12 September 2023

Fiscal deterioration highlighted

- **An extra year of deficits**
- **Debt levels forecast to rise**
- **A bigger debt programme**
- **Risk of more to come**
- **Post election could look very different**

Key PREFU forecasts

Fiscal surplus delayed until fiscal 2027

Core operating deficit of 2.5% of GDP estimated for the June year 2023. Deficit forecast to rise to 2.7% in 2024 and to then fall progressively to 1.4% in 2025 and 0.3% in 2026.

Net debt rises from an estimated 18.1% of GDP in fiscal 2023 to a peak of 22.8% in June 2025 before falling to 21.0% by June 2027.

Treasury forecasts June year GDP growth of 1.3% in 2024, rising to 2.0% in 2025 and then averaging 3.25% in the following two years.

The unemployment rate is forecast to peak at 5.4% in 2025.

Annual CPI inflation is forecast to fall to 3.8% by June 2024, 2.5% by June 2025 and to settle near 2.0% soon thereafter

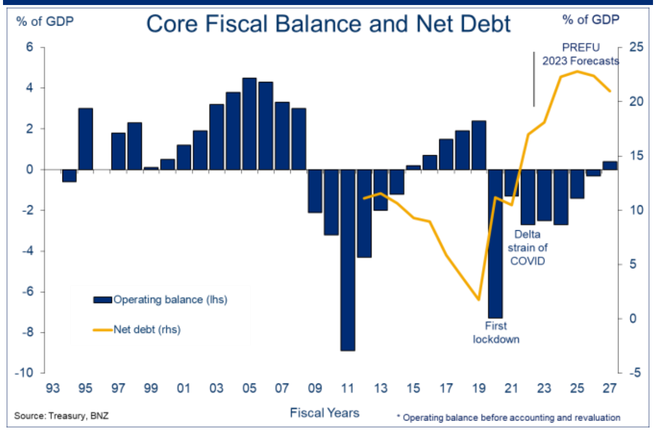
The 90 day bank bill rate is forecast to stay at around 5.6% until Q3 2024.

Fiscal deterioration as expected

It will come as a surprise to no one that the fiscal accounts published in today's Pre Election Fiscal Update looked "worse" than those provided when the Government put together its May Budget. Headlining the deterioration was the projected fiscal surplus being delayed for a year such that a surplus of 0.4% of GDP is now projected for the year ended June 2027.

The fiscal track is generally weaker across the forecast horizon largely driven by upwards revisions to expenses, in part due to recent weather conditions. Revenue, especially the corporate tax take, has been revised lower and is also a contributing factor to the deterioration. A core operating deficit of 2.5% of GDP is now estimated for the year ended June 2023 and forecast to rise to 2.7% in June 2024. These figures are respectively 0.7% and 0.9% of GDP higher than projected in the Budget.

Fiscal outlook



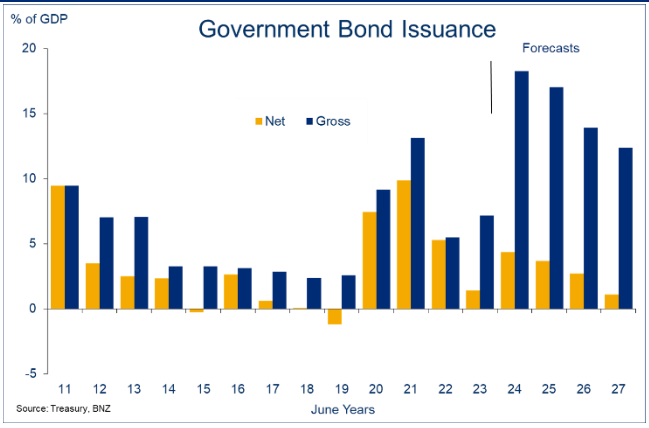
Debt programme increased

All this means a bigger bond tender programme compared to budget guidance. Debt issuance in the June 2024 year will be $2b greater than previously forecast taking gross issuance to $36bn. In fiscal 2025 issuance rises $3bn to $35bn. The 2026 programme is unchanged at $30b while in 2027 $28bn of paper will be issued, $4.0bn greater than previously estimated. The cumulative increase over the four year period is thus $9.0 bn. Net issuance actually rises a tad more at $9.9bn thanks to reduced repayment in fiscal 2026.

For the record, two new syndicated nominal NZGB lines will be launched before the end of this fiscal year: a 15 May 2035 bond and a 15 May 2054. And, inflation-indexed bond (IIB) issuance in 2023/24 will be less than $1bn. Plans are also in place to commence a repurchase programme of the 15 May 2024 bond pre maturity.

Also for the record, note that refinancing of the existing Kainga Ora/Housing New Zealand Limited Wellbeing bonds has not yet been approved by the Government so is not included in the government bond programme. There is a good chance they will, eventually. $3.2bn of these bonds are maturing in the forecast period with a further $4.425bn outside the period.

Forecast bond programme



Greater fiscal weakness likely

At face value there is little to get excited about by all this. However, we think that there is a strong balance of risk that the fiscal outturn deteriorates further.

To start with election promises are not accounted for in Treasurys projections. You'd have to say that whatever the election outcome policy settings will probably end up more relaxed than is currently the case whether that be higher levels of spending or tax cuts that are not fully offset. This puts serious doubt on the surplus track.

In particular, there is minimal money left in the tin for Government operating allowances for the next few years if one takes inflation into consideration. Treasury appears particularly concerned about this. It says: "In recent times, government's final allocations have exceeded the signalled Budget allowance. If this trend was to continue and there was no corresponding offset from either an increase in revenue or a reduction in expenses, there would be an adverse impact on the fiscal outlook."

To cap things off, Treasury does not forecast a return to recession. In fact its expectations for activity are marginally stronger than they were when they put the Budget together. This is largely due to stronger immigration than expected.

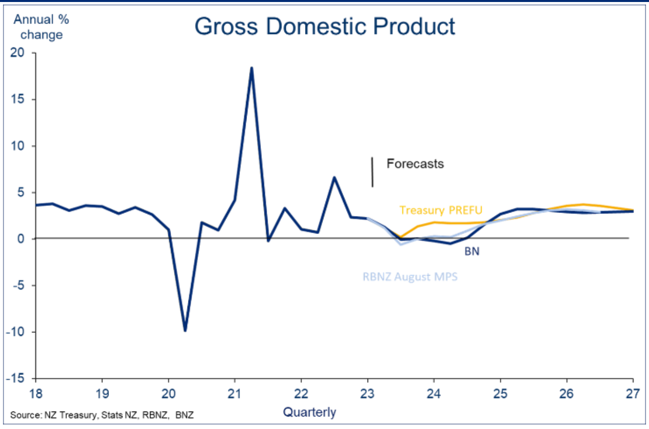
We acknowledge the surge in migration but, even taking this into consideration, Treasury's June Year 2024 growth forecasts look a tad optimistic to us. The domestic spending data we are now seeing should already be being influenced by the surge in migration yet it remains weak, and very weak on a per capita basis. If we are right, and growth is lower than Treasury anticipates, this will further adversely impact fiscal balances.

It is also worth noting that Treasury is more optimistic than the RBNZ in its growth expectations. The RBNZ has basically said it needs a return to recession to achieve its inflation objectives. Treasury does not believe this to be the case.

Nonetheless, Treasury does acknowledge the impact of stronger growth on inflation by postponing its expectation of rate cuts to late 2024.

With the operating balance deteriorating relative to forecast, debt levels have been revised higher. Net debt is now expected to peak at 22.8% of GDP in the year ended June 2025 compared with 21.7% previously. It lowers to 21.0% in June 2027 compared with 18.4% previously.

Who is right?



Implications for policy makers

In theory, this set of accounts could impose a major constraint on policy promises going into the election. Indeed, the ACT Party has already said it will need to scale back the party's tax cut policies given the state of the accounts. However, more generally, the extent of any policy moderation will depend very much on how these accounts are viewed. While the deterioration is bothersome, it should not be overlooked that the fiscal balances (especially the net debt position) look fairly good by international comparison. Moreover, the forecast peak in debt is still well below the "cap" that the Government has given itself. On this basis parties may yet adopt greater flexibility than some might expect.

All that said, don't forget that fiscal targeting is only one leg of the stool. Making sure that any fiscal relaxation does not result in higher inflation is of equal importance to any government lest such easing be met with higher interest rates from the central bank.

Implications for debt markets

While we differ with Treasury with regard to some of the detail, we think today's release is broadly in line with market expectations so should not have a major impact on market pricing. And, of course, everything we see needs to be taken with a pinch of salt with an election fast approaching. No matter who is holding the Government benches in a month's time, there will be policy changes that have not been taken into account in this set of forecasts.

stephen_toplis@bnz.co.nz

PREFU 2023	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
	actual	actual	actual	actual	actual	f/cast	f/cast	f/cast	f/cast	f/cast
(June years, % of GDP)										
Core Crown Revenue	29.4	30.1	29.0	30.6	32.4	31.2	32.2	32.4	32.8	32.7
Core Crown Expenses	27.3	28.0	34.3	31.4	34.6	32.5	33.5	32.7	32.2	31.4
OBEGAL	1.9	2.4	-7.3	-1.3	-2.7	-2.5	-2.7	-1.4	-0.3	0.4
Gross Debt	29.8	27.2	32.2	29.4	32.7	35.9	39.8	43.6	44.8	45.8
Net Core Crown Debt	19.5	18.6	26.3	29.7	35.5	39.5	43.6	42.4	40.4	39.6
Domestic Bond Programme ($NZm)	7,000	8,000	25,000	45,000	20,000	28,000	36,000	35,000	30,000	28,000
(June years)										
Real GDP (annual average % change)	3.6	3.2	-0.7	6.0	1.2	3.1	1.3	2.0	3.3	3.2
Consumer Price Index (annual % change)	1.5	1.7	1.5	3.3	7.3	6	3.8	2.5	2.1	2.0
Unemployment rate (June qtr)	4.6	4.0	4.1	4.0	3.3	3.6	4.8	5.4	4.8	4.6
90-day Bank Bill Yield (March qtr. av.)	2.0	1.7	0.3	0.3	2.2	5.6	5.6	3.9	3.4	3.1
Trade Weighted Index (March qtr. av.)	73.8	72.7	69.7	74.7	72.2	70.9	70.4	70.0	69.6	69.3

Contact Details

BNZ Research

Stephen Toplis
Head of Research
+64 4 474 6905

Craig Ebert
Senior Economist
+64 4 474 6799

Doug Steel
Senior Economist
+64 4 474 6923

Jason Wong
Senior Markets Strategist
+64 4 924 7652

Stuart Ritson
Senior Interest Rate Strategist
+64 9 9248601

Mike Jones
BNZ Chief Economist
+64 9-956 0795

Main Offices

Wellington
Level 4, Spark Central
42-52 Willis Street
Private Bag 39806
Wellington Mail Centre
Lower Hutt 5045
New Zealand
Toll Free: 0800 283 269

Auckland
80 Queen Street
Private Bag 92208
Auckland 1142
New Zealand
Toll Free: 0800 283 269

Christchurch
111 Cashel Street
Christchurch 8011
New Zealand
Toll Free: 0800 854 854