# WESTPAC ECONOMIC BULLETIN

## New Zealand Pre-Election Economic and Fiscal Update (PREFU) 2023 preview.

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## Bigger deficits and so more bonds.

- The Treasury will publish the Pre-Election Economic and Fiscal Update (PREFU) on 12 September, updating the economic and fiscal forecasts in Budget 2023.
- The outlook for nominal GDP – which drives the tax base – has deteriorated since the Budget forecasts.
- We expect that the Treasury will forecast a '23/24 OBEGAL deficit that is around $4-5bn larger than forecast in the Budget.
- The borrowing programme for '23/24 is likely to be lifted by about $6bn, given that the as-yet unpublished deficit for '22/23 has likely exceeded the Budget forecast.
- The projected programme beyond this year is also likely to be lifted somewhat. We expect cumulative issuance over the four-year period to rise by around $15bn.
- While markets are likely anticipating some increase in the bond programme, the revisions that we expect might lead to a modest rise in bond yields.

### The fiscal outlook has weakened.

The Treasury will release the Pre-Election Economic and Fiscal Update (PREFU) on 12 September. The PREFU – a book-opening exercise required by statute – will update the forecasts contained in Budget 2023, capturing the most up-to-date information on how the economy and public finances are tracking, post-Budget policy decisions and changes in the economic outlook. We expect that the PREFU will report that the fiscal outlook has worsened, reflecting both a weaker starting point from the 2022/23 year and a weaker outlook for tax revenue (especially in the near term).

Regarding the starting point, the audited accounts for the just-completed 2022/23 year will be released in early October. But for the first 11 months of the financial year, the provisional accounts point to a OBEGAL deficit that was $2.1bn larger than forecast – largely due to a shortfall on corporate tax that is expected to persist – and a core Crown residual cash deficit that was $4.3bn larger than forecast (higher net capital cash outflows also contributing to this variance). This reflects pressures on corporate profitability due to strong growth in wages and other costs of doing business, at a time when growth is slowing.

Looking ahead to the current year, we expect the Treasury to revise down its forecast of GDP growth, which will further reduce the tax revenue base. In the Budget, the Treasury assumed that the Official Cash Rate (OCR) would peak at 5.25% and would begin easing by mid-2024. Since then, the RBNZ has hiked the OCR by a further 25bps to 5.5% and indicated that interest rates are likely to remain at around current levels until early 2025. But leaning against this, and providing some near-term support to domestic demand, migrant inflows are currently running ahead of the Treasury's projections and have facilitated robust job growth as employers have filled longstanding vacancies.

Less ambiguously, we expect that the Treasury will be forced to downgrade its forecast of trading partner growth – especially as regards China – and its forecast for New Zealand's terms of trade. Amidst an increasingly disappointing recovery in the Chinese economy, export commodity prices have declined further since the Budget, led by a very sharp slump in dairy prices. In contrast, in the Budget the Treasury had assumed that stronger growth in China would limit weakness in export prices. This weakness will weigh on growth in nominal GDP and will lead to lower tax revenue from corporates and small businesses (with many dairy farms likely to be running at a loss this year, tax from this sector will be down sharply).

Economic assumptions

| | June Year (aapc) | | | | |
|---|---|---|---|---|---|
| | 2022/23 | 2023/24 | 2024/25 | 2025/26 | 2026/27 |
| **Real GDP growth** | | | | | |
| Budget 2023 | 3.2 | 1.0 | 2.1 | 3.1 | 2.9 |
| PREFU 2023* | 2.9 | 0.7 | 1.5 | 3.5 | 3.5 |
| Westpac | 2.9 | 0.4 | 0.5 | 2.6 | 3.6 |
| **Nominal GDP growth** | | | | | |
| Budget 2023 | 8.5 | 5.3 | 5.3 | 5.5 | 5.1 |
| PREFU 2023* | 7.5 | 3.3 | 4.7 | 6.2 | 6.0 |
| Westpac | 7.5 | 1.9 | 3.7 | 5.2 | 6.0 |

* Westpac's indicative expectation for the Treasury's forecast.

So, what does this mean for the fiscal outlook and bond programme in the PREFU? Forecasting a forecast is never easy. But even assuming the Treasury adopts a slightly more optimistic economic view than Westpac – as it did in Budget 2023 – we expect the Treasury to report a weaker outlook for the operating balance (OBEGAL), especially in the next year or two. For the 2023/24 year we think the forecast OBEGAL deficit could be revised up by a little over $4bn to $12bn. And so, with the deficit for 2022/23 also likely to have exceeded the Budget forecast, we expect the current year's bond programme to be revised up by around $6bn to $40bn (this includes the refinancing of around $19bn of maturing bonds).

Fiscal outlook

| | June Year (aapc) | | | | |
|---|---|---|---|---|---|
| | 2022/23 | 2023/24 | 2024/25 | 2025/26 | 2026/27 |
| **OBEGAL $bn** | | | | | |
| Budget 2023 | -7.0 | -7.6 | -3.6 | 0.6 | 3.2 |
| PREFU 2023* | -9.4 | -12.0 | -8.7 | -2.1 | 2.0 |
| **Bond Programme $bn** | | | | | |
| Budget 2023 | 28 | 34 | 32 | 30 | 24 |
| PREFU 2023* | 28 | 40 | 37 | 33 | 25 |

* Westpac's indicative expectation for the Treasury's forecast.

We expect that the underlying deterioration will be sustained in 2024/25. But if the Treasury counters near-term weakness by forecasting a stronger cyclical recovery in later years, as we think is likely, we expect the total increase in the bond programme over the four-year forecast horizon (out to 2026/27) will be limited to about $15bn.

Given the deterioration in the fiscal position already evident in the 2022/23 year, we expect investors are anticipating some increase in the bond programme to be announced in the PREFU. But we suspect that revisions as large as we expect would lie near the upper end of expectations, and so lead to a modest rise in bond yields.

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