HUGO*vision*

Assessing the economic and political environment in New Zealand

BUDGET EXTRA | May 18 2023 | **Confidential to HUGO members**

The 2023 Budget is a remarkably apolitical document for a government facing an election in five months.

Its **initiatives are either inevitable** – fixing cyclone and storm damage – **or relatively small-scale**. Perhaps the most important news is that the **Treasury does not believe that NZ will experience a recession** this year, in part because of higher government spending than previously anticipated in the year ahead. That will make the **election campaign environment a little more benign for Labour**.

This higher spending, in turn, pushes the timeline for returning to Budget surplus out a year, to 2026, and may see **inflation and interest rates higher for longer.** However, net core Crown debt never gets higher than 22% of GDP, inflation is forecast to be back in the 1-3% target range in the year to June 2025, and 90 day bill rates, currently around 5.3%, fall back to 3% by mid-2027 on these forecasts.

A surge in net migration, which the Treasury thinks will top 66,000 extra people this year before dropping back to a 40,000 increase next year, helps meet labour market shortages but is sufficiently significant also to create some demand bottlenecks too. NZIER is already questioning the assumption that migration will tail off that swiftly.

Unemployment is seen stuck around 5% in 2024 and 2025. While **hourly wages are forecast to increase by 5.7% and 5% in the next two years,** that is a slight moderation on the 6.4% and 6.5% of the last and current June year respectively.

The Budget sees the **pace of house price depreciation slowing markedly, from a 13.4% drop in the year to June 2023 to a 4.6% drop over the year to June 2024**, followed by an anticipated slow recovery.

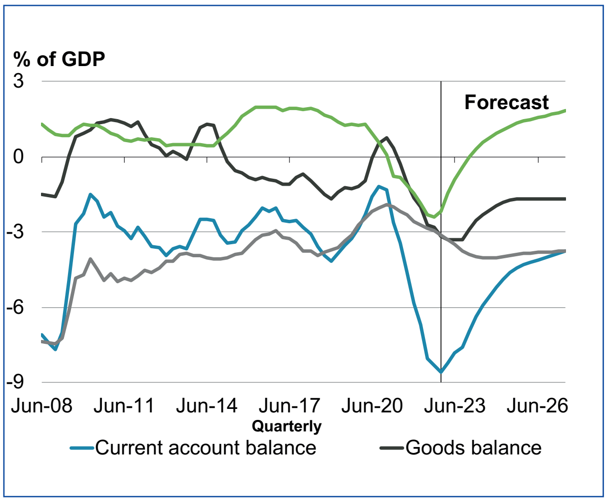
The **balance of payments deficit**, which has blown out to 8.9% of GDP and threatens to worry credit rating agencies if sustained at such high levels, falls back to around 4% of GDP over the next four years, according to the Treasury's forecasts. However, **Standard & Poor's remains to be convinced** and is concerned that if the cost of recovery from Cyclone Gabrielle is higher than anticipated, the current account deficit may remain elevated and create an argument for a rating review.

The Treasury forecasts a weakening NZ dollar over the next five years, falling from 70.9 this year to 69.3 on a trade-weighted index basis by the end of the forecast period, June 2027.

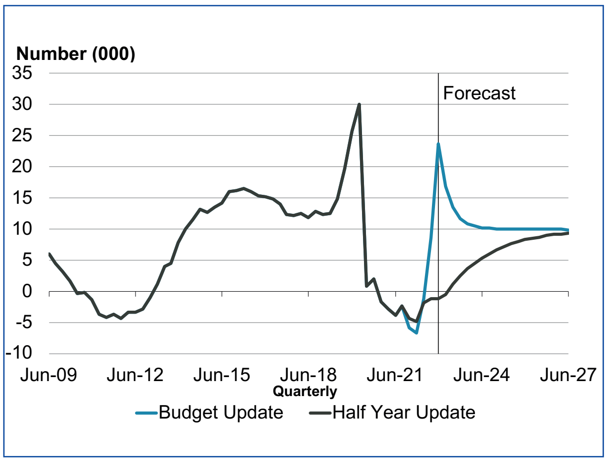
On the fiscal position, S&P observes that "the budget revises up the projected central government cash deficit for fiscal 2023-2024 (year-end June 30) to

Continues on page 2

BoP deficit - improvement expected



Net migration - on fire



THE HUGO GROUP™

PO Box 25120, Wellington 6140 **P.** 04 385 6249 hugo@thehugogroup.com **www.thehugogroup.com**

6.5% of GDP … **a big uptick from the 4.3% deficit pencilled in five months ago, and 2.2% a year ago.**

"However, we still anticipate fiscal improvement in the subsequent years as emergency spending programs are rapidly phased out."

The Budget commentary shows a **contractionary fiscal impulse for four of the next five years.** However, the one expansionary year is the 12 months ahead, with government activity contributing 1.7% to growth, rather than the previously forecast 0.8% contraction.

One of the oddities of this otherwise plain vanilla Budget is that the **forecast declines in total government consumption over the current and next two years still constitute the largest decline in real government spending since the early 1990s**, despite the expansionary stance in the year ahead.

As a result, the Budget delivered today is an essentially conservative document, in that it has very few announcements with "retail" political appeal. Other than 20 free hours of childcare being extended to two year-olds, free and half-price public transport fares for children and young adults, and extension of KiwiSaver contributions to public servants taking parental leave, **there is no significant largesse for any group other than the 20% rebate offered to the video gaming industry.**

This latter move is something of a surprise, but the government appears to have been convinced that a significant number of NZ-based companies were seriously contemplating relocation to Australia. The rebate scheme is still considerably less generous than what Australian states are offering, but was welcomed by the sector.

Among announcements of significance:

- The **trust tax rate, currently 33%, is aligned to the top personal tax rate of 39%** because of evidence that high income taxpayers immediately started channeling income through trusts to minimise tax after the top personal rate increased in 2021.
- Earmarking **$6b for a new National Resilience Plan,** which is additional to the $71b of infrastructure spending already anticipated over the next five years.
- A repurposing of the Christchurch development agency, Ōtākaro as Rau Paenga, the Central Crown Infrastructure Delivery Agency, to help government organisations deliver infrastructure projects. A new Infrastructure Plan – essentially a very long list of initiatives underway across many portfolio areas – was also released with the Budget.
- Three new **"multi-institution hubs" are being established in Wellington to increase collaboration in research and science.** The three hubs will focus on: climate change and disaster resilience; health and pandemic readiness; and technology and innovation. The latter will be based at the Gracefield innovation park and will see Callaghan Innovation, Victoria University, GNS, and the Malaghan Institute co-located. A programme business case still needs to be finalised before construction can begin.
- The **Apprenticeship Boost** scheme will be extended to the end of 2024, with new funding of $17.1m, while an extra $180.7m in tertiary education funding is intended to fund 16,000 full-time equivalent students in 2024 and 13,000 in 2025.
- **Te Pūkenga gets a $220m interest-free loan** from the government to integrate the mega-polytechnic's IT currently disparate array of IT systems.
- The government will press ahead with plans to regulate and improve the transparency of carbon market transactions, including earmarking **$38m over four years to develop a new carbon trading platform**.
- A $27m commitment to a Digital Skills package to grow the tech sector workforce.
- Investment in roading network resilience, with some 100 low cost projects starting immediately.

Key economic and fiscal indicators

June years	2022 Actual	2023 Forecast	2024 Forecast	2025 Forecast	2026 Forecast	2027 Forecast
Real production GDP (annual average % change)	1.1	3.2	1.0	2.1	3.1	2.9
Unemployment rate (June quarter)	3.3	3.7	5.0	5.3	4.9	4.8
CPI inflation (annual % change)	7.3	6.2	3.3	2.6	2.3	2.1
Current account (annual, % of GDP)	(8.0)	(7.8)	(5.9)	(4.6)	(4.1)	(3.8)
Total Crown OBEGAL[1] ($ billion)	(9.7)	(7.0)	(7.6)	(3.6)	0.6	3.2
as a percentage of GDP	(2.7)	(1.8)	(1.8)	(0.8)	0.1	0.7
Net debt[2] ($ billion)	61.9	71.0	91.2	94.7	95.3	89.2
as a percentage of GDP	17.0	18.0	22.0	21.7	20.7	18.4

Note: 1 Operating balance before gains and losses.
2 A series of net core Crown debt (the previous headline net debt indicator) is on page 156.

Sources: Stats NZ, the Treasury