Executive Summary

- Real gross domestic product (GDP) growth is expected to increase to 3% in the year ended March 2015, and average 2.5% over the five years to March 2017, a little above the Treasury's estimate of potential growth over this period. Growth averaged 0.8% in the prior five years.

- The operating balance before gains and losses (OBEGAL) is forecast to move from a deficit of $6.3 billion this year (compared with $7.3 billion forecast in the *Half Year Economic and Fiscal Update*) to a surplus of $75 million in the year ending June 2015.

- Net core Crown debt is forecast to peak as a share of GDP at 28.7% in the year ending June 2015.

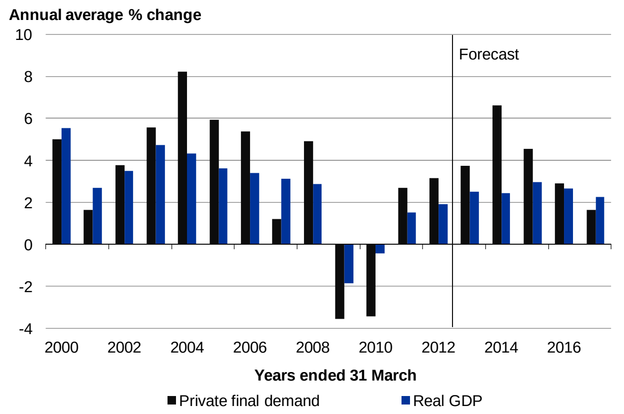
- Domestic demand is the main driver of economic growth, with private spending growth accelerating to over 6% in the year ahead.

- Strong growth in imports associated with higher investment provides a substantial offset to overall growth over the forecast period. In addition, the impact of drought lowers growth in the year ended March 2014.

- This growth outlook sees the unemployment rate decline to around 5% and annual Consumers Price Index (CPI) inflation move back to the middle of the 1% – 3% target band. As in the *Half Year Update*, the current account deficit is forecast to increase as the Canterbury rebuild gets into full-swing.

- The Canterbury rebuild is one of the main positive forces operating on demand over the forecast period, although the precise timing of activity remains a key uncertainty. The estimated level of investment associated with the rebuild has been revised up to $40 billion from $30 billion in the *Half Year Update.* This investment is expected to extend well beyond the forecast period. The government's fiscal costs are currently assessed to be $15.2 billion.

Figure 1 – Real GDP and private final demand*

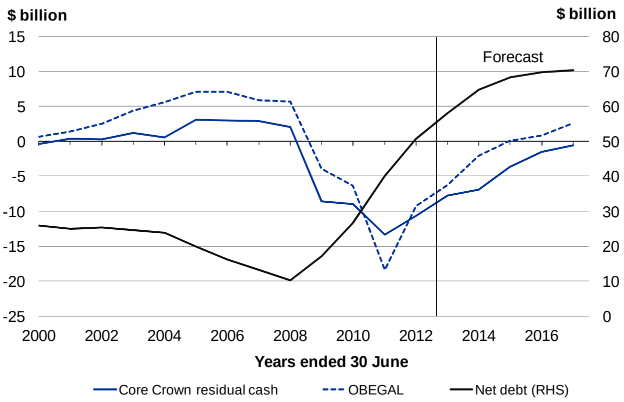


Sources: Statistics New Zealand, the Treasury

*Private final demand comprises private consumption, residential and market investment spending

- Household and business spending growth is expected to increase, although it is more muted than that seen in the 2000s. Household saving as a share of income is forecast to track around recent levels, up around 10 percentage points from its low of the past decade.
- Monetary policy stimulus is forecast to continue for some time. As spare capacity is absorbed and inflation pressures pick up, interest rates are expected to rise gradually.
- Budget 2013 incorporates a reduction in future operating allowances that sees a continuation of moderate government spending growth. This, together with some recovery in tax revenue, sees fiscal policy exerting a restraining influence on the economy and interest rates, notwithstanding signalled reductions in Accident Compensation Corporation (ACC) levies in the June 2015 and 2016 years.
- The exchange rate is assumed to remain high for much of the forecast period. This will hold back activity in exporting and import-competing firms, especially those not experiencing what are expected to be relatively strong export commodity prices.
- The terms of trade is forecast to increase in the year ahead, leading to a rebound in nominal GDP growth and supporting faster growth in tax revenue.
- While the OBEGAL returns to surplus in the year ended June 2015, core Crown operating cash flows remain in deficit for a further year. When combined with net capital spending, residual cash remains in deficit for each year of the forecast period.
- Since the *Half Year Update* forecasts were released, the risks to the main forecasts have become more balanced.
- Significant risks to global growth remain. But overall, global risks have become more even as policy-makers have moved to reduce the chance of more extreme downside risks materialising or to boost growth. Domestically, there is a mix of upside and downside risks, including the size and pace of the Canterbury rebuild, the path and pass-through of the exchange rate, impact of the drought, and the saving behaviour of households particularly in light of current house price increases.

Figure 2 – OBEGAL, core Crown residual cash and net core Crown debt



Source: The Treasury

- The *Budget Economic and Fiscal Update* contains two alternative scenarios to illustrate some of the risks to the main forecasts. While short-term growth is higher in the higher house price scenario, OBEGAL returns to surplus in the same year as in the main forecasts. In the lower inflation scenario, associated lower nominal GDP growth means that OBEGAL remains in deficit until the year ended June 2017.
- In addition to the fiscal impact of changes to economic activity, the Government is exposed to other fiscal risks. For example, the Crown's financial position is susceptible to market risk with regards to movements in market variables such as interest rates, exchange rates and equity prices. There are also a number of contingent liabilities and fiscal risks outlined in the Specific Fiscal Risks chapter.

Table 1 – Summary of the Treasury's main economic and fiscal forecasts

	2012 Actual	2013 Estimate	2014 Forecast	2015 Forecast	2016 Forecast	2017 Forecast
Economic (March years, %)						
Economic growth[1]	1.9	2.5	2.4	3.0	2.6	2.2
Unemployment rate[2]	6.7	6.9	6.0	5.9	5.5	5.2
CPI inflation[3]	1.6	0.9	1.9	2.0	2.0	2.2
Current account balance[4]	-4.4	-4.8	-4.8	-5.2	-5.8	-6.5
Fiscal (June years, % of GDP)						
Total Crown OBEGAL	-4.4	-2.9	-0.9	0.0	0.3	1.0
Net debt[5]	24.3	27.1	28.4	28.7	28.1	27.3

Notes:

1 Real production GDP, annual average percentage change
2 Percent of labour force, March quarter, seasonally adjusted
3 Annual percentage change. March quarter 2013 is actual
4 % of GDP
5 Net core Crown debt excluding the New Zealand Superannuation Fund and advances

Sources: Statistics New Zealand, the Treasury

Finalisation Dates for the Update

Economic data	17 April
Economic forecasts	18 April
Tax revenue forecasts	19 April
Fiscal forecasts	29 April
Specific fiscal risks	29 April
Text finalised	9 May

Important Notice

The economic numbers and forecasts in the *Budget Update* pre-date the release of the Household Labour Force Survey (HLFS) for the March 2013 quarter by Statistics New Zealand on 9 May 2013. The Survey showed that the unemployment rate fell to 6.2% compared with a forecast of 6.9% and quarterly employment grew by 1.7% compared with a forecast of 0.4%. While the outturn paints a stronger picture of near-term labour market conditions, recent volatility in the HLFS suggests caution about being too definitive about this strength. The release does not change our view of the medium-term outlook included in the forecasts.