

Economic Note

NZ 2021 Half Year Economic and Fiscal Update

15 December 2021

HYEFU depicts resilient fiscal outlook

- The HYEFU revealed a resilient economic outlook and improved trajectory for the public finances: lower government borrowing, the eventual return to OBEGAL surpluses in 2023/24 flagged, and lower Crown borrowing.
- The HYEFU reaffirmed the need for ongoing fiscal policy support considering the highly uncertain outlook, with higher Crown expenditures maintained over the forecast profile.
- Time will tell whether the Government has struck the right balance between meeting short-term demands and preparing for future economic and fiscal challenges.

Summary & implications

A lot has happened since the May 2021 Budget, with COVID-19 now in the community and the elimination strategy now consigned to the dustbin. Pleasingly, today's Half Year Economic and Fiscal Update (HYEFU) showed a resilient economic and fiscal outlook, notwithstanding the risks to the NZ economy and Crown balance sheet from COVID-19.

The stronger fiscal starting point and the resilient economic outlook have translated into a much-improved outlook for Crown revenues. With the Government keen to not go down the austerity route and run the risk of potential economic scarring, Crown expenditures have been revised up, with operating and capital allowances also increased.

The net result has been a stronger outlook for fiscal balances, with the return to an OBEGAL surplus by 2023/24. Net public debt is forecast to peak at a lower level of GDP (around 40% by 2022/23) and approaching 30% of GDP by 2025/26. This has enabled the Crown to pare back its borrowing programme over 2022-25 by close to \$30bn relative to Budget 2021.

The Budget Policy Statement reaffirmed the Government will stick to a balanced approach to managing the public finances. Whether the Government has actually got the balance right between meeting shorter-term demands and preparing for future economic and fiscal challenges remains to be seen.

Improved NZ economic outlook despite Delta variant now in the community

The economic assessment in the Half Year Economic and Fiscal Update (HYEFU) took a glass half-full view of the economic outlook, with near-term volatility giving way to a rebound in 2022 and a solid medium-term trajectory for the economy, underpinned by strong income growth. The Treasury reiterated that the outlook is still inherently uncertain, with COVID-19 a clear risk to the economic outlook and Crown balance sheet. They characterise risks to be broadly balanced, with the HYEFU forecasts presenting alternative upside and downside scenarios.

Once again, the NZ economy has also proved to be more adaptable and resilient to the COVID-19 hit than earlier assumed by the Treasury. The Treasury cited broad-based strength across most industry groups and sectors with strong domestic spending, notwithstanding the hit to the tourism sector that should slowly recover as the borders are opened next year.

The post-Delta rebound that Treasury sees unfolding in late 2021/2022 will be underpinned by pent-up demand, higher employment, continued strength in building activity, as well as the greater freedoms permissible under the COVID-19 Protection Framework ('traffic light' system). However, given little spare capacity, momentum is set to slow, with growth of just over 2% over the latter part of the projection period. **Additional fiscal support will also underpin domestic spending over the short-term**, with the Treasury Fiscal Impulse at around 5% of GDP in 2021/22. We note that the shift to a more restrictive fiscal stance beyond 2021/22 (particularly in 2022/23) will bolster the impact of OCR hikes in slowing the economy.

Linked to the resilience of the economy has been the household sector, which has benefitted from the supportive housing market backdrop, policy support and the tight labour market. While the Treasury expects house price inflation to slow (with moderate declines expected during 2023), higher wage growth should support broader household spending. Business investment is expected to pick-up from next year given stretched capacity. Despite a slowdown in global growth and global supply frictions, demand for New Zealand's goods exports is expected to remain strong. Key supports, such as NZ's terms of trade, are expected to remain near record highs.

As the Treasury acknowledged, capacity pressures have intensified and there is very little spare capacity within the economy. This, and freight disruptions, have caused Treasury to significantly revise up its forecasts for consumer price and wage inflation. The demand for labour remains strong, with the unemployment rate forecast to drop to 3.1% early next year and then to gradually rise as the borders are reopened, with the unemployment rate remaining historically low over the projection period.

Stronger fiscal outlook and lower debt to GDP over the projection period

FISCAL PROJECTIONS - HYEYU vs Budget 2021						
June years	2021	2022	2023	2024	2025	2026
Core Crown Revenue (\$bn)	105.0	110.7	122.3	129.5	136.9	144.3
<i>BEFU 21</i>	97.9	99.8	108.9	114.9	121.3	
Core Expenses (\$bn)	107.8	128.0	120.2	124.8	128.5	133.6
<i>BEFU 21</i>	110.7	114.7	115.4	117.8	121.1	
OBEGAL (\$bn)	-4.6	-20.8	-0.8	2.1	5.9	8.2
<i>BEFU 21</i>	-15.1	-18.4	-9.5	-5.7	-2.3	
OBEGAL (% GDP)	-1.3	-5.7	-0.2	0.5	1.4	1.8
<i>BEFU 21</i>	-4.5	-5.3	-2.6	-1.4	-0.6	
Operating Bal (\$bn)	16.2	-23.8	3.9	7.7	12.0	14.7
<i>BEFU 21</i>	1.3	-15.6	-5.2	-0.9	3.0	
Net core Crown debt (%GDP)	30.1	37.6	40.1	39.9	34.6	30.2
<i>BEFU 21</i>	34.0	43.8	48.0	46.9	43.6	

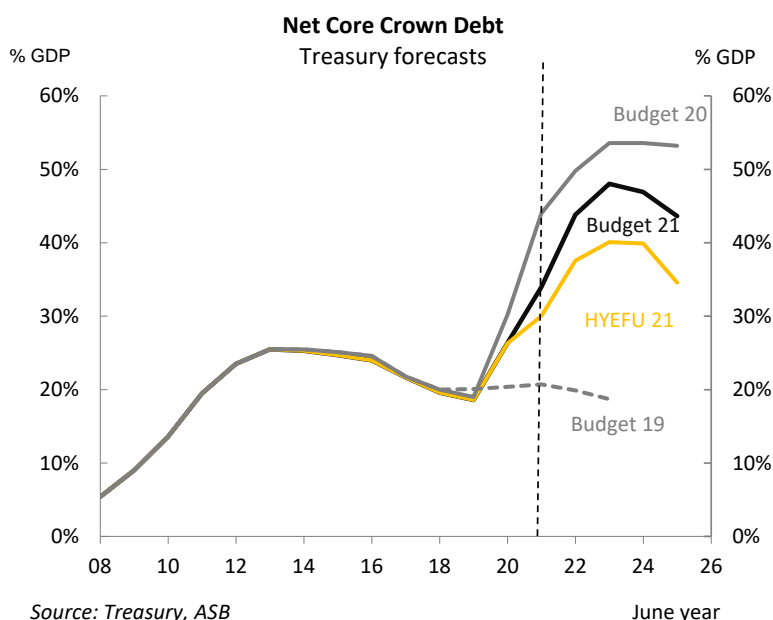
Source: Treasury

The stronger starting point for Crown revenues has been carried through the projection period, with core Crown revenues comfortably above the Budget projections over the forecast horizon (see table). Compared to the Budget projections, nominal GDP is approximately a cumulative \$78.5bn higher over the forecast period to June 2025. This translates into a significantly higher tax take. Treasury cited strength in most tax types, most notably, corporate tax, source deductions, Goods and Services Tax (GST) and other person's tax. **This reflects the widespread number of supports in the current outlook. It is a reminder that COVID-19 is not the only influence around.**

This revenue boost was only partly offset by higher government spending. Core Crown expenditures for 2021/22 are adjudged to be \$13.3bn higher than forecast in Budget 2021. This mostly reflects the additional fiscal support to cushion the economy from the Delta variant outbreak, with extra spending on the COVID-19 Response and Recovery Fund (CRRF), which is not expected to persist in the latter years of the forecast period. Operating allowances for Crown spending were revised up by \$6.0bn per annum for Budget 2022, \$4.0bn per annum for Budget 2023, and \$3.0 billion per annum for Budgets 2024 and 2025 (an increase of \$12.8bn). Core Crown finance costs are also higher, likely a consequence of higher interest rates. **Given pressures on wages and inflationary pressure in general, we see considerable upside risk to the expenditure forecasts.**

As such, the forecast operating balances in all years are expected to be better than forecast in Budget 2021. The Operating Balance before Gains and Losses (OBEGAL) shifts from a (Delta-induced) deficit of just over \$20bn in 2021/22 to a circa \$2bn forecast surplus by 2023/24, with growing surpluses beyond that.

The improvement in OBEGAL flows through to the forecasts for core Crown residual cash and net core Crown debt despite capital allowances being increased by \$10bn. Net core Crown debt is expected to peak at just over 40% of GDP by 2022/23 before easing to around 30% of GDP by 2025/26. This is compared to the peak of 52.6% of GDP by 2022/23 and 46.9% of GDP by 2024/25 in Budget 21. This debt ratio is low in relation to our trading partners and illustrates the importance of prudent management of the public finances so as to provide a cushion for future demands (both expected and unexpected).



Source: Treasury, ASB

Bond tender issuance reduced given improved fiscal outlook

As a consequence of the improved fiscal outlook, NZ Debt Management (NZDM) announced a lower bond tender programme. Issuance in the year to June 2022 was nudged down to \$20b from \$30b, with issuance also \$7bn lower each year through to 2024/25. All up, cumulative issuance over the 2022-25 period is now adjudged to be \$74bn, roughly \$30bn lower than forecast in Budget 2021. The 2025/26 year has been added to the forecast period, with a NZ\$10bn NZGB programme. The reduced debt supply will impact future issuance, with NZDM announcing that it no longer expects to introduce bonds via syndication in 2021/22.

Gross bond tender and NZGB outstanding

Bond tender programme						
Period Ending June	2022	2023	2024	2025	2026	22/25
Half-Year Update 2021	20.0	18.0	18.0	18.0	10.0	74.0
Budget 2021	30.0	25.0	25.0	25.0		105.0
NZGB Outstanding						
Half-Year Update 2021	144.8	147.3	151.5	154.7	152.8	
Budget 2021	158.1	167.2	179.6	189.4		

Source: Treasury

Budget Policy Statement

Today, the Government also published its Budget Policy Statement (BPS), which outlined the Government’s policy goals and Government’s overall fiscal strategy. It reaffirmed the Government’s three policy goals, including:

- Keeping kiwis safe from COVID-19
- Accelerating the recovery and rebuild from the impacts of COVID-19
- Laying the foundations for the future by addressing key issues, including climate change, housing affordability, and child poverty.

It also committed to a balanced approach to public finances by continuing to support the economic recovery through fiscal stimulus, and then looking to reduce public debt levels once economic conditions permit. This looks prudent given future fiscal challenges posed from population ageing and the need to prepare for the next event that will require support from the Crown balance sheet. Whether the Government will walk the talk and convert words into actions remains to be seen.

ASB Economics & Research

Chief Economist

Senior Economist

Senior Economist

Senior Economist

Senior Economist, Wealth

Economist

Nick Tuffley

Mark Smith

Jane Turner

Mike Jones

Chris Tennent-Brown

Nat Keall

nick.tuffley@asb.co.nzmark.smith4@asb.co.nzjane.turner@asb.co.nzMike.jones@asb.co.nzchris.tennent-brown@asb.co.nznathaniel.keall@asb.co.nz**Phone**

(649) 301 5659

(649) 301 5957

(649) 301 5853

(649) 301 5660

(649) 301 5915

(649) 301 5720

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