

At a glance

Today's Half Year Economic and Fiscal Update (HYEFU) highlighted a deterioration in the economic and fiscal outlook compared to Budget 2024 forecasts. Economic growth is predicted to begin to recover from 2025. However, it will be slower than previously forecast. The fiscal outlook is weaker across all indicators compared to Budget 2024.

A new headline operating balance indicator 'OBEGALx' was introduced today. This indicator excludes ACC revenue and expenses, and will be reported alongside OBEGAL (as the total Crown indicator). Both indicators show a delay in the return to surplus compared to previous forecasts – with OBEGALx expected to return to surplus in 2028/29, and OBEGAL not expected to return to surplus within the forecast period.

Alongside the updated fiscal and economic outlook, the Budget Policy Statement signalled a continued focus on fiscal restraint for Budget 2025, with the Government retaining the decreased \$2.4bn operating allowance announced at Budget 2024 over the forecast period. We note that \$1.37bn of this operating allowance is already committed to Health initiatives.

Economic update

GDP forecast

Real GDP growth is expected to have contracted 0.1% in the second half of 2024, followed by modest growth from early 2025 – a deterioration on previous forecasts.

Inflation

Inflation is expected to stabilise around 2% from early 2025, earlier than previously forecast.

Unemployment

Unemployment is expected to peak at 5.4% in 2025/26, slightly later than previously forecast. This is due to a reduced labour force size, the result of net migration slowing faster than expected due to an increasing number of New Zealanders moving overseas.

Wage growth

Wage growth is forecast to continue to ease, from 5% in June 2024, to 2.9% by mid-2025.

Fiscal update

OBEGAL

(operating balance before gains and losses)

A new headline operating balance indicator 'OBEGALx' was introduced as part of HYEFU, which excludes ACC revenue and expenses. This will be used alongside OBEGAL (the total Crown indicator) for future fiscal updates.

Under both indicators, HYEFU forecasts show a delay in the return to surplus:

- Under the new OBEGALx indicator, a small OBEGALx deficit of \$304m is expected in 2027/28, followed by a \$1.9bn surplus in 2028/29.
- Under the previous headline OBEGAL indicator, the operating balance does not return to surplus in the forecast period, showing a continued deficit in 2028/29.

Net debt

Net core Crown debt will peak at 46.5% of GDP in 2026/27, before reducing to 45.2% of GDP by 2028/29. Overall, net core Crown debt is higher than forecast at Budget 2024. The Government reiterated its longer-term objective to get net core Crown debt below 40%.

Overview of the Budget Policy Statement

The Budget Policy Statement (BPS) signalled a continued focus on fiscal restraint for Budget 2025, with the Government retaining the decreased \$2.4bn operating allowance announced at Budget 2024 over the forecast period. This is similar to Budget 2017, where the operating allowance was \$1.8bn.

Of the \$2.4bn Budget 2025 operating allowance, \$1.37bn is already committed to Health spending, leaving \$1.03bn available for further spending.

The Government has also indicated a shift in the treatment of the capital allowance – replacing the Multi-Year Capital Allowance (MYCA) framework with an annual capital allowance to provide flexibility. As a transitional measure, the Government has set the capital allowances for each of the next four Budgets at \$3.625bn.

Against a background of downgraded economic and fiscal forecasts, the Government has signalled three key expectations for Budget 2025; a high bar for new initiatives, further savings beyond those already identified in Budget 2024, and no additional funding for most government departments.

Alongside this, the BPS sets out the policy areas the Government will focus on for Budget 2025:

- Lifting economic growth
- Implementing a social investment approach
- Keeping tight control of government spending, while funding a limited number of high-priority Government policy commitments and cost pressures (justice, health and education)
- A pipeline of infrastructure investment.