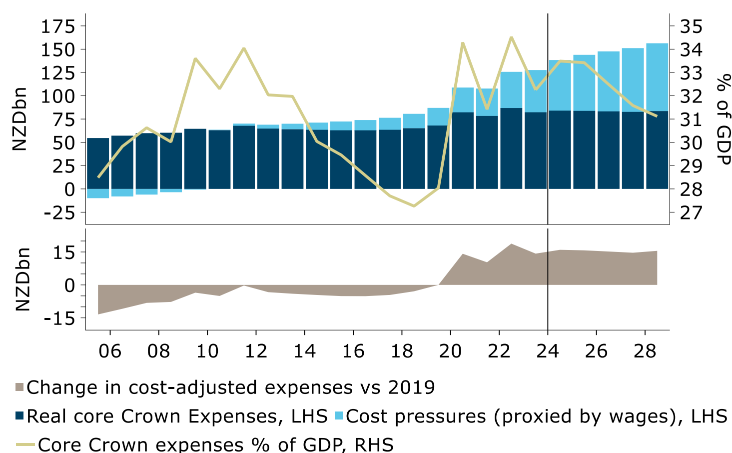
- For markets, a potential delay to surplus, a slightly more pessimistic tone from the Treasury regarding the economic outlook, and an upgrade to bond issuance guidance are likely to be the key focal points on the day. But without a meaningful change to discretionary fiscal policy settings, the HYEFU is likely to have very few implications for monetary policy compared to the Budget Update. Fiscal policy is still expansionary (the Government is still running sizable deficits), but those deficits are expected to narrow over the next few years towards an eventual surplus (which hopefully arrives before the next inevitable crisis comes along).

Overview

On 17 December, the Treasury will publish its Half-Year Economic and Fiscal Update (henceforth HYEFU) and the Government will publish the Budget Policy Statement (BPS) for 2025.

We don't expect any changes to the Government's fiscal strategy and would be surprised if operating allowances for Budgets 2025 and beyond were increased above those signalled in Budget 2024. As we've noted before, the gargantuan spend-up following the pandemic appears to have created plenty of room within existing baselines to reprioritise spending while still maintaining a larger Government sector in cost-adjusted terms than that prevailing prior to the pandemic (figure 1).

Figure 1. Cost-adjusted (using wages) government expenses



Source: NZ Treasury, Macrobond, ANZ Research

In the bigger picture, while the pursuit of public sector efficiency is a healthy exercise for the economy overall (particularly given the fact that fiscal policy is still expansionary and there's a need to keep a lid on CPI inflation), there's only so far a restrained spending approach can take us. Ongoing pressure on health and superannuation spending from an aging population, pressure on infrastructure from climate change and past underinvestment, and rising debt-servicing costs as higher Government bond yields meet the last Government's debt-funded spending spree are all major challenges waiting for us down the road – challenges that will be difficult to overcome in an equitable way without broadening the tax base. But adjusting revenue policy to address such challenges, let alone turn forecast structural deficits into surpluses sooner than otherwise, does not appear to be on this Government's agenda.

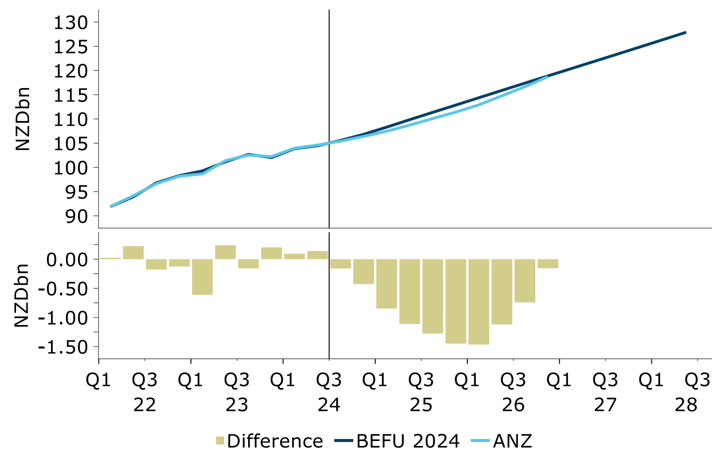
Nonetheless, containing spending growth and reprioritising less-effective spending from within existing baselines is a good first (albeit baby) step towards addressing these challenges. This Government's fiscal strategy is at the more prudent end of the spectrum compared to the previous Government's, and prudence today means more options when the next inevitable crisis comes along.

The Treasury to downgrade their economic outlook, but by how much?

Recent comms from the Treasury suggests its economic outlook will be downgraded. In a recent speech, the Treasury's Chief Economic Advisor signalled that the near-term outlook for economic activity and government revenues was looking weaker than previously forecast, and that its productivity assumption was due a downgrade. We noted in our Budget Update Review that the Treasury's productivity assumption was a little rosy. The Treasury provides a little more detail in this "Special Topic".

It's important to note that while real GDP growth in Q2 was weaker than the Treasury's forecast (-0.2% q/q vs +0.2% q/q), the level of nominal GDP was actually marginally higher than their expectation. But that was largely owing to data revisions (figure 2). Quarterly growth in nominal GDP in Q2 was in line with the Treasury's forecast at 0.6% q/q. When it comes to the fiscal outlook, nominal GDP is what really matters, but the Treasury hasn't provided much of a steer on that front.

Figure 2. Nominal GDP forecast



Source: The Treasury, Stats NZ, Macrobond, ANZ Research

It's also worth noting that the RBNZ's November MPS forecasts included a downgrade to its real potential GDP forecast, which has led to a downgrade to its medium-term real GDP outlook. In part, this appears to be a weaker productivity story too. However, an outlook for higher prices meant the RBNZ's nominal GDP forecast was revised higher! Could the Treasury's nominal GDP forecast go the same way? We think not. Our base case is that the Treasury will downgrade the price side of things too. Weaker-than-forecast net migration inflows and Q3 CPI both point to a smaller nominal economy and therefore limited scope for higher prices to offset weaker real GDP.

That said, we're still not convinced the HYEFU will deliver a *significantly* pessimistic downgrade. The "weaker economy vibe" doesn't really pass the sniff test when you compare the Treasury's Budget Update Q3 unemployment rate forecast of 5.2% to the outturn of 4.8%. But there's nuance here too: this forecast miss was driven by the participation rate falling more than the Treasury expected (another reason to lower potential GDP perhaps). The number of employed persons came in very close to forecast, and arguably, it's employment that matters for the fiscal outlook (eg PAYE and welfare expenses). So let's call this another fiscally-important macroeconomic indicator that's printed in line with the Treasury's Budget forecast, but is perhaps at risk of a downgrade to the outlook.

Lastly, it's worth noting that the Treasury's GDP forecast may not have a very long shelf life. The Q3 GDP data is scheduled for release just two days after the HYEFU, and Stats NZ have signalled that this will include significant revisions to history (as is common in Q3), potentially changing our understanding of recent implied labour productivity and per capita GDP – both of which have been looking dire of late, but should improve at least marginally after these revisions.

All in all, we'd say the starting point for the economic forecasts that really matter for the fiscals are a lot closer to the Treasury's Budget forecast than some may think. But that doesn't mean the outlook isn't due a downgrade. How far that downgrade goes is the big question. But with monetary restriction being rapidly withdrawn, it would be very surprising if the Treasury's forecast didn't include a solid recovery from the latter half of 2025.

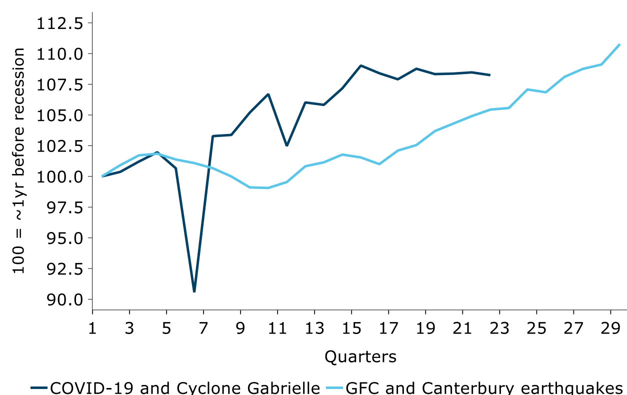
A deterioration in the fiscal outlook

Monthly fiscal statements for the first four months of the current fiscal year show both revenues and expenses running close to the Treasury's Budget forecasts (matching the vibe from the fiscally important economic data to date). And while the residual cash deficit was around $3bn wider than forecast as at October, this is mostly a timing story as more tax receipts came in prior to the Matariki holiday than the Treasury assumed (ie landing in the 2024 fiscal year opposed to the current one).

Indeed, the audited financial statements for the twelve months to June 2024 show the residual cash deficit was $2.6bn narrower than forecast due to tax receipts coming in $2.8bn above forecast. Looking through the noise here, it would appear that pressure on NZDM's funding requirement from a weaker fiscal starting point is quite minimal, meaning any increase to bond issuance guidance (see next section) will largely come down to the magnitude of downgrade to the Treasury's outlook.

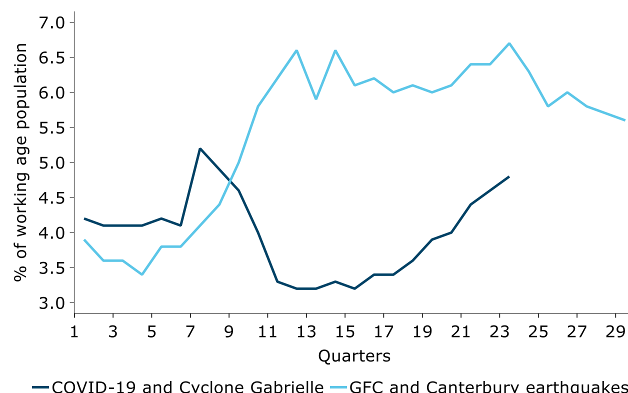
In terms of key fiscal indicators, we expect forecast net core Crown debt to peak a little higher as a share of GDP (a touch above 44%) but to remain on a modest downward trajectory over the latter part of the forecast. The OBEGAL balance is expected to remain in deficit one year longer (first surplus in the year to June 2029), which, if correct, would mark nine years of consecutive deficits since COVID-19 and Cyclone Gabrielle. That would be three more years in deficit than following the Global Financial Crisis (GFC) and Canterbury earthquakes, which were more severe economic shocks in many respects (figures 3 and 4 show how GDP and the unemployment rate have evolved since time zero for both the GFC and COVID-19).

Figure 3. Real GDP since time zero



Source: Stats NZ, Macrobond, ANZ Research

Figure 4. Unemployment rate since time zero



Source: Stats NZ, Macrobond, ANZ Research

But perhaps one of the more telling fiscal sustainability indicators regarding the appropriateness of fiscal deficits will be the Treasury's updated estimate for the structural balance (the OBEGAL after removing one-off expenditure shocks and cyclical revenues and expenses). Given the Treasury is likely to forecast an output gap close to zero over the latter half of their forecast horizon and not forecast any one-off shocks, such as earthquakes and cyclones, this measure is likely to return to surplus at the same time as the OBEGAL. Based on this indicator alone, one could argue that if the Government is unable or unwilling to significantly reduce spending in order to get the books back into shape before the next crisis comes along (and there are good reasons not to cut spending too aggressively) then it would be appropriate to consider revenue initiatives that would help get the books on a more sustainable path. But while that might make sense from an economic standpoint, politics do tend to get in the way.

Weaker economy likely to require higher bond issuance

Compared to the Budget Update, we've pencilled in a $4-6bn increase in issuance guidance to June 2028 (note: Table 1 shows the upper end of this range).

While we're reasonably comfortable with our estimate for a $4-6bn increase, the current fiscal year is looking like a coin toss between $38bn and $40bn (rounding to the nearest $2bn). That is, we wouldn't be surprised if guidance for 2025 and 2026 came in at $40bn and $36bn respectively (as shown in Table 1) or $38bn for both years. A good reason for NZDM to signal $40bn this year is that this could allow them to maintain a downward-sloping profile (which does tend to be their preference). Another possibility is that NZDM will signal a $38bn programme for the current year but remain opportunistic when it comes to the remaining syndications this year. As they showed last year, if there's solid demand at syndication, they're more than happy to get a bit of prefunding in the door.

Table 1. NZDM bond issuance guidance ($bn)

Year to June	Jun-25	Jun-26	Jun-27	Jun-28	Jun-29	Total (25-28)
2024 Budget Update	38	36	32	20	NA	126
HYEFU (ANZ expectation)	**40**	**36**	**34**	**22**	**18**	**132**

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The back of the envelope that got us to the above table is as follows:

- We've assumed the Treasury's economic forecast downgrade shaves around $6-8bn from the forecast tax take to June 2028;
- Lower yields between forecast finalisation dates should provide a small partial offset to that;
- On the "automatic" expenses side (eg benefits), the weaker economy should add a little pressure.
- We expect no major changes to discretionary fiscal policy settings (ie no change to forecast operating and capital allowances compared to Budget);
- After issuing more bonds than forecast in the year to June 2024, NZDM started the current fiscal year with $1.3bn of prefunding. This should provide a meaningful offset to the weaker economy for the current year's funding requirement.
- NZDM prefers a relatively stable issuance profile and tends to round to the nearest $2 or $5bn, so we have done a little smoothing to our expected profile to account for this.

For the extra year that will be added to the Treasury's forecast horizon (the year to June 2029), we have pencilled in a $18bn programme, but $16bn would not surprise.

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.

Summary

All up, the HYEFU and accompanying Budget Policy Statement are likely to reconfirm the Government's "steady as she goes" approach to fiscal consolidation (ie contained spending growth and ongoing reprioritisations, but little else) as the Minister *walks the talk* - all against a weaker economic backdrop. And while contained spending may see the chorus calling for more government support get louder (especially as the labour market continues to cool), we all must remember that the more the Government adds to aggregate demand, the more upwards pressure on interest rates there will be (as the RBNZ offsets the inflationary impacts). In the absence of a significant crisis, fiscal policy should focus on delivering key public services within the constraints of fiscal sustainability and let monetary policy do the heavy lifting from a macro stabilisation perspective.

For markets, a potential delay to surplus, a slightly more pessimistic vibe regarding the NZ economic outlook, and an upgrade to bond issuance guidance are likely to be the key focal points on the day. But without a meaningful change in discretionary fiscal policy settings, the HYEFU is likely to have very few implications for monetary policy vs the Budget Update.

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