ANZ Research

NZ Half-Year Economic and Fiscal Update 2024

17 December 2024

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Staying the course amid choppy seas

Summary

- The Treasury has downgraded its economic and fiscal forecasts to the point where the forecast return to the OBEGAL surplus and residual cash surplus is not achieved over the forecast horizon. That's much weaker than we anticipated.
- However, the Government has tweaked its key operating balance indicator from the "OBEGAL" to "OBEGALx", which excludes ACC expenses and revenues (which should be "self-funding" over the longer run). OBEGALx is forecast to return to surplus in 2028/29 and the Government is targeting a surplus in 2027/28.
- New Zealand Debt Management has lifted their bond issuance guidance by a whopping $20bn to June 2028, much more than we had pencilled in. Short-term issuance has had a bump too. The increased issuance guidance is primarily due to the downgrade to the economic and tax outlook, with just a little more capital spending added.

Debt issuance guidance ($bn)

	Jun-25	Jun-26	Jun-27	Jun-28	Jun-29	Total (25-28)
Bonds						
2024 Budget Update	38	36	32	20	NA	126
2024 Half-Year Update	**40**	**40**	**38**	**28**	**22**	**146**
Short-term borrowings (T-bills and ECP)						
2024 Budget Update	13	13	13	13	NA	NA
2024 Half-Year Update	**20**	**20**	**18**	**13**	**13**	**NA**

- Discretionary fiscal policy settings and the Government's fiscal strategy have not changed in a meaningful way compared to May's Budget. Operating allowances for Budgets 2025 and beyond remain at $2.4bn (as expected). On the capital side, the Government intends to move away from the Multi-year Capital Allowance approach back to setting annual allowances at each Budget. These are set at $3.625bn from Budget 2025 onwards, meaning discretionary capital spending has been lifted a touch over the forecast horizon, but this isn't a large enough increase to move the dial for monetary policy (~$0.5bn to June 2028).
- Broadly, the Government is doing what they said they would: keeping spending growth contained in the pursuit of long-overdue fiscal consolidation.
- Implications for monetary policy appear minimal. Fiscal policy is still expansionary (the Government is still running sizable structural deficits), and things haven't changed much since May's Budget.
- Looking forward, big fiscal challenges remain. Living within the allowance profile set out today won't be easy and will require ongoing review and reprioritisation from within existing baselines.

Big picture

The Treasury's Half-Year Economic and Fiscal Update (HYEFU) and the Government's Budget Policy Statement (BPS) delivered a few surprises. The Treasury's updated economic forecasts have been downgraded meaningfully (but for the first time in a long time, we would characterise risks around their outlook as balanced, as opposed to thinking the forecasts look rosy).

Accordingly, the downgrade to the fiscal outlook has been a lot sharper than expected. The residual cash and "old" OBEGAL balance are not expected to return to surplus over the forecast horizon, and the new "OBEGALx" measure (which excludes ACC) returns to surplus in the final year of the forecast horizon (2028/29). Net core Crown debt is projected to peak at a higher level, and NZDM is expecting to issue a lot more bonds than previously signalled ($20bn more to June 2028 vs Budget).

In terms of discretionary fiscal policy, the Government has maintained the operating allowance profile signalled at Budget 2024 for Budgets 2025 and beyond (at $2.4bn). There isn't much wiggle room here, meaning the Government will need to continue reprioritising less-effective spending from within existing baselines as needs arise. But given the magnitude of the last Government's spend-up, we think that's achievable.

Capital allowances have been lifted marginally (by ~$0.5bn to June 2028) as the Government moves away from the Multi-year Capital Allowance and back to single year allowances. Annual capital allowances for Budgets 2025 and beyond have been set at $3.625bn.

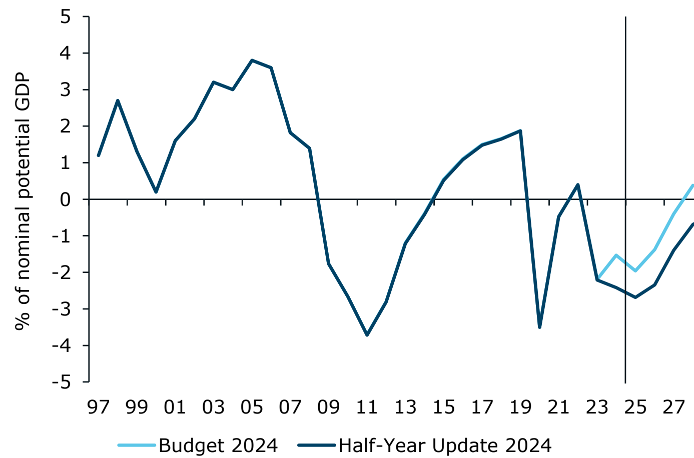
Other than replacing OBEGAL with the new OBEGALx indicator, the Government's fiscal strategy has not changed. Of note, the Government intends to return the OBEGALx to surplus by 2027/28 – the Treasury's forecast is for a deficit of $0.3bn that year, but a surplus of $1.9bn in 2028/29. Had the Government stuck with the old OBEGAL measure, this would not be forecast by the Treasury to return to surplus over the forecast horizon.

Stepping back, the change to the new operating balance indicator shouldn't have much impact on discretionary fiscal policy decisions. The big surprise today hasn't come from changes to the Government's strategy or discretionary policy choices, but rather the extent of the Treasury's downgrade to the economic outlook, which has weighed heavily on the fiscals.

However, there was one omission from the Budget Policy Statement that caught our eye. The line that "upside revenue surprises will contribute to reducing the deficit" has been removed. We think that's potentially quite important, given upside risks to the Treasury's economic forecast appear more significant than is typical.

All up, we'd still characterise the current fiscal consolidation as very gradual, and the current (and near-term) stance of fiscal policy as "expansionary" (given sizable deficits). That's very clear when viewed through the lens of the Treasury's structural balance estimate, which is forecast to remain in deficit over the whole forecast horizon. This indicator strips out the cyclical component of revenues and expenses as well as one-off shocks (such as natural disasters) to tell us what the underlying operating balance would be regardless of where we are in the business cycle. A structural deficit implies discretionary fiscal policy settings are pumping more money into the economy than they are taking out, while a surplus implies the opposite. This indicator also informs our assessment of how sustainable fiscal settings are. Running a structural deficit is analogous to topping up the home loan each week to pay for day-to-day expenses, such as groceries and petrol. That might be okay for a short while, but in the long run you'll need to find a way to balance the books.

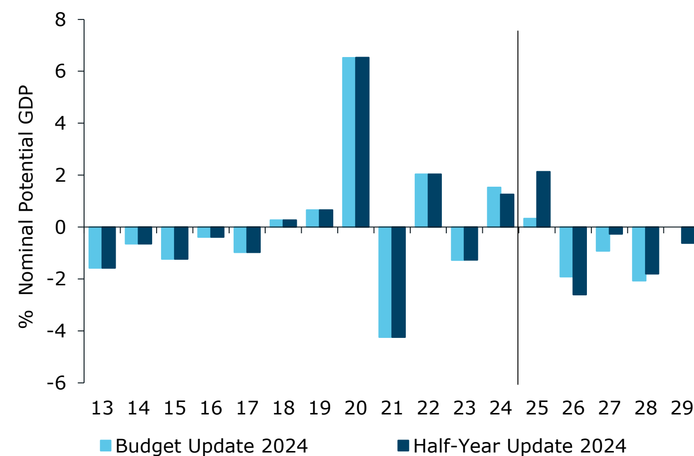
Figure 1. Structural balance



Source: The Treasury

The fiscal impulse provides another way to assess the impacts of fiscal settings on aggregate demand. This indicator tells us if fiscal policy is adding more or less to demand compared to the year prior. However, it does not tell us if fiscal settings are expansionary or contractionary in an absolute sense. Overall, the near-term fiscal impulse shows the current fiscal year (to June 2025) is more expansionary than estimated at the Budget Update (+2.1% vs +0.3%). However, this kind of rephasing is not uncommon with this indicator, as spending often gets pushed into the next fiscal year from the current one. But for what it's worth, the average impulse between the 2025 and 2028 fiscal years is estimated at -0.6% of potential nominal GDP vs the Budget Update average of -1.1%.

Figure 2. The fiscal impulse



Source: The Treasury

That said, we don't see any major implications here for monetary policy. As far as we can tell, most of the movement in the fiscal forecasts are either "automatic" in nature (eg a weaker forecast tax take driven by a weaker economic outlook) or a question of the Treasury's forecast assumptions and timing. Fiscal policy is still expansionary, but the picture hasn't changed materially since May's Budget, meaning there isn't a lot of new news here for the RBNZ.

Turing to the longer term, New Zealand faces significant challenges via an aging population, climate change, a sizable infrastructure deficit, and a growing government debt-servicing burden, as well as the need to rebuild

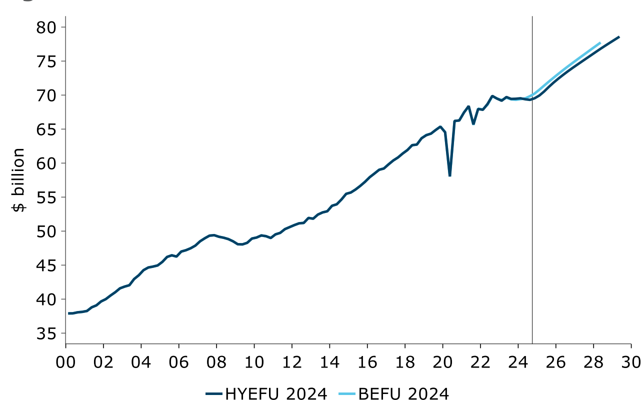
the coffers for the next natural disaster. Containing spending growth and reprioritising less-effective spending from within existing baselines is a good first (albeit baby) step towards addressing these challenges, but it's hard to see these challenges being overcome in an equitable way without bigger policy adjustments, such as broadening the tax base.

Treasury's economic outlook downgraded…

As signalled by the Treasury well in advance, their economic outlook has been downgraded.

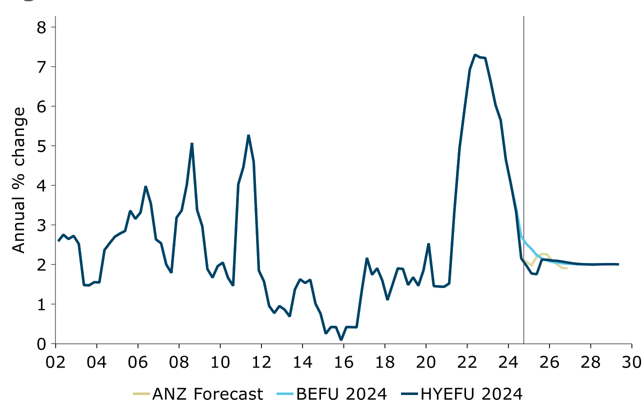
Figures 3 to 6 show the Treasury's forecasts compared the May's Budget Update. Nominal GDP is what really matters for the fiscal outlook and on that front the Treasury have trimmed their forecast by $19.8bn between the 2025 and 2028 fiscal years. Overall, the Treasury's economic outlook is broadly similar to our own, and we'd categorise the risks around the outlook as balanced.

Figure 3. Real GDP forecast



Source: NZ Treasury, Macrobond, ANZ Research

Figure 5. CPI inflation forecast

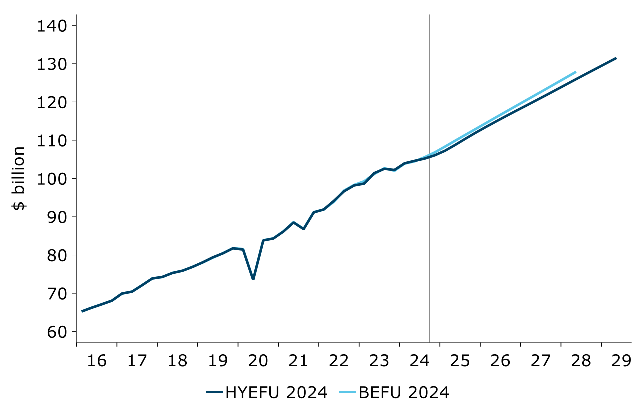


Source: NZ Treasury, Macrobond, ANZ Research

Figure 4. Unemployment rate forecast

Source: NZ Treasury, Macrobond, ANZ Research

Figure 6. Nominal GDP forecast

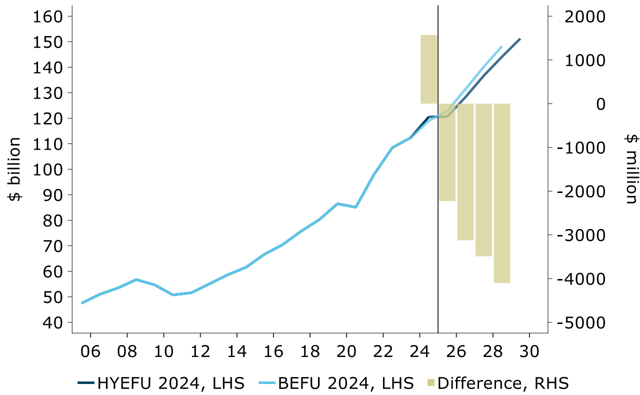


Source: NZ Treasury, Macrobond, ANZ Research

…with expenses higher and revenues lower

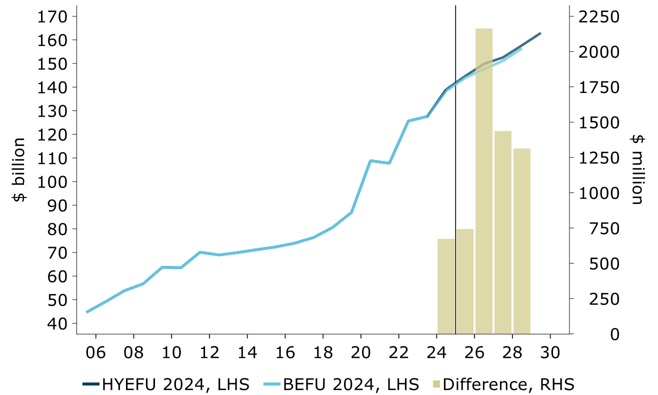
Changes to the Treasury's economic outlook have had meaningful impacts on forecast revenues and expenses. Core Crown tax revenue is forecast to be $13bn lower than the Budget Update on a cumulative basis to June 2028 and expenses are $5.7bn higher. As a share of GDP, core crown expenses reduce from 33.9% in 2024/25 to 31.5% in 2028/29, still above the 30% level the Government is aiming for over the longer run.

Figure 7. Core Crown tax revenue



Source: NZ Treasury, Macrobond, ANZ Research

Figure 8. Core Crown expenses



Source: NZ Treasury, Macrobond, ANZ Research

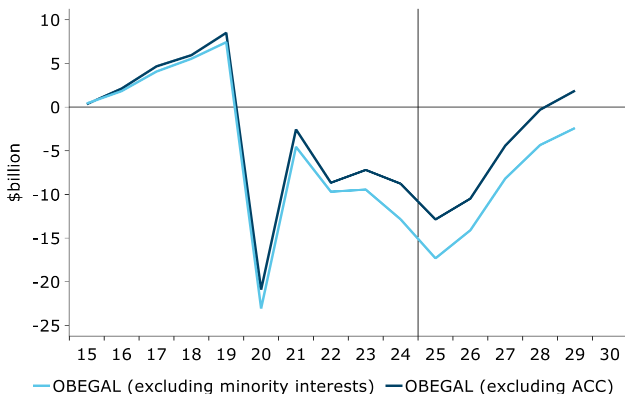
The forecast return to surplus had been pushed out; debt higher

Reflecting the Treasury's weaker economic outlook (as opposed to discretionary fiscal policy decisions), the Treasury no longer expects OBEGAL to return to surplus in the forecast horizon, with a deficit of $2.4bn forecast for 2028/29.

The Government's newly adopted headline operating indicator, OBEGALx (which excludes ACC revenue and expenses) does return to surplus by the end of the forecast horizon, improving from a deficit of $12.9bn in 2024/2025 to a $1.9bn surplus in 2028/2029. That said, the Government is forecast to be inches away from surplus in 2027/28 (which is one of the Government's key short-term fiscal strategy objectives), with the deficit in 2027/2028 just $0.3bn (0.1% of GDP).

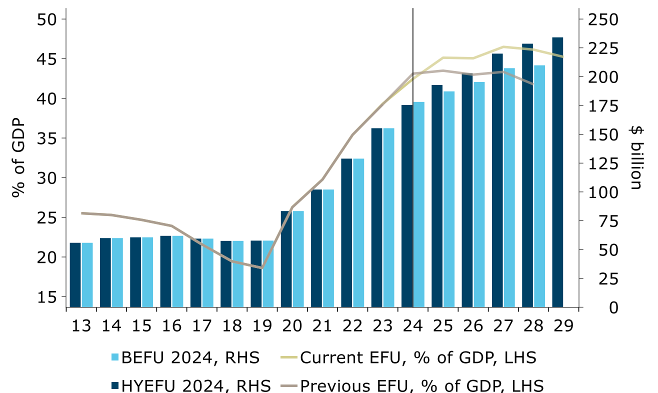
At $228.6bn, net core Crown debt is projected to be $44.4bn higher at the end of the 2027/28 fiscal year compared to the Budget Update. As a share of GDP, it is projected to peak at 46.5% in the 2026/27 fiscal year and fall to 45.2% by the end of the forecast period, still well above the Government's goal to reduce net debt below 40% of GDP.

Figure 9. Total Crown OBEGAL



Source: NZ Treasury, Macrobond, ANZ Research

Figure 10. Core Crown net debt



Source: NZ Treasury, Macrobond, ANZ Research

More bonds on issue

We went into today's Budget expecting a $4-6bn increase to bond issuance guidance to June 2028, but in the end New Zealand Debt Management lifted it by a whopping $20bn!

Table 1. Issuance guidance ($bn)

	Jun-25	Jun-26	Jun-27	Jun-28	Jun-29	Total (25-28)
Bonds						
2024 Budget Update	38	36	32	20	NA	126
2024 Half-Year Update	**40**	**40**	**38**	**28**	**22**	**146**
Short-term borrowings (T-bills and ECP)						
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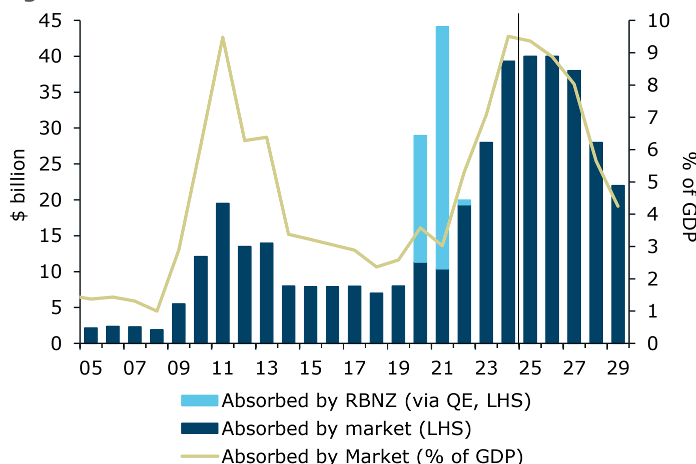
Source: NZ Treasury

For the remainder of the current fiscal year guidance has been lifted by $2bn to $40bn (as we expected). However, the wall of bonds continues, with 2025/26 guidance also at $40bn and only a small drop to $38bn signalled for 2026/27. That's a lot of bonds for the market to absorb. Stripping out the Large Scale Asset Purchase bonds absorbed by the RBNZ in 2020/21 (which are now adding to issuance pressure via quantitative tightening), the recent and near-term "wall" of bonds is staggering; a similar share of GDP as the GFC and Canterbury earthquakes-induced 2010/11 programme, but more persistent (figure 11).

Figure 11. Bond issuance



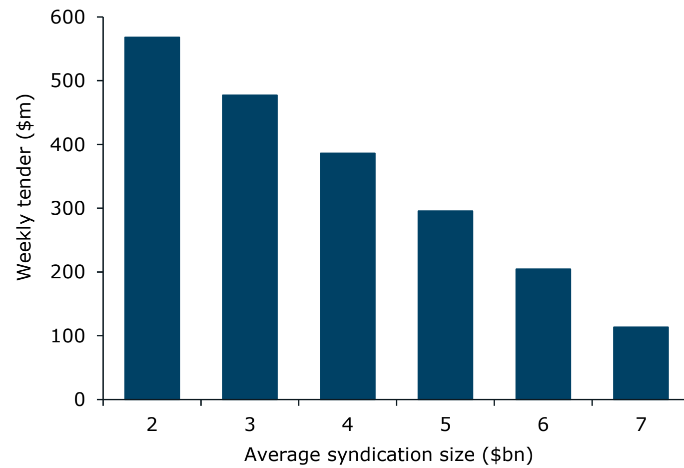
Source: NZ Treasury, RBNZ, Stats NZ, Bloomberg, ANZ Research

In terms of syndications, NZDM has added a fourth syndication to the current fiscal year, meaning there are two more to go between now and the end of June 2025 – both will be taps of existing bonds. The next cab off the rank will be a tap of the nominal 2035 bond (in line with our expectation) at some point in the March quarter. Details of the following tap will be provided in subsequent updates. Stepping back, today's release suggest four syndications could be on the cards for the 2025/26 fiscal year too.

NZDM has already issued $23.5bn of the $40bn signalled this fiscal year, leaving $16.5bn to issue over the remaining syndications and tenders. Assuming a 16 January resumption of tenders, that leaves 24 weeks of tenders, less two for syndications. Figure 12 shows what the tender run rate could be after assuming an average syndication size (bottom axis) and 22 tenders to go this fiscal year. Anywhere between $4-6bn per syndication seems reasonable, and would suggest there is scope for NZDM to lower the

tender run rate somewhat. That could be signalled tomorrow (the January 2025 tender schedule will be published tomorrow morning at 8am) or after the next syndication.

Figure 12. Possible tender/syndication mix for rest of 2025 fiscal year



Source: NZ Treasury, ANZ Research

As expected, no material changes have been made to NZDM's liquidity strategy (to maintain a buffer of around $15bn) and the pace of LSAP repurchases is unchanged. As was the case in the Budget Update, Kāinga Ora bonds that mature within the Treasury's forecast horizon are captured in today's guidance.

Short-term borrowings guidance (Treasury bills and Euro-Commercial Paper) has been increased from $13bn to $20bn at the end of the current and next fiscal years, with a lift to $18bn in the 2026/27 fiscal year, followed by $13bn each fiscal year thereafter. NZDM reiterated that intra-year short-term borrowings are expected to vary from $10bn to $25bn, noting that the composition will include a minimum of USD3bn of ECP (up from $1bn) and NZD3bn of T-bills (up from $2bn).

Summary

For markets, the key takeouts today are the significant increase to bond issuance, a meaningful downgrade to key fiscal indicators, and the Treasury sounding less upbeat (but more realistic in our view) about NZ's growth prospects. The Government is following through on its fiscal strategy by keeping spending growth contained, but Budgets 2025 and 2026 (the latter being an election year) will present bigger tests than today's HYEFU. Growing pressure on public services means the Government will need to maintain a laser focus on the efficacy of current baseline spending (which ballooned under the last Government) and continue to reallocate as needs arise. That won't be easy, and may not be popular, but that approach can certainly facilitate efficiencies across the public sector in the shorter run, while also getting the books back into the black (albeit gradually). In the longer run, however, it's difficult to envisage adequate delivery of health, education and infrastructure needed to bolster productivity without reviewing revenue settings and broadening the tax base. Building discipline and efficiency into the spending side is a good start, but will only take us part of the way.

The RBNZ will factor today's numbers into their February MPS forecasts. We see the numbers as having limited implications for their outlook and assessment of appropriate monetary conditions. Fiscal policy remains expansionary, but not in a meaningfully different way to the Budget given most of the change in key fiscal indicators are related more to timing, treasury forecast assumptions, and underlying economic conditions than discretionary fiscal policy settings.

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