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Assessing the economic and political environment in New Zealand

HYEFU EXTRA | DECEMBER 15 2021 | Confidential to HUGO members

Plenty of cash flowing in

Inflation is the bugbear of voters, business owners and politicians alike these days, but it is very helpful for a govt looking to balance its books quickly.

Today's Half Yearly Economic and Fiscal Update (**HYEFU**) and **Budget Policy Statement** (BPS) updated the govt's forecasts for economic growth, inflation, interest rates and spending to account for the surge in prices seen in late 2021 and an expected strong rebound in spending and incomes this summer.

They showed what happens to budget deficits, debt-to-gdp levels and spending plans when inflation rises to nearly 6% and wage growth surges north of 4%. **The IRD's brand new tax collecting machine will be humming** in the years to come, hoovering up higher PAYE, GST and corporate income tax. Along with stronger than expected revenues from the Emissions Trading Scheme, the govt will be flying into next year to extra spending for health and a $4.5b stockpile for spending on climate policies to be announced in the May 2022 Budget.

Fiscal drag will be dig deep in the next four years, adding $36.5b in tax revenues over the four years and powering the Budget deficit to a surplus at least three years earlier than expected. This is forecast to reduce borrowing plans by over $30b and give the govt some room for a one-off record $6b of operational spending in the first year of the new Public Health body to replace the outgoing DHBs. Note that much of this extra spend will go to extinguishing accumlated DHB deficits rather than investment in any new health services. That said, Health Minister Andrew Little has a bunch of capital projects to announce for hospitals tomorrow, including a small but much-sought boost to ICU beds.

Nominal GDP will be $78.5b higher over the next four years than was forecast in the May Budget just seven months ago. That's all thanks to a ratcheting up of growth forecasts next year, along with CPI inflation hitting nearly 6% early next year and wage growth rising to 4.6% in the 2023/24 year.

All that will drive the govt to a budget surplus of $2.1b in 2023/24, when in May the Treasury was forecasting a $5.7b deficit. Altogether there is a $32.8b reduction in deficits from the May forecast.

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Table 3 – Summary of the Treasury's Half Year Update economic forecasts

June years	2021 Actual	2022 Forecast	2023 Forecast	2024 Forecast	2025 Forecast	2026 Forecast
Real GDP growth (annual average per cent change)	5.1	0.8	4.9	2.2	2.3	2.3
Real GDP per capita (annual average per cent change)	3.8	0.1	4.1	1.2	1.2	1.1
Unemployment rate (June quarter)	4.0	3.2	3.3	3.6	3.8	4.1
Consumers Price Index (annual per cent change)	3.3	5.1	3.1	2.7	2.4	2.2
Wage growth (annual per cent change)	4.0	4.1	4.5	4.6	4.4	4.2
Current account (annual, per cent of GDP)	-3.3	-5.8	-5.4	-4.8	-4.4	-4.0

Sources: Stats NZ, the Treasury

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That flows through to a Debt Management Office borrowing programme that is $31b smaller than forecast seven months ago.

A new climate fund

Finance Minister Grant Robertson and Climate Change Minister James Shaw had previewed the creation of a climate measures fund for this half yearly update.

The govt will have a $4.5b fund to spend over the next three years on measures to reduce climate emissions and on mitigation for climate change.

Robertson kept his powder dry in the news conference releasing the HYEFU, but the size of the hypothecated fund from ETS proceeds will give the govt some room to play with on public transport and subsidies for a shift to electric vehicles.

There may also be help for councils and the govt itself with mitigation measures to deal with more extreme weather, rising sea levels and increasing need from our Pacific neighbours.

The rise in carbon credit prices has improved the outlook for ETS revenues by $3.5b over the next four years, compared to the May budget, with the value of NZUs now assumed to be $64.50 – almost double May levels.

A record new allowance

Robertson was also quick to point to the one-off nature of a $6b operating allowance for new spending in the 2022/23 year, mostly to fund the shift from DHBs to the new national health body, Health New Zealand, and the new Māori Health Authority.

The allowances then drop away to $4b in 2023/24 and then $3.0b in each of the two following years.

That leaves plenty in the kitty for Budget 2023, which will the last one before the election. Changes to Working For Families, as called for by the Welfare Expert Advisory Group, look on the cards.

The focus of the govt's rhetoric for 2022 is on climate measures, including further thinking to come on long term financing. This could include new discount rates to encourage very long term investment.

Higher new capital spend

Robertson also unveiled a $4b increase in the new capital spending allowance, spread over the four years.

This also beefs up the govt's warchest ahead of the next election.

There is now $9.8b in unallocated capital spending in the Budget track for the next four years, although Treasury also pointed out almost $2b of that would not actually be able to be spent in time.

Reviewing two clusters

The govt is also experimenting with a new more 'joined-up' approach to spending across sectors. It is grouping together justice and natural resources 'clusters'.

There is rhetoric but little detail on a desire to better review the quality of existing spending as well.

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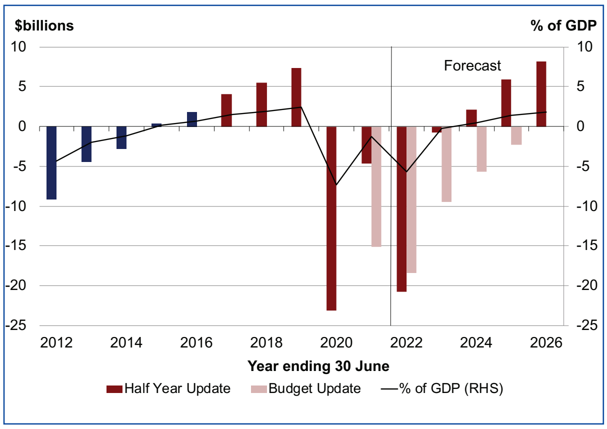
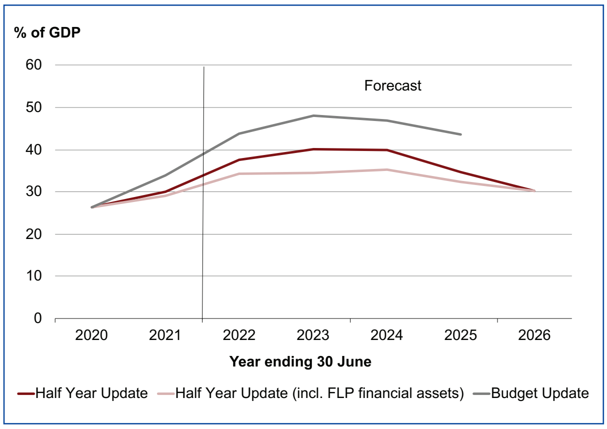


Net core Crown debt comparison



Wage growth