ANZ Research

NZ Half-Year Economic & Fiscal Update 2023

20 December 2023

Contact

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Not much the wiser

Summary

- Finalised before the coalition agreements, and excluding the new Government's updated policy mix, the Half-Year Update is little more than an update of September's Pre-election Update.
- However, the Treasury has provided some preliminary costings of the new policy agenda for decisions made to date by Cabinet. These are not in the main Treasury forecasts, as there will be a lot more decisions between now and Budget to be incorporated. We are not taking much signal from these partial costing in terms of how the new policy agenda will net out in macroeconomic terms. We'll just have to wait for the May Budget for that, but the Minister has reasserted that the new policy mix will be fiscally neutral.
- Forecast expenses and revenues are little changed from the Pre-election Update, but on balance are a little worse. An OBEGAL surplus is still forecast for the year to June 2027, but at a wafer-thin $0.1bn it's $2bn smaller than the Pre-election Update. The Government will face some very tough decision over the next few months to maintain that.
- The Treasury's economic outlook is a little optimistic, not least because it was finalised before the surprisingly weak Q3 GDP release.
- Bond issuance has been lifted $7bn overall, a little more than the $5bn increase to June 2027 we had pencilled in.

Issuance guidance ($bn)

	Jun-24	Jun-25	Jun-26	Jun-27	Jun-28	Jun-24 to Jun-27
Bonds						
2023 Half-Year Update	38	36	34	28	16	136
2023 Pre-election	36	35	30	28	NA	129

The Treasury

- The mini-Budget was much as expected. More policy statement than Budget, it outlined the general vibe for how the Government intends to run things, including a list of cost savings identified to date (that are not in the Treasury's forecast). There wasn't a lot of new news in here that's meaningful for the economic and fiscal outlook.
- When it comes to monetary policy implications, there is a slightly larger fiscal impulse estimated for the current fiscal year, but it's not a game changer. While we have some info on the new policy mix, it is only partial. It would make sense for the RBNZ to focus only on the official Half-Year Update forecast at this stage and wait for May's Budget to see how the new policy mix nets out. The May MPS is likely to be the earliest occasion at which the RBNZ's forecasts will capture the new policy mix.
- Given how much government spending was increased in the wake of COVID (and never unwound, despite the overheating economy), we think there is scope for deeper spending cuts in time. There is very little wiggle room in today's outlook when it comes to the overdue fiscal consolidation, and it's very likely that hard choices will need to be made to deliver tax relief and get the books back into balance by 2026/27. But faced with the trade-off between delaying the forecast return to surplus (after it was pushed out multiple times under the last government) and deeper spending cuts, we think the new Government is likely to preserve the surplus (unless a big shock comes along).

- All up, we're not a lot wiser after today's release. The increase in bond issuance was a couple of yards more than expected (reflecting changes to economic and financial conditions, as opposed to policy choices). Risks around issuance are two-sided: the Government could cut spending by more, but the economy is already weaker than the Treasury's forecast. We think the former will at least offset the latter going forward.

Treasury's economic outlook mostly unchanged, but is already out of date

The Treasury's economic forecasts were finalised on 6 November 2023. The Treasury has not incorporated the impacts of the mini-budget, the Q3 GDP release, nor the RBNZ's Monetary Policy Statement into their economic projections, meaning they are already significantly out of date and do not reflect any extra domestic demand from tax cuts or offsetting reductions in government consumption from the coalition Government's spending cuts.

Q3's GDP print surprised meaningfully to the downside (including large negative historical revisions), so it's not a surprise that the Treasury's updated economic outlook looks optimistic from the get-go. The Treasury's forecast was for an 0.4% expansion in Q3; the data printed at -0.3% q/q.

Other than the GDP miss, the economic forecasts are similar to those the Treasury published in the Pre-election update in November. Unemployment now peaks at 5.2% (previous 5.4%) and CPI returns to the RBNZ target range in Q4 2024, as before. One notable difference between our forecasts and the Treasury's is the medium-term outlook for house prices. The Treasury expects house prices to increase just 0.5% in 2025, while we expect a 5.0% lift.

Figure 1. Real GDP forecast

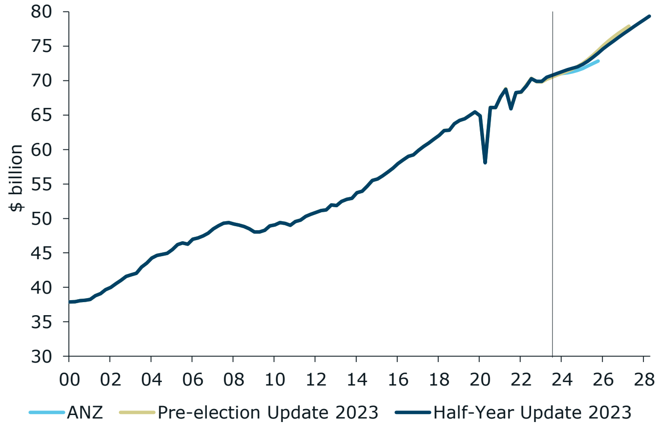
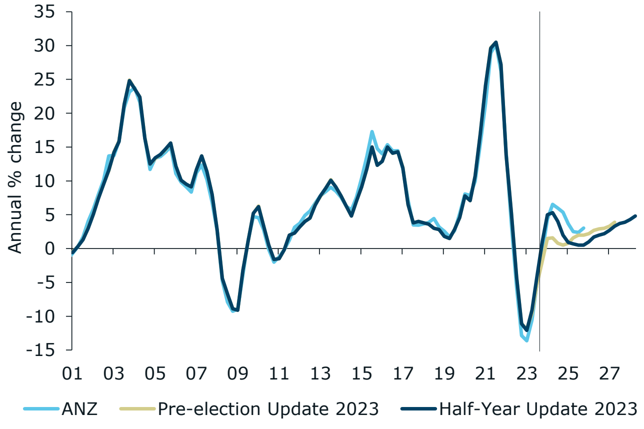


Figure 2. House price forecast



Source: Stats NZ, REINZ, CoreLogic, The Treasury, ANZ Research

Expenses and revenue are similar, but do not reflect the new Government's policies

Before reflecting changes to government policy, core Crown tax revenues are expected to come in $1.5bn below the Pre-election Fiscal Update forecast to June 2027. At the same time, core crown expenses are $6.3bn above the Pre-election Update forecast.

The weak Q3 GDP data represent a significant risk that the tax take could come in lower than forecast. Given a weaker economic backdrop than that captured in the Treasury's forecast, risks around the revenue outlook appear skewed to the downside, while risks around expenses (chiefly automatic stabilisers) appear skewed to the upside.

However, it's important to note that the Treasury had some oversight of the fiscals beyond Q3 (eg monthly fiscal statements to October were published well before GDP), meaning it's only the momentum implications, not the Q3 starting point shock, that matters for the risks around the fiscal outlook. We think the Q3 GDP data reflect weaker economic momentum, but we'll have to wait for Budget 2023 to get the Treasury's view on that (at which point they'll have the Q4 GDP data).

Figure 3. Core Crown tax revenue

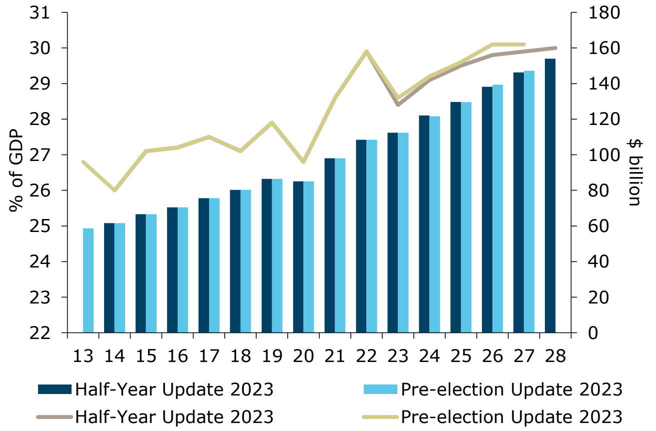
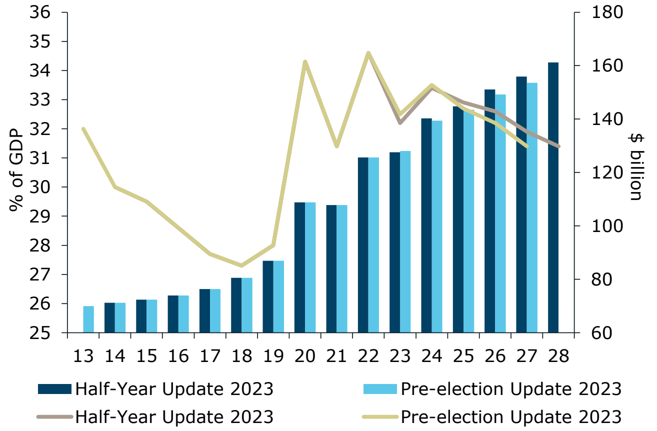


Figure 4. Core Crown expenses



Source: The Treasury

The forecast OBEGAL surplus is barely maintained for 2026/27

The Treasury is forecasting that the return to OBEGAL surplus will still occur in the 2026/27 fiscal year (figure 5), but at just $0.1bn it's wafer thin and the starting point downgrade from GDP alone is likely to turn it into a deficit. Without larger government spending cuts (or new revenue initiatives) that exceed the cost of both tax cuts and delivering on other coalition agreement commitments, the surplus would likely need to be pushed back a year to the 2027/28 fiscal year. We will get more detail on how the Government is likely to respond to higher cost pressures or lower tax revenues in the Budget Policy Statement, due before the end of March. But won't get the full details in forecast form until the Budget in May.

Figure 5. Total Crown OBEGAL

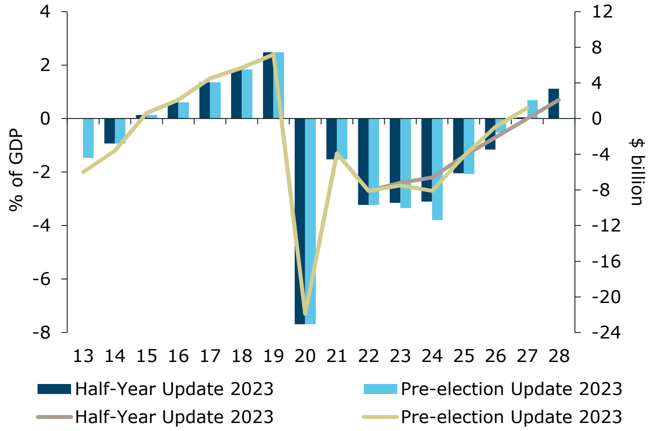
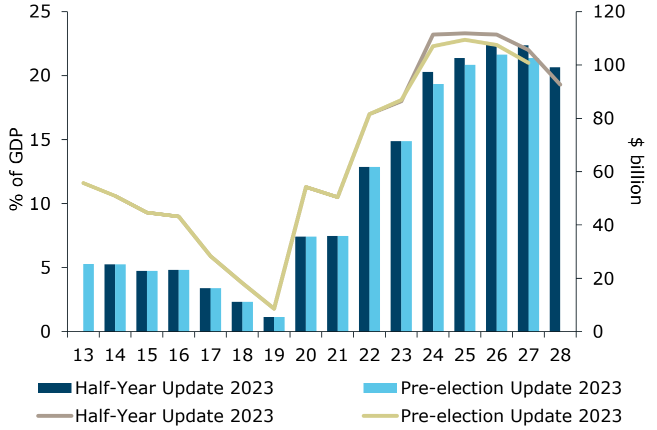


Figure 6. Net debt



Source: The Treasury

The Treasury has costed the small number of "mini-budget" policies that have been fully approved by Cabinet and have outlined their impact on the OBEGAL (Table 1). The Treasury has not included everything in the Government's 100-day plan; most notably the questions of both the impact of tax cuts and how those tax cuts are funded are excluded. This means the mini-Budget is only a very partial view of the coalition Government's agenda. We don't know if decisions made between now and Budget will move the OBEGAL higher or lower.

The forecast OBEGAL deficit for the current fiscal year has been revised narrower by around $2.1bn to $9.3bn. Including capital expenditure, the core Crown residual cash deficit has been revised wider by $0.4bn in 2023/24 to $25.8bn. That shortfall in funding adds to debt and means NZDM has a slightly larger funding task at hand.

At $107.4bn, net debt is expected to be around $4.8bn higher by June 2027 than the Pre-election Update forecast. However, comparisons between forecast rounds do not fully reflect changes in the core fiscal position because valuation changes (largely driven by the NZ Super Fund's performance) tend to be quite wild. While this debt indicator is better for international comparisons, it's a dud for assessing the Government's fiscal management. The old (and more stable) measure (net core Crown debt) shows debt $1.4bn higher come June 2027 compared to the Pre-election Update forecast.

A $7bn increase to bond issuance guidance

We had pencilled in a cumulative $5bn increase to bond guidance to June 2027, but with no change to the current fiscal year. As it turns out, it was lifted by $7bn (Table 1), $2bn more than our expectation, with guidance for the current fiscal year lifted $2bn to $38bn. Guidance for 2024/25 has been increased $1bn to $36bn (as expected), 2025/26 has been increased $4bn to $34bn ($2bn higher than we expected), and 2026/27 is unchanged at $28bn. For the additional forecast year (2027/28), NZDM have signalled a $16bn programme, smaller than the $20bn we had pencilled in. While only a slightly larger increase than we expected over the period as a whole, this is a lot of bonds for the market to absorb. If demand for NZGBs softens, the taxpayer could be on the hook for higher financing costs.

No material changes have been made to NZDM's liquidity strategy (to maintain a buffer of around $15bn). As was the case in the Pre-election Update, Kāinga Ora bonds that mature within the Treasury's forecast horizon (to June 2028) are assumed to be refinanced by NZDM and are therefore captured in today's guidance.

Short-term borrowings guidance (Treasury bills and Euro-Commercial Paper) has been kept stable at $9bn at the end of each fiscal year. NZDM note that intra-year short-term borrowings are expected to vary from $6bn to $15bn, noting that the composition will include a minimum of USD1bn of ECP and NZD2bn of T-bills.

Table 1. Issuance guidance ($bn)

	Jun-24	Jun-25	Jun-26	Jun-27	Jun-28	Jun-24 to Jun-27
Bonds						
2023 Half-Year Update	38	36	34	28	16	136
2023 Pre-election	36	35	30	28	NA	129
Short-term borrowings (T-bills and ECP)						
2023 Half-Year Update	9	9	9	9	9	
2023 Pre-election	9	9	9	9	NA	

Source: NZ Treasury

NZDM maintained their signalled intention to syndicate two new nominal bonds before the end of the fiscal year: a May 2035 and a May 2054. No further details have been provided. The new news on the syndication front is a signal that NZDM will tap an existing shorter-dated nominal NZGB before the end of the fiscal year.

Beyond the slightly bigger uplift in issuance than we had pencilled in, which includes an extra $2bn of bonds this year, the main thing markets are interested in is the question: which bonds will come via syndication, and when? We remain of the view that the new 2054 bond will come next, in February, followed by the new 2035 bond in April. Prior to the announcement of a larger bond programme today, the two already-planned syndications needed to raise around $8.5bn, assuming NZDM sticks to a $500m/week pace of tender issuance. While that maths changes a little with the announcement of a tap syndication of a "shorter-dated" bond, adding in another syndication strongly suggests that the pace of tender issuance won't need to be lifted.

With one more tender knocked out for an additional syndication, syndications now need to raise $11bn (the original $8.5bn plus the $2bn uplift plus $0.5bn for one extra tender being cancelled). But needing to raise $11bn over 3 syndications gives NZDM more flexibility than needing to raise $8.5bn over 2 syndications, and our best guess is that we see something like $2-4bn of 2054s, $3-5bn of 2035s and the balance (call that $2-6bn) of the shorter bond tap. In terms of which bond will be tapped, to us the phrase "shorter-dated" speaks more to the 2028s than the 2030s (which we think of as a mid-curve bond), with those two bonds the only ones in that part of the curve with material line capacity. The 2026s are too short and NZDM's forecast maturities and repurchases suggest that this line is already tapped out.

In terms of timing, we suspect the tap of the short bond will occur in June. While that's not ideal if NZDM wish to hit the ground running in 2024/25 with a syndication in July (which was our prior assumption), we're not overly concerned. By late May, we'll have the Budget, and NZDM will probably feel comfortable enough going into the last month of the fiscal year with just one low-duration syndication needing to be done.

Stepping away from the detail, this was mostly a "nothing to see" update, albeit one that erred on the less market-friendly side of possible outcomes. More bonds means that the market has to work harder, but with the slack mostly taken up by an additional shorter-dated bond syndication this year and only small increases in the out years, the market will hardly be running scared.

Looking forward, risks around issuance are two-sided: the Government could cut spending by more, but the economy is already weaker than the Treasury's forecast. We think the former will at least offset the latter going forward.

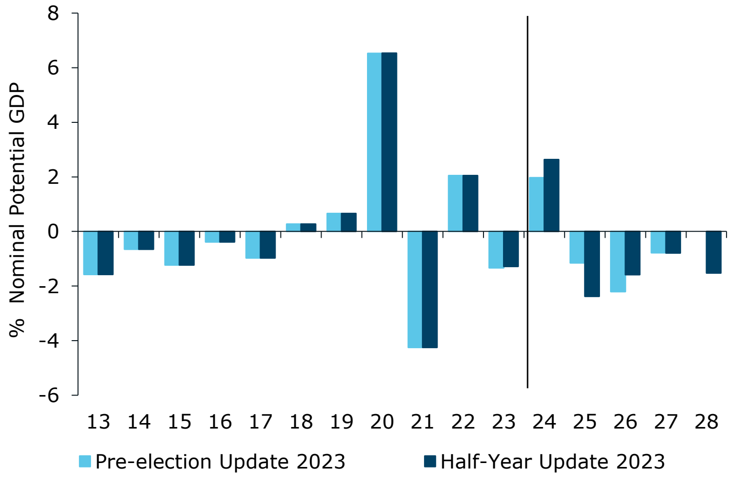
Implications for the RBNZ

Overall, the Half-Year Update suggests the degree of fiscal stimulus is about the same as presented in the Pre-election Update, but with a slightly larger fiscal impulse in the near term. And while we have some info on the new policy mix, it is only partial. It would make sense for the RBNZ to focus only on the official Half-Year Update forecast at this stage, and wait for Budget to see how the new policy mix nets out. Upshot: today's release means the RBNZ is unlikely to access the economic implications of tax and government spending cuts until after Budget 2024 (ie the May MPS at the earliest). Accordingly, today's release doesn't mean much for the February MPS.

At face value, the fiscal impulse is larger over the remainder of the current fiscal year (2.64% vs 1.97% at the Pre-election Update), and its average between the 2024 fiscal year and the 2027 fiscal year is little changed (-0.53% vs -0.54% in the Pre-election Update).

The fiscal impulse attempts to capture the impact of fiscal settings on aggregate demand compared to the year prior. It is calculated as the change in the fiscal balance (a cash balance that strips out the stuff that doesn't influence aggregate demand). While this indicator tells us if fiscal settings are adding more or less pressure to demand (and therefore CPI inflation) compared to a year ago, it doesn't tell us if the overall fiscal stance is expansionary or contractionary through time. For that, it's probably better to focus on the fiscal balance itself. If it's in deficit (as it's expected to be all the way through to June 2027), then fiscal settings are pumping more cash into the economy than they are taking out.

Figure 7. Fiscal impulse



Source: The Treasury

We were hoping to dive into the details of the statement of cash flows to identify how the new Government's policy mix may influence how much cash is expected to be pumped in or taken out of the economy from different sources (eg the net impacts of tax cuts, transfer payments, subsidies, personnel etc), but that will have to wait for Budget 2024 next May.

All up, the RBNZ are likely to view today's set of forecasts as much the same as the Pre-election Update.

Summary

All in all, the major surprise in the Half-Year Update was what was missing, as opposed to what was included. It was always going to be a challenge to incorporate the new policy agenda, so the Treasury has adopted the cleaner approach, choosing to leave it out of the central forecasts until Budget. While we do have some initial costings of recent policy decisions, this is only partial. More decisions will be made between now and Budget, meaning this partial information is unlikely to provide a good feel for how the new policy mix will net out over time.

That said, with the forecast surplus in 2026/27 wafer thin, there is very little wiggle room for surprises while also maintaining the greatly overdue fiscal consolidation. And with some immediate downside risk around the economic outlook, the Government will have some very tough decisions to make come Budget time in May. But with the COVID stimulus never unwound (despite the overheated economy), there is scope for deeper spending cuts while still maintaining a larger Government (in cost-adjusted terms) than before the pandemic. The hard (and not very popular) part is finding the areas of spending that are not delivering value to taxpayers. But while deeper spending cuts will likely prove unpopular to many, the alternative, which may not be so obvious to people on the street, could be a delayed return to fiscal (and external) balance that triggers a sovereign credit ratings downgrade, which could leave New Zealand in a higher-than-otherwise interest rate environment. That is, a higher risk premium would add to the cost of servicing government debt, which could flow through to wholesale markets and therefore fixed mortgage rates. The NZD could be a lot weaker in that world too. For households, higher-than-otherwise mortgage rates, and reduced spending power on imported goods and services would certainly make them feel worse off.

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