HUGOvision

Assessing the economic and political environment in New Zealand

HYEFU Special	December 16 2020	Confidential to HUGO members

Much sunnier outlook

Treasury has significantly improved its forecasts for economic growth, tax revenues and Budget deficits over the next four years because of a bouncier-than-expected recovery from the covid-19 lockdowns. The combined deficits over the next four years dropped by almost $25b, while debt issuance plans also dropped by $26.5b.

The Half Yearly Economic and Fiscal Update (HYEFU) appeared like night and day compared to both the Treasury's PREFU shortly before the election and the May Budget itself. From forecasting double-digit unemployment in the middle of the lockdown, the government is now forecasting a peak of 6.8% and a drop back to 4% by June 2025.

Treasury forecast the government's net debt track could fall back to a peak of 43.2% of GDP by 2024 if its more positive economic scenario played out and it looked through the accounting effects of the Reserve Bank's programme of government bond buying.

'Banking the bonus'

Grant Robertson was resolute in his HYEFU lockup news conference in saying the government had no plans to expand its spending allowances beyond those proposed in its pre-election fiscal strategy.

However, strategic decisions relating to the 2021 Budget, including spending and debt envelopes, have yet to be considered.

Robertson indicated the government would 'bank' the extra tax revenues in the form of a lower debt track and repeated his pre-election promise to repay debt if the $14b contingency fund for covid-19 was not used.

Asked if the government planned to increase its allowances when it updates its Budget Strategy early next year, Robertson said it was 'unlikely.'

However, when challenged about the government's thinking on the most appropriate track for net debt, which sets the parameters for tax and welfare and capital spending, Robertson said the government was still considering its position.

New Zealanders would need to get used to higher debt numbers than over the last couple of decades, he said, confirming that targets for net Crown debt of around 20% of GDP are now a thing of the past.

Net debt of 40-50% of GDP, which is in prospect, is significantly lower than New Zealand's AAA-rated peers.

Treasury forecast government financing costs would fall to around $1b or less than 0.3% of GDP by 2023/24. That is one eighteenth of the amount spent that year on NZ Superannuation and just a third of the amount spent on the Accommodation Supplement.

House price inflation

Where the pre-election FEU was forecasting a 5.1% fall in house prices in the year to June 2021, it now expects an 8.5% increase, which implies some moderation from the 13.5% increase measured by REINZ in the year to September, and may therefore prove too cautious. However, the Treasury is warning that economic conditions over the summer may surprise on the downside after a winter in which the NZ domestic economy proved more robust than initially anticipated. House prices are forecast to rise 32% in the next four years.

It cited three reasons for that:

- the rebound in household spending may have been driven by savings accumulated during lockdowns and may not be sustained, the wealth effect of house price increases notwithstanding;

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- uncertainty is likely to constrain business investment;
- seasonal patterns may also have limited the economic impact of the closed border so far. "Tourism-related businesses are expected to come under more spending pressure during the normal peak travel period over summer."

"As a result, economic growth is forecast to continue at a slower pace in 2021 and then pick up from 2022 as NZ's border reopens." Despite that, Treasury secretary Caralee McLiesh said there were "material upside risks" in the forecasts.

Border opening timing

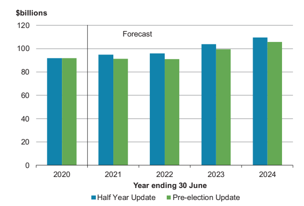
The Treasury continues to forecast the border will reopen fully only from Jan 2022, as outlined in the PREFU.

However, its main scenario in these forecasts presumes a steadily increasing flow of people across the border from June onwards - and from March in its upside scenario.

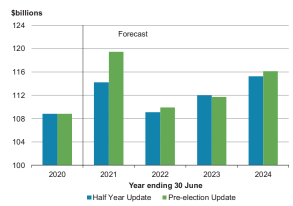
Fiscal Outlook

The fiscal outlook reflects the economic conditions and fiscal response to COVID-19.

Core Crown revenue

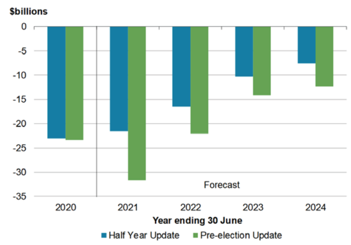


Core Crown expenses



Operating balance before gains and losses (OBEGAL)

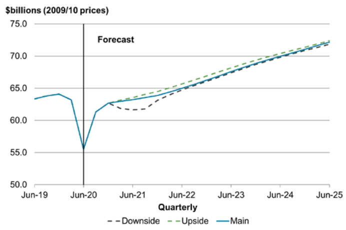
OBEGAL deficits are forecast to be smaller than expected in the Pre-election Update.



New Zealand's Growth Outlook

The outlook has improved, but uncertainty remains high.

Real GDP in alternative scenarios

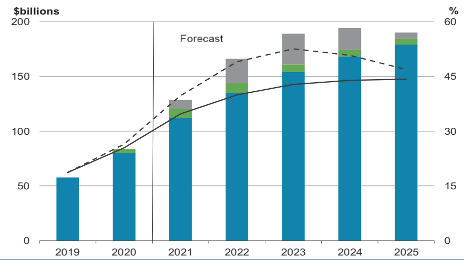


Real GDP annual average % change, June years

	2019 actual	2020 actual	2021 forecast	2022 forecast	2023 forecast	2024 forecast	2025 forecast
HYEFU main	2.8	-2.1	1.5	2.6	3.7	3.8	3.2
PREFU	2.8	-3.1	-0.5	3.6	3.9	4.1	NA
Upside scenario	2.8	-2.1	1.7	3.4	3.7	3.5	2.9
Downside scenario	2.8	-2.1	0.4	2.5	4.7	3.8	3.1

Net core Crown debt

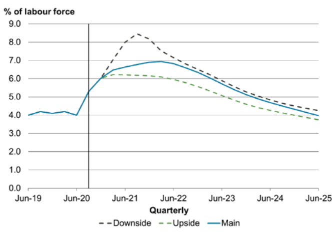
Nominal net core Crown debt is expected to rise over the forecast period.



Unemployment and the Labour Force

Unemployment is expected to peak lower, then drop gradually once borders open.

Unemployment rate under alternative scenarios



Unemployment % of labour force, June quarter

	2019 actual	2020 actual	2021 forecast	2022 forecast	2023 forecast	2024 forecast	2025 forecast
HYEFU main	4.0	4.0	6.6	6.8	5.7	4.7	4.0
PREFU	4.0	4.0	7.7	7.6	6.6	5.3	NA
Upside scenario	4.0	4.0	6.2	6.0	5.1	4.3	3.7
Downside scenario	4.0	4.0	8.0	7.2	5.9	4.8	4.2

Economic Forecasts: International

Real GDP Growth	2019	2020	2021	2022
New Zealand	**2.3**	**-4.6**	**4.5**	**3.0**
Australia	1.8	-4.0	3.2	3.3
United States	2.2	-3.6	3.8	2.9
United Kingdom	1.3	-10.1	6.0	3.1
Canada	1.7	-8.0	4.9	3.4
Japan	0.7	-5.6	2.7	1.6
Euro Zone	1.3	-7.9	5.3	2.9

Source: The Treasury (uses December years for comparison)

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