TE TAI ŌHANGA
THE TREASURY

BEFU Basics 2021

Our Budget Economic and Fiscal Update (BEFU) gives an outlook for the New Zealand economy and the Government's finances over the next five years (our forecast horizon), providing context for Budget 2021

20 May 2021

Our Economic and Fiscal Updates

The Treasury is New Zealand's economics and finance ministry. We advise on the direction of New Zealand's economic policy with the aim of achieving a strong and sustainable economy and raising living standards for all New Zealanders. We also advise the Government on its fiscal strategy, report on the revenue and expenditure of the Government (fiscal outlook), and assist to ensure spending is fit for purpose and can improve outcomes for current and future generations. We use our Living Standards Framework and He Ara Waiora to recognise the different aspects of New Zealanders' living standards and wellbeing.

The Treasury is responsible for economic and fiscal forecasts. We release these every six months. We have an annual Budget Economic and Fiscal Update (BEFU, or Budget Update) and an annual Half Year Economic and Fiscal Update (HYEFU, or Half Year Update). In the 20-30 days before a general election we also prepare a Pre-election Economic and Fiscal Update (PREFU, or Pre-election Update).

This BEFU forms part of Budget 2021 and provides context about the economy and the Government's finances, including Budget 2021 decisions and the Government's future spending intentions. It primarily outlines what the Treasury observes in our current economic and fiscal climate, what we might see in the future, and what risks we may face over the next five years. This gives an indication of what the economy is most likely to do and what the fiscal situation is most likely to be.

BEFU Basics 2021 provides an overview split into two parts. The Economic outlook is how our country is expected to do economically. It is the big picture that helps us position ourselves as a country to earn, grow, spend wisely, and pay off debt. The Fiscal outlook is about the health of our public purse. It looks at the Government's expected income (largely from tax), and how the Government is expecting to spend and manage its debt.

Economic outlook: indicators

Here are some of the key indicators we use to tell us what’s happening in the economy:

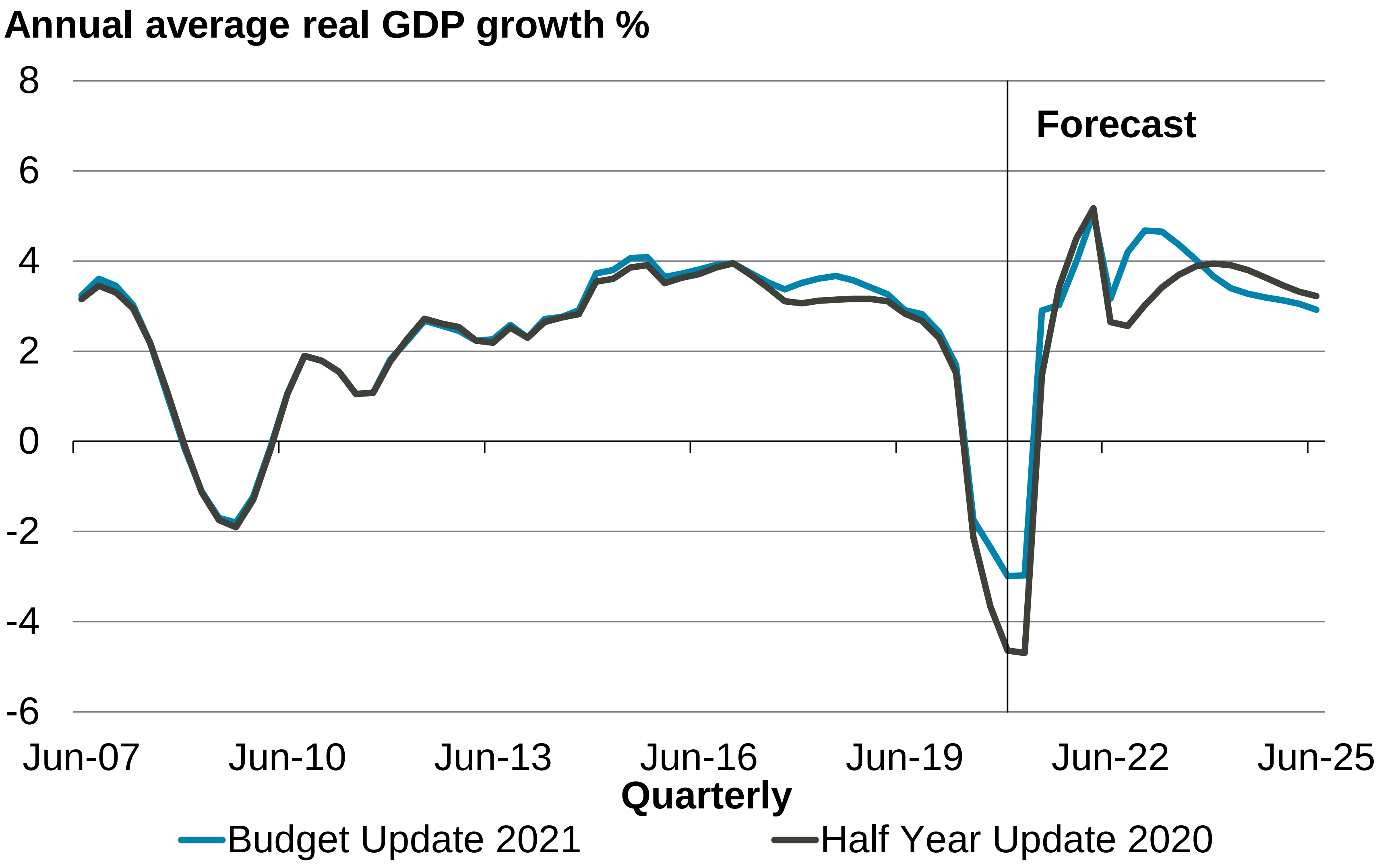
- **Gross Domestic Product (GDP)** measures the value of goods and services produced in an economy in a period of time. When GDP increases the economy is growing. If GDP falls for two quarters in a row we call it a recession. There are two ways we look at GDP – nominal and real. Nominal GDP is estimated at current prices and is a good indicator for how much tax is generated by all the individuals and businesses in the economy. Real GDP is estimated at constant prices so it takes account of inflation. How real GDP changes over time is a good measure for how fast the economy is growing.
- **Unemployment** is the number of people actively looking for work who are not currently in jobs.
- **Inflation** is the rise in prices for goods and services over time and decline of the purchasing power of money. A common measure of inflation is the Consumers Price Index (CPI), which measures the changing price of a ‘basket’ of goods and services New Zealand households buy.
- **Terms of Trade** represent the ratio between a country's export prices and its import prices. Terms of Trade above 100% means the country is earning more from its exports than it spends on imports, and vice-versa if the figure is less than 100%.

Gross Domestic Product (GDP)

The New Zealand economy has been very resilient in the face of COVID-19. The economy is expected to grow throughout the forecast period, supported by the return of international visitors, higher Government spending and a boost in business investment. Annual real GDP growth is forecast to rise from 2.9% in 2021 to 4.4% in 2023, then ease to 2.9% in 2025. By June 2025 annual nominal GDP is expected to be $414.4 billion, which is around $19.5 billion higher than the forecast made in the 2020 Half Year Update.

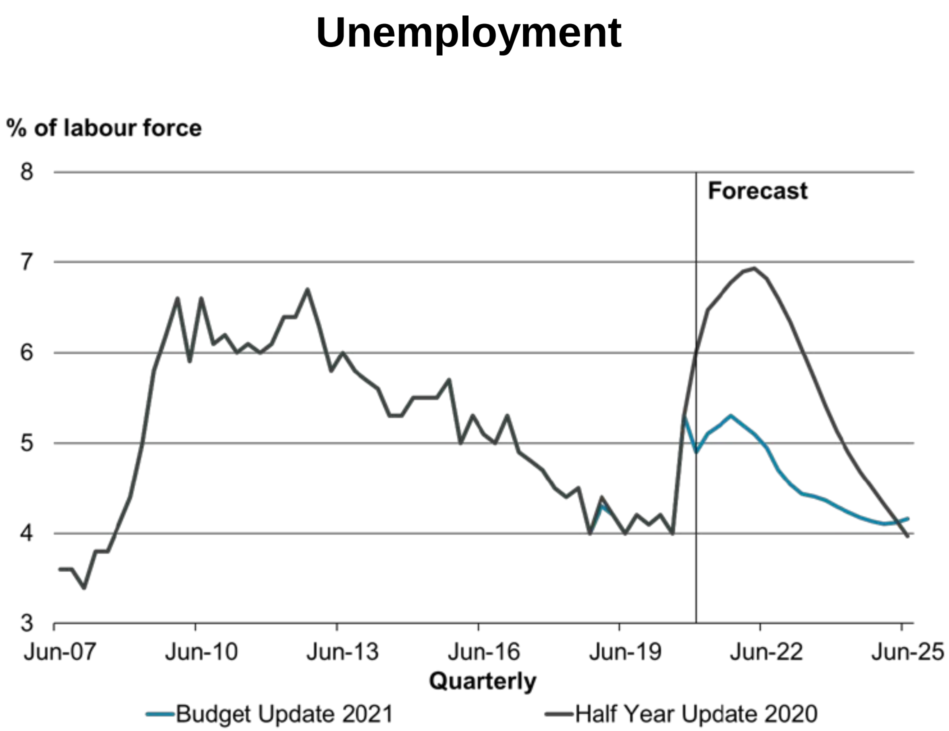
There is still a lot of risk and uncertainty that could affect our economy. The COVID-19 pandemic continues to play a large role in the economic and fiscal outlook, especially hitting those sectors dependent on migration and tourism.

GDP (continued)



Labour market

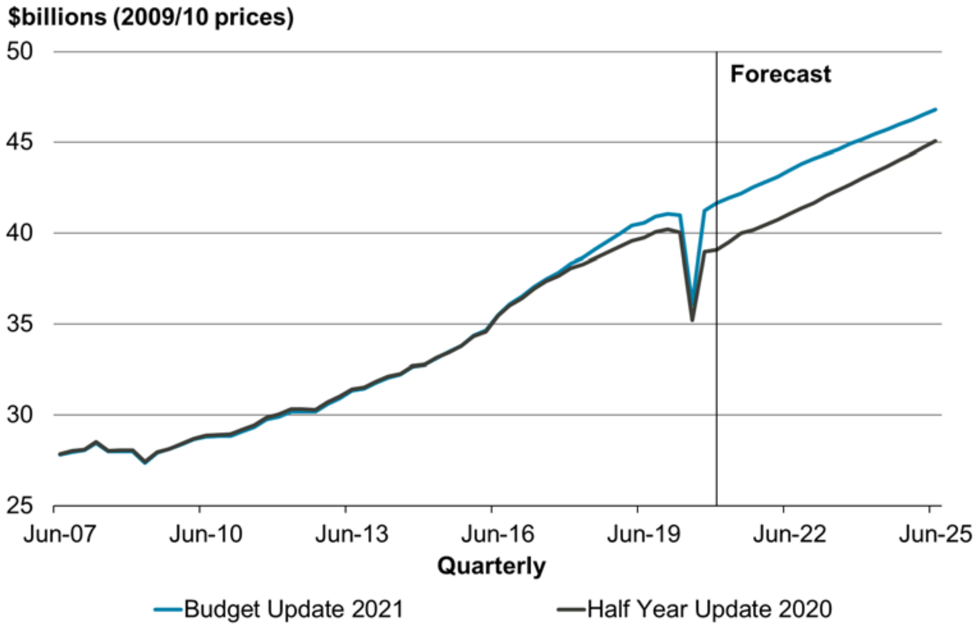
The labour market outlook is far better than previously expected during the height of COVID-19, as businesses showed flexibility and initiatives such as the Wage Subsidy Scheme helped keep people in jobs. The unemployment rate dropped in December 2020 (4.9%) and again in March 2021 (4.7%), although the underutilisation rate (which includes, amongst other things, employed people who want to work more hours) increased. Unemployment is expected to rise in the short term and peak at 5.3%, well below the 6.9% peak forecast in the 2020 Half Year Update, before falling to 4.2% at the end of the forecast horizon.



Household spending

Household spending is expected to rise steadily, as employment continues to grow and interest rates for borrowing stay low. Although a slowdown in house price growth is forecast to drag on spending, the easing of border restrictions and the Budget's core benefit increases are assumed to boost household incomes and support spending over the remainder of the forecast.

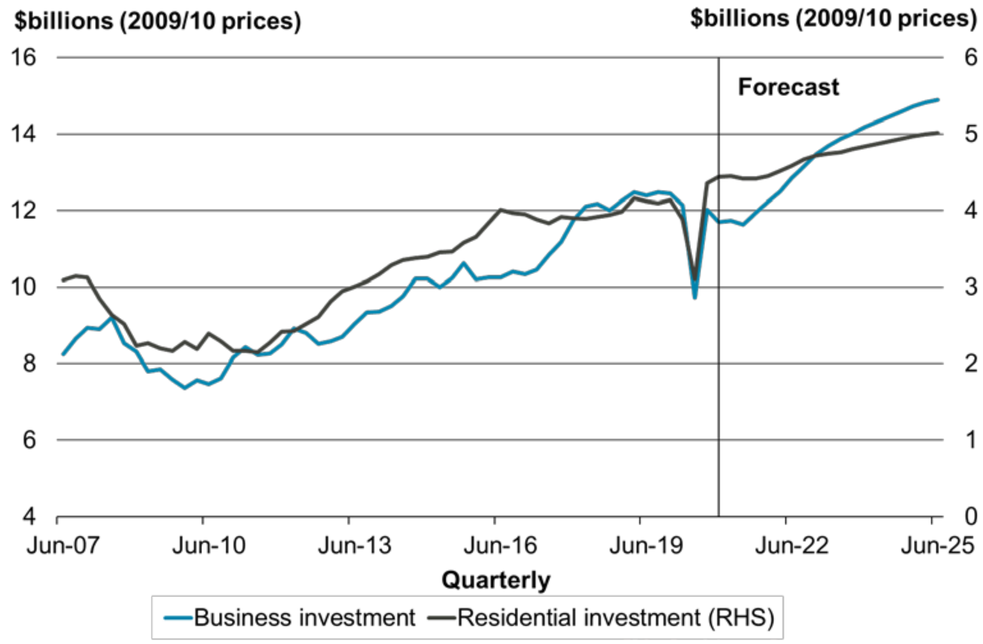
Real private consumption



Business investment

Business investment is expected to stay subdued over the first half of 2021, as tourism-related businesses continue to deal with the loss of international visitors and uncertainty about future earnings. Government investment, steady household demand and the gradual return of overseas visitors drive a strong recovery from the second half of 2021, and business investment is forecast to overtake pre-pandemic levels by the start of 2022.

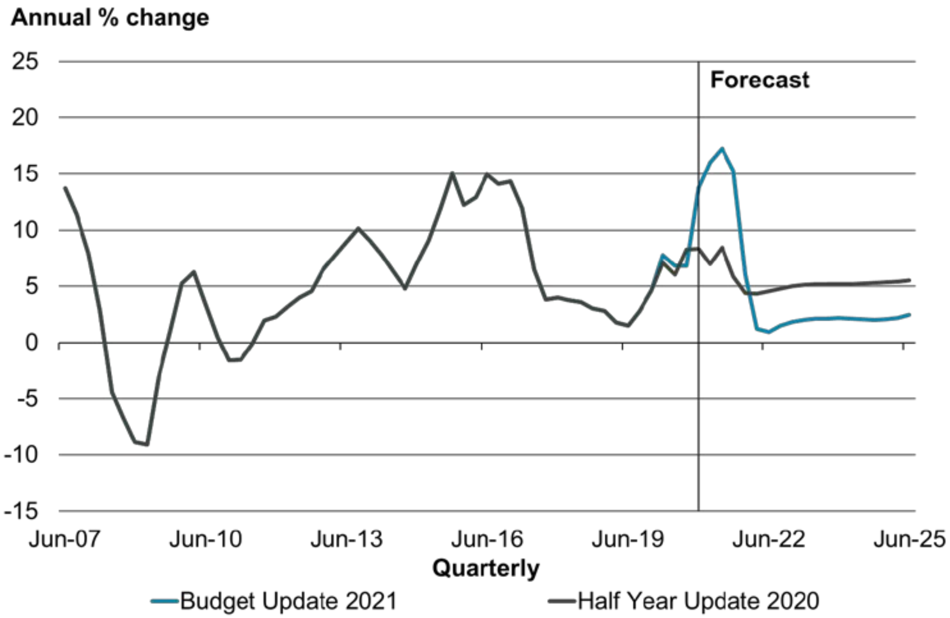
Real investment



House prices

Annual house price growth is expected to peak at 17.3% in the June 2021 quarter, then slow to 0.9% by June 2022 owing to factors such as new Government housing policy measures, lower net migration and a strong pipeline of building consents. As borders reopen, higher population growth and continued low interest rates are expected to gradually increase annual house price growth to 2.5% in 2025.

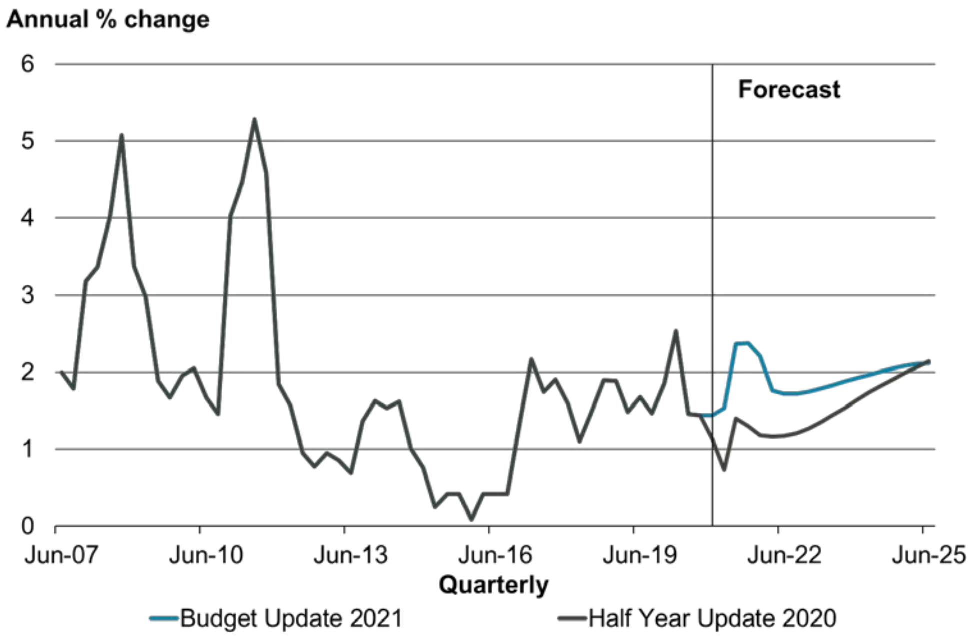
House price growth



Inflation

Strong household spending, supply chain disruptions for businesses and the rising cost of new homes have supported price growth. Annual consumers price index (CPI) inflation is forecast to rise in the near term to 2.4%, before falling below 2% in 2022. Inflation is then expected to rise again from 2023, reaching 2% in early 2024.

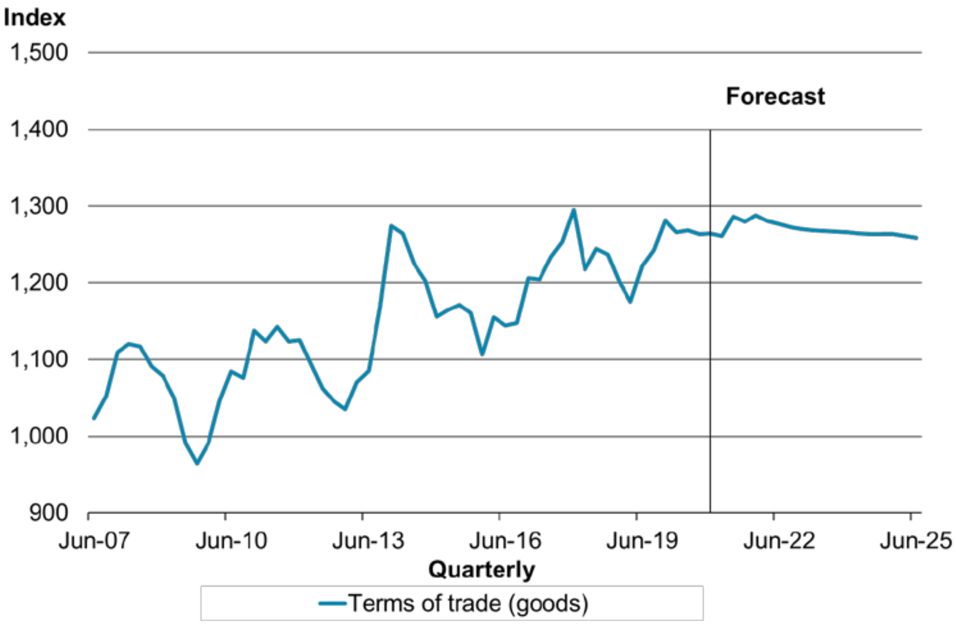
Consumers Price Index



Terms of trade

Most of New Zealand's top trading partners are performing well, which is positive for our terms of trade and the demand for our exports. World prices for dairy, forestry and horticultural products were up between 10% and 25% in April 2021 compared to pre-pandemic levels. Some of the rise in commodity prices is likely to be temporary, driven by disruptions to global supply, and the terms of trade are forecast to ease from 2022 as world trade flows normalise. Goods exports are expected to grow steadily across the forecast period as the world economy recovers.

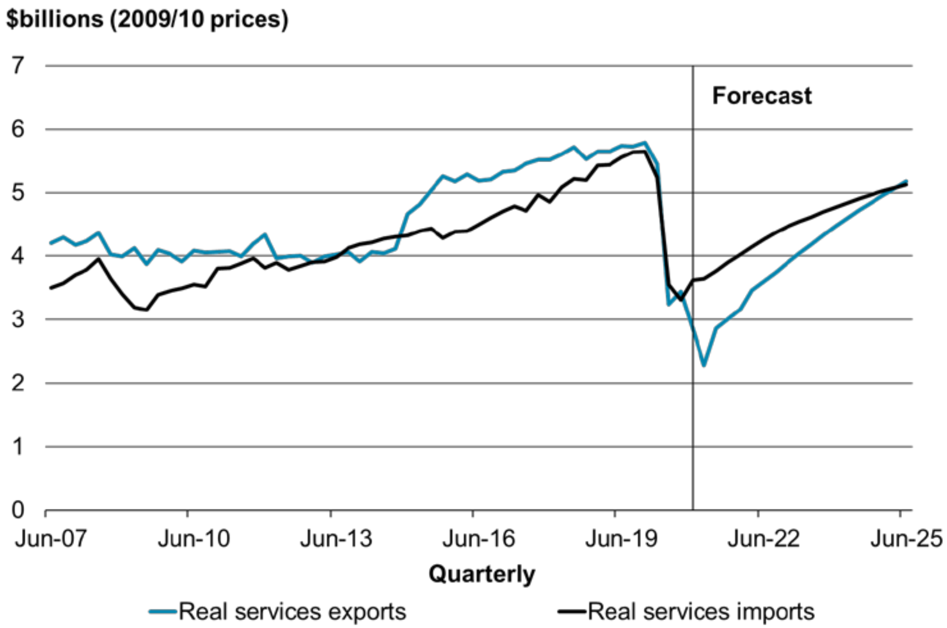
Terms of trade (goods)



Services exports

Success against COVID-19 has allowed a swift economic recovery, but border restrictions still affect parts of the economy. Services exports – usually dominated by tourist spending – fell by 17% in the December 2020 quarter on a seasonally adjusted basis, following a 40% fall in the June 2020 quarter. A further 20% quarterly fall in services exports is forecast in the March 2021 quarter, although followed by a 25% rise in the June 2021 quarter. While we assume more open borders by 2022, it's likely to be longer before unrestricted global travel can resume given differences in vaccination progress worldwide, so the recovery in services exports will be gradual.

Real services exports and imports



Fiscal outlook: indicators

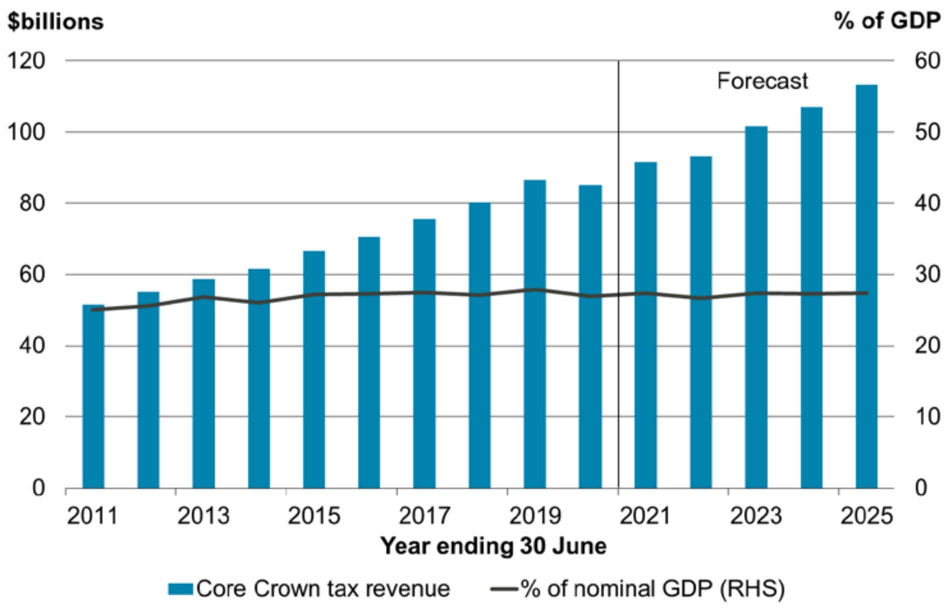
We use some key indicators to tell us what's happening with the Government's revenue and expenditure trends:

- **Core Crown Tax Revenue** is the income the Government receives from taxpayers (eg, income tax, GST, companies tax).
- **Core Crown Expenses** are the day-to-day spending of the Government to provide services to New Zealanders (eg, health and education), as well as to run the agencies that provide those services and interest costs from borrowing money. (It excludes Crown entity and State-owned enterprise expenses.)
- **OBEGAL** stands for operating balance before gains and losses and is what's left after expenses are deducted from revenue. It includes profits/losses from Government controlled entities such as ACC and New Zealand Post, as well as the tax revenue and core Crown expenses discussed above.
- **Net core Crown debt** is what the central Government has borrowed less what it owns (assets) that can be used to pay off debt if required (referred to as financial assets). Examples of financial assets are cash and share investments.

Core Crown tax revenue

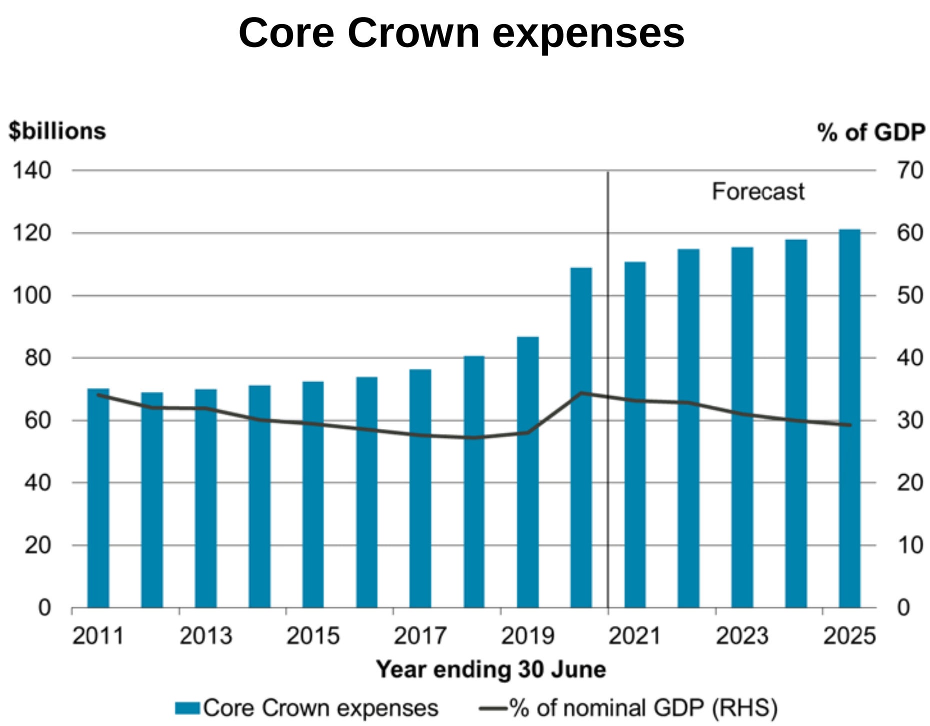
The financial results of the Government have recovered strongly during the 2020/21 fiscal year. Growth in employment, wages, household spending, residential investment and profits have contributed to stronger year-to-date core Crown tax revenue. Across the forecast period, core Crown tax revenue is expected to increase by $21.7 billion, reaching $113.2 billion in 2024/25. As a percentage of nominal GDP, core Crown tax revenue remains relatively stable at around 27%.

Core Crown tax revenue



Core Crown expenses

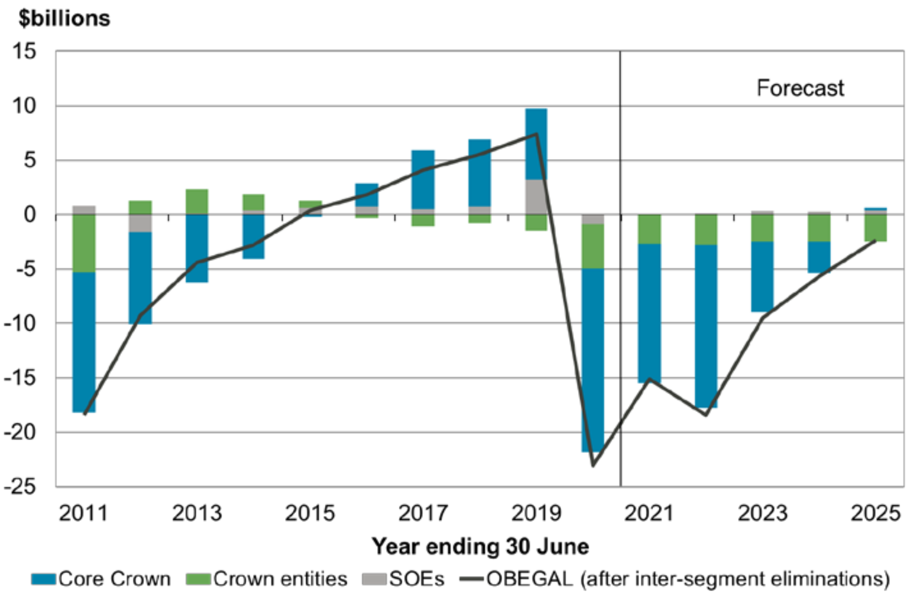
Core Crown expenses in the near term continue to reflect increased spending from the COVID-19 pandemic, for example on Managed Isolation and Quarantine (MIQ) facilities, vaccine purchasing and targeted support for industries. Core Crown expenses also show the spending intentions of the Government reaching $121.1 billion by 2024/25. While core Crown expenses are forecast to increase nominally each year, as a percentage of GDP they decline gradually across the forecast, reaching 29.2% of GDP by 2024/25.



OBEGAL

The operating balance before gains and losses (OBEGAL) is forecast to be in deficit across the forecast period. Strength in the 2020/21 fiscal year results in an initial decrease in the OBEGAL deficit, which is forecast to be $15.1 billion in the current year (a reduction of nearly $8 billion compared to 2019/20). The OBEGAL deficit is then expected to increase between 2020/21 and 2021/22 as growth in core Crown expenditure exceeds the growth in core Crown tax revenue, before reducing to a $2.3 billion OBEGAL deficit forecast by 2024/25.

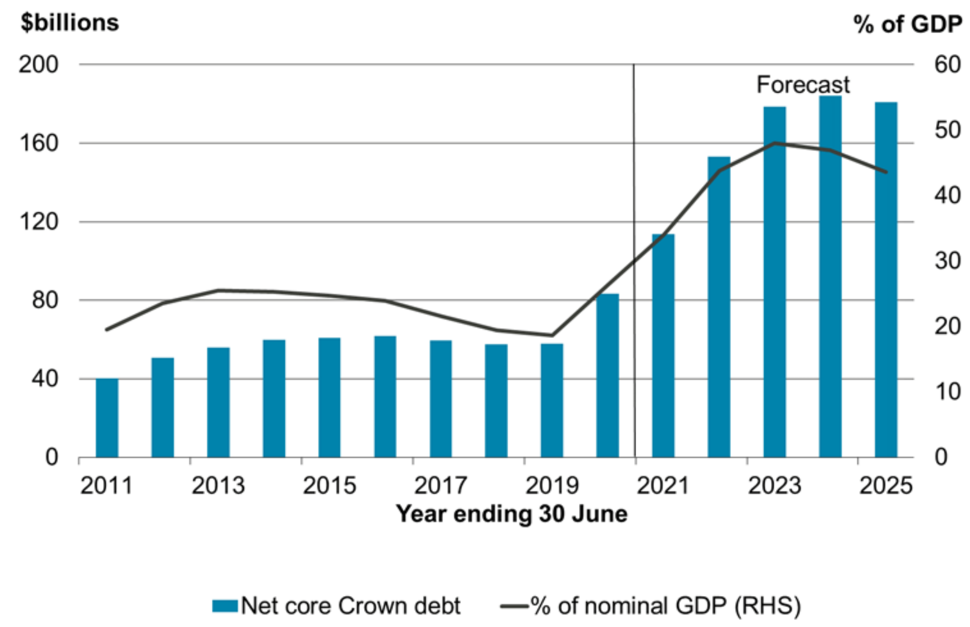
Components of OBEGAL by segment



Net core Crown debt

COVID-19 has also had an impact on Government debt levels, in excess of the impacts of the global financial crisis and Canterbury earthquakes. Net core Crown debt is forecast to increase in nominal terms, peaking at $184.2 billion in 2023/24. However, as a percentage of GDP, net core Crown debt is expected to peak a year earlier at 48.0% of GDP in 2022/23. Across the forecast, both nominally and as a percentage of GDP, net core Crown debt has reduced compared to the 2020 Half Year Update.

Net core Crown debt



2021 BEFU forecast summary

June years	2020 Actual	2021 Forecast	2022 Forecast	2023 Forecast	2024 Forecast	2025 Forecast
Real production GDP (annual average % change)	-1.7	2.9	3.2	4.4	3.3	2.9
Unemployment rate (June quarter)	4.0	5.2	5.0	4.4	4.2	4.2
CPI inflation (annual % change)	1.5	2.4	1.7	1.8	2.0	2.1
Current account (annual, % of GDP)	-1.8	-2.7	-3.4	-3.5	-3.3	-3.1
Fiscal measures ($billions)						
Core Crown tax revenue	85.1	91.5	93.2	101.7	107.1	113.2
Core Crown expenses	108.8	110.7	114.7	115.4	117.8	121.1
Total Crown OBEGAL[1]	-23.1	-15.1	-18.4	-9.5	-5.7	-2.3
Core Crown residual cash	-23.7	-25.3	-39.2	-25.7	-6.0	3.3
Net core Crown debt	83.4	113.7	153.3	178.5	184.2	180.8
as a percentage of GDP	26.3%	34.0%	43.8%	48.0%	46.9%	43.6%
Net worth attributable to the Crown	110.3	112.0	96.6	91.5	90.8	94.0

Note: 1 Operating balance before gains and losses.

Resources

If you want to dig deeper, you can access the different chapters of our full BEFU here:

- Executive Summary
- Economic Outlook
- Fiscal Outlook
- Risks to the Fiscal Forecasts
- Forecast Financial Statements
- Core Crown Expense Tables

There is a glossary explaining some of the terms used.

We publish a lot of useful up-to-date information on the Treasury website, including:

- Weekly Economic Updates
- End-of-month Financial Statements of the Government

You can also keep in touch with the work of the Treasury by:

- signing up to our Te Tai Ōhanga newsletter
- following us on LinkedIn
- following us on Twitter