Research

Economy Watch

17 December 2024

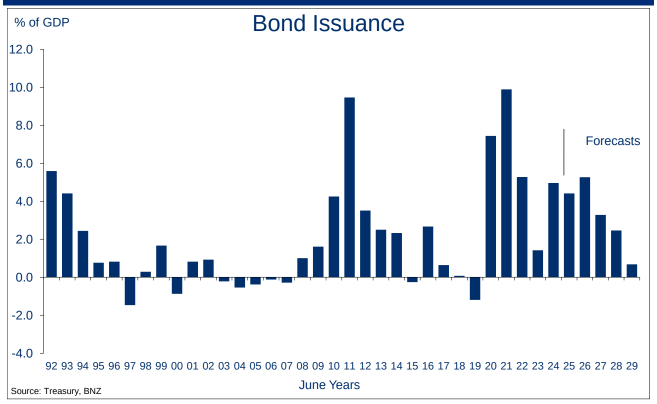
NZ Debt Funding Requirements Soar

- **Surplus postponed**
- **As faltering growth slaughters revenue**
- **Debt moves higher**
- **Years of austerity ahead?**
- **OBEGALX makes an appearance**

The big surprise in today's Half Year Economic and Fiscal Update was the news that the Government bond programme will be $20bn higher over the next four years than was the case at the May Budget.

There are increases of: $2bn in the 2024/25 programme, $4bn 2025/26, $6bn 2026/27 and $8bn 2027/28. This is substantially higher than market commentators were expecting and has been reflected in a modest sell off in bonds.

A lot to digest



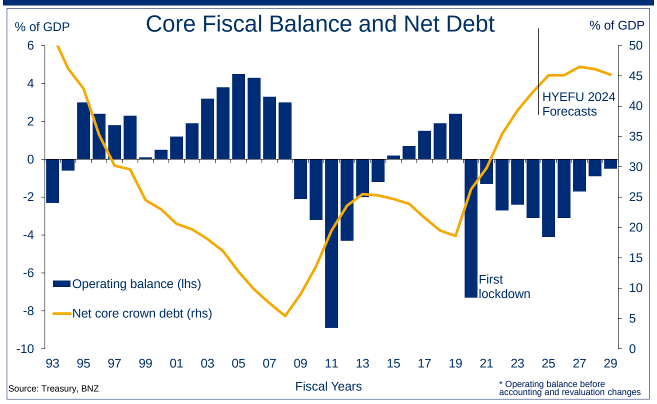
The market response seems entirely appropriate as the rating agencies will not be overjoyed by these developments, and there are concerns about market indigestion given the quantum of issuance that will occur over the next few years.

Net bond issuance will climb to a peak of 5.3% of GDP in fiscal 2026. Since the early 1990s we have only seen issuance of this magnitude in times of crisis such as following the Christchurch earthquakes and the Pandemic.

The main reason for the debt blowout is the much higher than previously forecast fiscal deficits for the next four years. On average the deficit has been revised upward 1.1% per annum starting with a 4.1% deficit expectation for 2024/25 compared with a previous estimate of 3.1%.

Worryingly, the deficit is on a rising trend. Moreover, the OBEGAL is expected to stay in deficit through the forecast period which now ends in June 2029. The Budget had assumed a surplus in the June year 2028.

Deficits for a decade

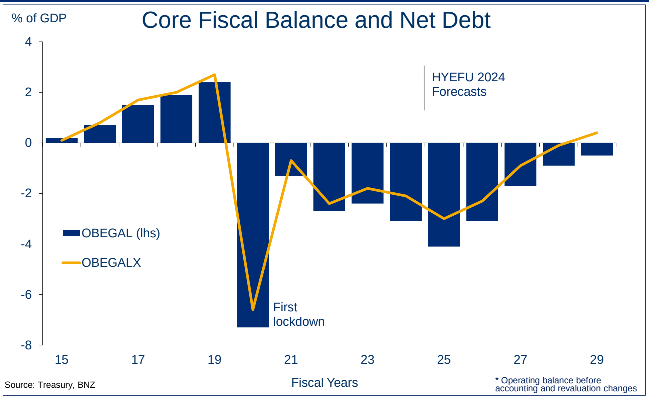


Based on these new forecasts New Zealand will have been in deficit for a whole decade. The last time we experienced something like this was the awful period in New Zealand's economic history between 1979 and 1993.

That said, be aware that the Government introduced a new fiscal balance this HYEFU called OBEGALX, the X standing for "excluding ACC". The rationale for this is that ACC is a self funding Crown Entity which is current running a significant deficit. The view is that fiscal policy should not be adjusted to compensate for what should be a self correcting ACC deficit over time. We agree with this stance. The good news then is that the Government is expecting to achieve an OBEGALX surplus in 2028\2029.

Year ending 30 June (face value)	2024 (actual)	2025	2026	2027	2028	2029
Gross NZGB issuance (NZ$b)	39.3	40	40	38	28	22
NZGB maturities & repurchases (NZ$b)[1]	18.8	21.3	16.5	22.6	15.9	18.5
Net NZGB issuance (NZ$b)	20.5	18.8	23.6	15.4	12.1	3.5
NZGBs outstanding (NZ$b)	172.9	191.7	215.2	230.6	242.7	246.2
NZGBs outstanding (% of GDP)	42%	45%	48%	49%	49%	48%

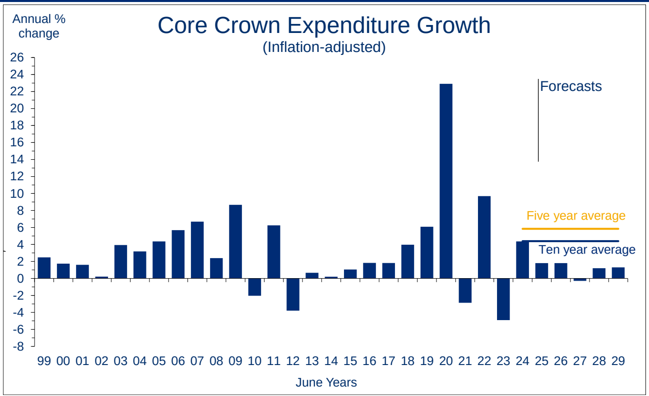
A new measure



Nonetheless, the path back to surplus will remain very challenging. To start with the Government has not increased its operating allowance at all from the Budget. This means it is going to have to achieve expenditure restraint that has rarely been seen before not to mention requiring that restraint in the run up to the next election.

Realistically the only way that this can be achieved is for ongoing spending reductions that will become increasingly unpalatable for the electorate.

Can it be done?

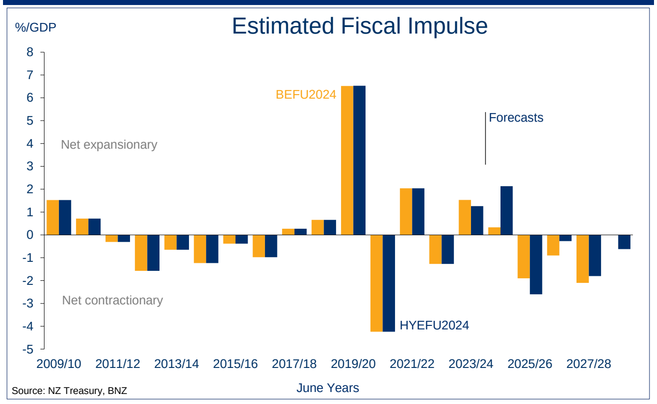


Revenue growth will, of course, be highly dependent on Treasury's growth forecasts. To us their bottom-line GDP forecasts look a bit optimistic in expecting 0.9% growth in the year to June 2025 whereas we are looking at a figure closer to zero.

That said, we are struggling to convert this to fiscal outcomes as we don't really understand the composition of Treasury's forecast. Treasury has strong net export growth whereas we have a negative contribution from net exports. But Treasury also assumes almost no growth in private consumption and very weak investment both of which we would have expected to benefit from falling interest rates.

For the record Treasury is forecasting 0.2% private consumption growth for the year ended June 2025. We are forecasting 1.3% and the Reserve Bank 1.5%.

More stimulus?



With the deficit surprising to the topside net debt expectations have been pushed even higher. Net debt is now forecast to peak at 46.5% of GDP in the June year 2027. Its previous peak was 43.5% in the June 2025 year. This also means that getting debt back to its target of 40% of GDP is going to take quite some time.

Economic Forecasts	BNZ							Treasury (HYEFU 2024)						
(Annual average % change, June years)	**2023 Actual**	**2024 Fcast**	**2025 Fcast**	**2026 Fcast**	**2027 Fcast**	**2028 Fcast**	**2029 Fcast**	2023 Actual	2024 Fcast	2025 Fcast	2026 Fcast	2027 Fcast	2028 Fcast	2029 Fcast
Private consumption	3.1	0.2	1.3	2.5	2.6	2.4	2.7	3.1	0.2	0.2	1.7	2.6	2.5	2.4
Public consumption	0.2	-0.2	-1.6	0.1	1.3	1.6	1.8	0.2	-0.2	-0.2	0.5	-0.2	0.2	0.6
Residential investment	-0.2	-5.7	-4.5	11.6	8.4	0.7	1.8	-0.3	-5.7	-8.4	7.1	5.9	3.9	3.0
Business investment	3.5	-3.1	-0.9	2.5	5.0	4.0	4.9	3.5	-3.1	-3.2	4.5	5.1	3.2	2.4
Exports	12.2	5.0	1.9	5.3	3.9	3.5	3.4	11.9	4.9	3.2	4.4	2.5	2.3	2.3
Imports	2.9	-1.4	3.7	4.6	4.6	3.1	3.8	2.9	-1.2	-1.0	2.1	2.0	1.6	1.5
GDP (expenditure measure)	**3.1**	**0.3**	**0.1**	**2.8**	**2.7**	**2.5**	**2.7**	**3.2**	**0.2**	**0.9**	**3.2**	**2.9**	**2.5**	**2.3**
GDP (production measure)	**3.0**	**-0.2**	**0.1**	**2.9**	**2.8**	**2.5**	**2.7**	**3.0**	**-0.2**	**0.5**	**3.3**	**2.9**	**2.6**	**2.4**
Employment	2.6	1.8	-0.4	2.1	2.4	1.6	2.0	2.6	1.8	-0.4	1.7	2.2	1.8	1.6
Unemployment	3.6	4.6	5.5	5.2	4.9	5.1	5.0	3.6	4.6	5.4	4.8	4.5	4.3	4.3
CPI inflation	6.0	3.3	2.1	1.7	2.3	2.0	2.0	6.0	3.3	1.8	2.1	2.0	2.0	2.0
Current account balance - % of GDP	-8.1	-6.7	-5.9	-4.7	-4.4	-4.4	-4.5	-8.1	-6.7	-5.1	-4.2	-3.9	-3.7	-3.4
TWI (June qtr avg)	71.0	71.5	68.9	71.9	73.8	74.4	74.8	70.9	71.4	69.7	69.6	69.6	69.5	69.5
90-day bank bill rate (June qtr avg)	5.6	5.6	3.4	2.9	4.2	4.2	4.2	5.6	5.6	3.6	3.0	2.9	2.9	2.9

The impact of the HYEFU on monetary policy is difficult to gauge. However, we think it is more likely to be seen as being more stimulatory than previously thought given that the fiscal impulse over the next four years is higher on average.

As an aside, it is worth noting that Treasury assumes the 90 day bank bill rate will fall to a low of 2.9%. This implies a low in the cash rate of 2.75%. This is a number that we currently concur with.

On a technical note, be aware that Thursday's GDP announcement will be accompanied by major upward revisions to GDP for the last two years. This is unlikely to impact Treasury's dollar-value forecasts but it could well reduce deficits and debt as a percentage of GDP making the numbers look a tad better than is currently the case.

So all in all, the HYEFU paints a picture of a country that remains very much fiscally hamstrung. Achieving the targets that the government continues to pursue means there is still a long battle ahead and any thought that fiscal policy might be relaxed in the years ahead should be dismissed.

stephen_toplis@bnz.co.nz

HYEFU2024	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
	actual	actual	actual	f/cast	f/cast	f/cast	f/cast	f/cast	f/cast	f/cast
(June years, % of GDP)										
Core Crown Revenue	29.0	30.6	32.3	31.2	32.0	31.6	31.7	32.0	32.2	32.2
Core Crown Expenses	34.3	31.4	34.5	32.3	33.5	33.4	32.5	31.6	31.1	31.1
OBEGAL	-7.3	-1.3	-2.7	-2.4	-2.7	-3.1	-1.9	-0.6	0.3	0.3
Gross Debt	32.2	29.4	32.7	34.3	42.3	45.7	48.3	49.9	48.4	48.4
Net Core Crown Debt	26.3	29.8	35.4	39.3	43.1	43.5	43.0	43.3	41.8	41.8
Domestic Bond Programme ($NZm)	25,000	45,000	20,000	28,000	38,000	38,000	36,000	32,000	20,000	20,000
(June years)										
Real GDP (annual average % change)	-0.8	6.1	0.7	3	-0.2	1.7	3.2	2.9	2.7	2.7
Consumer Price Index (annual % change)	1.5	3.3	7.3	6	3.4	2.2	2.0	2.0	2.0	2.0
Unemployment rate (June qtr)	4.1	4.0	3.3	3.6	4.9	5.2	4.8	4.5	4.4	4.4
90-day Bank Bill Yield (March qtr. av.)	0.3	0.3	2.2	5.6	5.7	4.5	3.5	2.9	2.5	2.5
Trade Weighted Index (March qtr. av.)	69.7	74.7	72.2	70.9	71.3	70.4	69.6	69.1	68.6	68.6

Contact Details

BNZ Research

Stephen Toplis
Head of Research

Doug Steel
Senior Economist

Matt Brunt
Economist

Jason Wong
Senior Markets Strategist

Stuart Ritson
Senior Interest Rate Strategist

Mike Jones
BNZ Chief Economist

Main Offices

Wellington
Level 2, BNZ Place
1 Whitmore St
Private Bag 39806
Wellington Mail Centre
Lower Hutt 5045
New Zealand
Toll Free: 0800 283 269

Auckland
80 Queen Street
Private Bag 92208
Auckland 1142
New Zealand
Toll Free: 0800 283 269

Christchurch
111 Cashel Street
Christchurch 8011
New Zealand
Toll Free: 0800 854 854