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Budget Policy Statement

BUDGET
2023

14 December 2022

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FOREWORD

New Zealand's strength and resilience to global forces are about to be tested again by the combination of a global economic downturn, high inflation here and around the world, and a geopolitical situation dominated by war, trade disputes and ongoing supply chain issues. Budget 2023 will continue our commitment to providing Kiwis with economic security through these times.

This requires a fine balance of policy responses. This *Budget Policy Statement* confirms what we set out in the Budget earlier this year: that the Government will carefully manage fiscal policy to take pressure off inflation, and return spending to normal levels following the emergency pandemic response.

At the same time, we need to balance this with preparations to support Kiwis through a shallow 'speed-bump' recession forecast for 2023. As we navigate through this period, our primary focus at the Budget will be on supporting families and households experiencing cost of living pressures.

The Treasury is continuing to forecast the Government will return the books to surplus in 2024/25, marking five years of deficits following the onset of COVID-19, compared to the six years of deficits run by the previous Government after the Global Financial Crisis. In the two years between now and the surplus, deficits are a combined $5.1 billion smaller than forecast back in May.

As a result, real Government consumption is forecast to fall by 8.2 per cent between September 2022 and December 2024. This contraction follows the emergency economic response, with this measure of Government spending set to return to the same level as before COVID-19.

The contraction in our fiscal policy will require tough choices on where to focus the Government's resources. Ministers have been directed to run a reprioritisation process ahead of Budget 2023 to create space for new initiatives within their existing budgets, outside of the cost pressures that will be funded from the $4.5 billion operating allowance, unchanged from Budget 2022.

Over the past six months, more than $3 billion of unused spending mainly set aside for COVID-19 measures has been returned to the central Government accounts. This has created space to fund emerging cost of living priorities like the fuel tax cut and half price public transport, while also keeping a lid on public debt.

We have also been planning ahead for this period while the economy was growing, by setting aside funding to continue investing in priority areas. We have already built into the Budget important contingencies like $1.3 billion for health cost pressures, $0.3 billion for new health initiatives, and $62.7 billion for infrastructure investment over the next five years. A priority for Budget 2023 is to keep supporting key government services like health, education and housing.

New Zealand faces a turbulent economic period with a strong set of economic foundations. A key aspect of this is the six new or upgraded free trade agreements signed since 2017. Despite the worsening global outlook, exports are forecast to bounce 14.3 per cent in the 2022/23 year as tourists return and for growth to average a solid 3.4 per cent a year after that. Budget 2023 will continue investing in our economic plan to create a high-wage, low-emissions economy that provides economic security in good times and bad.

The choices we face at Budget 2023 won't be easy. The Government will continue to use a wellbeing approach to ensure we look after people now, and build a strong foundation for future generations. New Zealand is as well placed as any country to deal with the challenges of 2023, and look towards a strong recovery in the years to come.

HON GRANT ROBERTSON
Minister of Finance

14 December 2022

NEW ZEALAND'S WELLBEING OUTLOOK

The Labour Government is committed to achieving its policy goals using a wellbeing approach. This approach aims to improve New Zealanders' living standards by tackling long-term challenges and ensuring that what matters to New Zealanders drives Government decision-making. It also means looking beyond traditional measures of success, such as gross domestic product (GDP), and towards broader indicators of wellbeing.

The Treasury's **Living Standards Framework** recognises that human capability, the natural environment, social cohesion, and physical and financial capital need to be developed and sustained in order to achieve wellbeing. It should be used as a complementary framework alongside **He Ara Waiora**, which draws on a te ao Māori perspective.

LIVING STANDARDS FRAMEWORK: THE FOUR ASPECTS OF NATIONAL WEALTH

This *Budget Policy Statement* is the first to use the Treasury's updated Living Standards Framework, released in October 2021. The updated framework only uses 'capital' to refer to financial and physical capital, reflecting the fact that human capability, social cohesion, and the natural environment contribute to the wealth of New Zealand beyond their roles as factors of production.

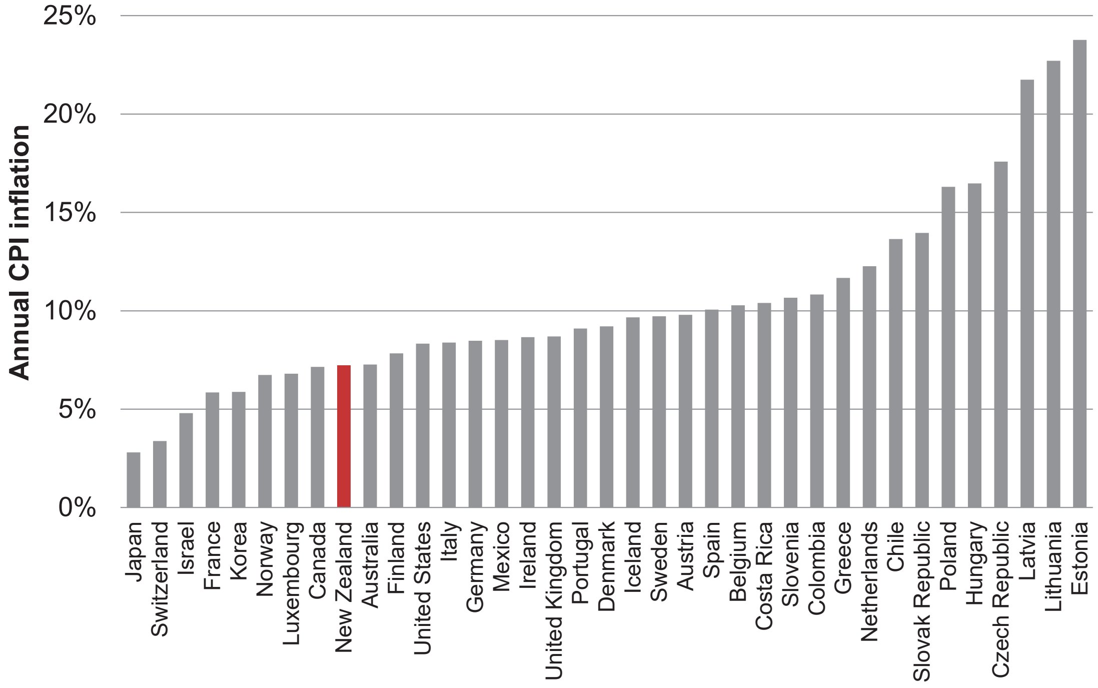
HUMAN CAPABILITY: OUR PEOPLE AND SKILLS

Human capability includes our skills, knowledge, and physical and mental health, which impact on areas like employment, income, housing, and social connections.

Cost of living

Price growth throughout 2022 has been challenging for families and businesses and is set to continue to be a significant issue through 2023. The outlook for New Zealanders' cost of living is being driven by high rates of inflation around the world. New Zealand's inflation rate was the ninth lowest of the 38 Organisation for Economic Co-operation and Development (OECD) countries at the end of the September 2022 quarter (see Figure 1), but it is inevitable that an open trading economy such as ours will be affected by global factors.

Figure 1 – Annual consumer price inflation (OECD countries† – Quarter 3 2022)



Source: OECD († excluding Turkey)

There is no easy fix to this complex and global challenge. Where inflationary shocks have emanated from events such as Russia's invasion of Ukraine and the zero-COVID-19 policies in China, there is little that fiscal or monetary policy in New Zealand can do to respond directly to these effects. But the Government continues to support New Zealanders through this difficult period, with a particular focus on assistance to low- and middle-income New Zealanders who are more affected by the challenges that rising prices cause.

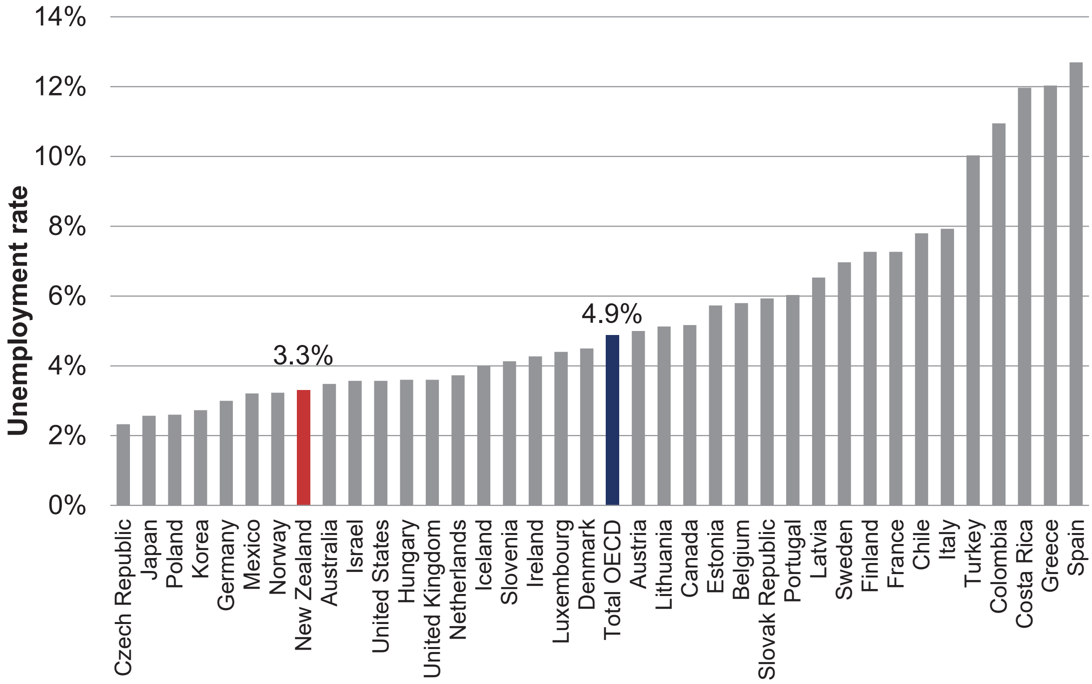
This is why we reduced petrol excise duty by 25 cents per litre and made equivalent changes to Road User Charges, while also halving public transport fares. The Winter Energy Payment helped to support New Zealanders to heat their homes through winter. And the $350 Cost of Living payment made an approximate $27 per week contribution to the weekly expenses of low- and middle-income New Zealanders between August and October this year.

The exposure of parts of the New Zealand economy to volatile global energy markets highlights the need to improve our resilience to unexpected shocks over the longer term. As oil prices rose following Russia's invasion of Ukraine, the areas where we had made less progress towards decarbonisation – such as private transportation and freight – were some of the areas where global disruptions were transmitted most directly through to household expenses. Measures such as the Clean Car Discount and Clean Car Standard, and investments in our public transportation network and the decarbonisation of freight, are all important in helping to lessen our reliance on global fossil fuels and improve our domestic energy and economic security.

Labour market

Employment is a key vehicle for improving individuals' wellbeing, by generating income and bringing meaning and satisfaction to people's lives. New Zealand's unemployment rate of 3.3 per cent remains among the lowest rates in the OECD (see Figure 2).

Figure 2 – Harmonised unemployment rate (OECD countries† – Quarter 3 2022)



Source: OECD († excluding Switzerland)

Unemployment rates for Māori and Pacific peoples remain higher than all-of-population averages. But while Māori and Pacific peoples were disproportionately affected by the initial rise in unemployment caused by the COVID-19 pandemic, employment outcomes for these groups have been a notable strength of New Zealand's economic recovery. The Māori unemployment rate peaked at 9.1 per cent in quarter four of 2020, then fell to 5.5 per cent – the lowest level recorded since at least 2007 – in quarter two of 2022, before rising in the most recent quarter. Post the Global Financial Crisis, Māori unemployment peaked at 14.7 per cent in quarter three of 2012 and remained above 10 per cent until quarter three of 2017.

Similarly, the unemployment rate for Pacific peoples during the COVID-19 pandemic peaked at 10.4 per cent at the beginning of 2021. It fell to 5.4 per cent – the lowest rate since 2007 – in quarter two of 2022, before increasing to 6.4 per cent in the most recent quarter. Post the Global Financial Crisis, the unemployment rate for Pacific peoples peaked at 15 per cent and remained at or above 10 per cent until the end of 2015.

Treasury wellbeing analysis indicates that, after mental health, having an income that's enough to meet everyday needs is one of the factors most strongly associated with New Zealanders' life satisfaction. New Zealanders' average ordinary hourly earnings increased by 7.4 per cent in the year to September 2022, meaning that average earnings rose at a faster rate than inflation, helping families with rising cost pressures. Labour Cost Index data also indicates that, in percentage terms since the beginning of 2018, the salaries and ordinary-time wages of our lowest-skilled workers have increased about 1.7 times faster than those of our most highly skilled workers.

Health

The proportion of 2021/22 New Zealand Health Survey respondents who said they were in good health has slightly improved since last year (88.4 per cent, up from 88 per cent). This is higher than the OECD median of around 70 per cent.

Recent Treasury analysis has found that mental health is the factor most closely associated with life satisfaction. 11.2 per cent of adults reported experiencing high or very high levels of psychological distress in 2021/22, an increase from 9.6 per cent in 2020/21. Psychological distress is most prevalent among 15- to 24-year-olds, with rates of high or very high distress in this group increasing from 5.1 per cent in 2011/12 to 23.6 per cent in 2021/22. Budget 2022 continued the Government’s work to improve mental wellbeing services, including by expanding the Mana Ake mental health support for primary- and intermediate-school-aged children.

The proportion of Māori who report being in good health (81.3 per cent) is lower than that for Asian and European populations. This is reflected in lower life expectancy and higher-than-average deaths from cancer and cardiovascular disease among Māori. The Government’s response in Budget 2022 included a $168 million investment (across four years) in establishing Te Aka Whai Ora – the Māori Health Authority, which will fund health services that best suit Māori and the services they are asking for.

New Zealand’s COVID-19 vaccination and booster uptake, and the automatic access to COVID-19 antivirals for all New Zealanders aged over 65 (and Māori and Pacific peoples aged over 50), continue to help mitigate the impacts of the pandemic on our wellbeing. New Zealand’s rate of COVID-19 deaths per capita remains very low relative to other OECD countries.

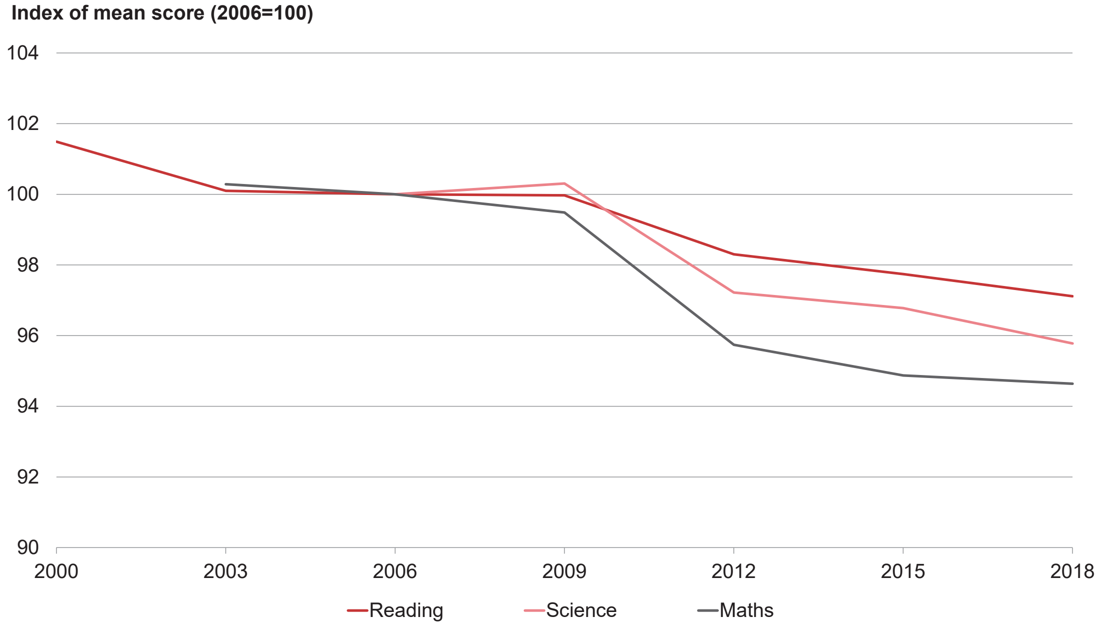
Education

Developing knowledge and skills is foundational to New Zealanders’ wellbeing, including our participation in the labour market, our health, and our willingness to trust each other.

Access to skills and training opportunities for adult New Zealanders is important for growing intergenerational prosperity. New Zealand adults’ literacy and problem-solving skills are among the best in the OECD. And the proportion of adults aged 25–64 with tertiary education qualifications has increased from 54 per cent in 2001 to 64 per cent in 2020, driven entirely by a more-than-doubling of those with bachelor’s degrees during the past two decades (up to 36 per cent in 2021).

The reading, mathematics, and science skills of 15-year-old New Zealanders sit at around the OECD average. But we have seen a decline in the educational performance of our young people on some key international measures for at least the past decade (see Figure 3). National Certificate of Educational Achievement (NCEA) data presents a slightly different picture, with a general upward, albeit non-linear, trend over the past decade. Data shows slightly lower rates of NCEA attainment in 2021 than in 2020, although attainment rates for NCEA levels 1, 2, and 3 – and University Entrance – remain similar to, or higher than, those in 2019 before the pandemic. The Government has action plans to facilitate changes in the way literacy and numeracy are taught in New Zealand. These include giving more support to teachers, ensuring these subjects are taught consistently across schools, and taking an inclusive approach that values students’ cultural, linguistic, and neuro diversity.

Figure 3 – OECD Programme for International Student Assessment (PISA) New Zealand scores



Source: Stats NZ

School attendance is a key measure of student engagement and wellbeing. Attendance is strongly linked with student attainment, and research shows that every day of attendance matters. School attendance in New Zealand has been gradually declining for both primary- and secondary-age students since 2015. The COVID-19 pandemic has affected how attendance data has to be viewed, due to isolation requirements.

Data shows that 59.7 per cent of students attended school regularly (9 in 10 days) in 2021 and 7.7 per cent of students were chronically absent (attending seven or fewer days in every 10). This decline in attendance continued in Term One and Term Two of the 2022 school year. As New Zealand experienced the Omicron wave and higher levels of typical winter illness, approximately three quarters of the growth in school absences between Term Two 2021 and Term Two 2022 was attributable to illness or other reasons that fell within school policies. Only 3.2 per cent of all term time in Term Two 2022 was attributable to absences where no explanation or a trivial reason was provided. This was a 0.6 percentage point increase from the figure one year prior.

The Government has a clear focus on improving attendance and has set targets to lift regular attendance rates to 70 per cent by 2024 and 75 per cent in 2026. Our plan to lift attendance will support local solutions crafted by those who know their school communities best, and is backed by Budget 2022 funding to iwi, schools, councils, and community groups.

The Government set out our objectives for early childhood education – another vital part of our education system – in *He Taonga Te Tamaiti/Every Child a Taonga: Early Learning Action Plan 2019-29*. The Ministry of Education's most recent report back on the action plan showed good progress in some areas. For example, work to grow the early childhood education workforce is progressing well, with the number of qualified and unqualified teaching staff increasing by 6 per cent and 14 per cent respectively in 2021. The number of three- and four-year-olds attending early learning centres for 10+ hours a week did, however, fall by 6 and 8 percentage points respectively (to 68 per cent and 76 per cent) between 2020 and 2021. The Government's recently announced changes to income thresholds for subsidised childcare assistance will mean more than 10,000 additional children are eligible for support, including nearly every child in a sole parent household. Changes to the thresholds for support will also increase the size of the subsidy for many families already eligible for assistance.

NATURAL ENVIRONMENT

The natural environment supports life and human activity. It has significant impacts on life satisfaction outcomes and serves as a catalyst for other variables relevant to wellbeing, like health outcomes and social connections.

Climate change

The Government is very concerned about the impacts of recent extreme weather events on New Zealanders' wellbeing. Scientists are clear that the severity and frequency of these events are being exacerbated by climate change. New Zealand's first ever National Adaptation Plan, announced in August 2022, outlines the Government's strategy to manage the risks to lives, livelihoods, homes, businesses, and infrastructure caused by the changing climate. It also sets out the actions the Government will take in the next six years to improve New Zealand's climate resilience. The strategy outlines a joined-up approach that combines support for community-led adaptation with national policies and legislation. This plan is closely linked to the Government's ongoing resource management reforms. The eligibility criteria for the Climate Emergency Response Fund has also been extended for Budget 2023 to include climate change adaptation.

Alongside adapting to the physical effects of already-occurring changes in our climate, the Government's work to implement our first Emissions Reduction Plan continues. The plan covers climate action over the next 15 years and will be succeeded by regular plans, with the next Emissions Reduction Plan to be published by the end of 2024. Over time these plans will guide our path to reducing New Zealand's greenhouse emissions to net zero by 2050, as required by the Zero Carbon Act. Facilitating a fair and equitable transition to our low-carbon future, which leaves no community, family, or person behind, is central to this effort.

Environmental quality

Recently published analysis by the Ministry for the Environment and Stats NZ found that the quality of New Zealand's environment is improving in some areas but continues to reduce across several domains. Pressures from land-use change and intensification, pollution, invasive species, and climate change are all having detrimental impacts on our environment.

The quality of New Zealand's air is high by international standards and is slowly improving in most areas. But New Zealand still exceeds the World Health Organization guidelines for most air pollutants at least some of the time. A 20-year trend analysis has shown our river water quality is improving at some sites and declining at others (particularly those where land has been transformed by human activity), and we continue to experience the loss of our wetland ecosystems. Native forest cover has remained reasonably static overall in recent years, but habitat destruction and the introduction of predators have reduced the populations of many unique birds, reptiles, and plants.

The Government has work underway across water, climate, biodiversity, and other domains to improve environmental quality. This includes:

- **reforming the resource management system to make it faster, cheaper, and better:** these reforms are intended to enhance protections for our natural environment, better enable development within environmental limits, and reduce costs and delays within our resource management system
- **the Plastics Innovation Fund:** the Government's $50 million Plastics Innovation Fund is supporting projects that will cut plastic waste and reduce its impact on the environment. The recently announced first round of investment will support innovative projects to recycle plumbing pipes, develop biodegradable nursery pots, and turn waste polystyrene into building products
- **Jobs for Nature:** this $1.2 billion programme has funded more than 421 projects and created more than 9,000 environment-oriented jobs
- **rural land use advisory services:** the Government has invested more than $125 million (over four years) in expanding and strengthening the network of support for rural land users. This initiative supports the adoption of more sustainable land-use practices to deliver better environmental and productivity outcomes
- **the Clean Car Discount:** the Government's scheme to help accelerate the decarbonisation of New Zealand's vehicle fleet has been a success, with more than 57,000 light-electric and non-plug-in hybrid vehicles registered in the scheme's first year of operation. This is the most on record.

SOCIAL COHESION: OUR CONNECTIONS

Social cohesion includes the social connections, attitudes, norms, and institutions that contribute to societal wellbeing, for instance through giving us a sense of belonging.

Life satisfaction and social connections

On a scale of 0 (not at all satisfied) to 10 (completely satisfied), the average New Zealand adult rates their life satisfaction at 7.7 out of 10. This is higher than the OECD median, and has remained largely unchanged since 2014.

New Zealanders generally have strong relationships with friends and family. The proportion of New Zealanders who report having someone they can count on in times of trouble is in the top quartile of OECD countries.

Annual surveys conducted by the Institute for Governance and Policy Studies have found that the proportion of New Zealanders who trust the government to do what is right for New Zealand increased from less than 50 per cent in 2016 to a peak of nearly 75 per cent in 2021. At about 60 per cent in 2022, it remains at a similar level to that immediately before the COVID-19 pandemic. The survey also showed a growing polarisation regarding trust in government between 2020 and 2022, with an increasing number of people having either very low or very high levels of trust, and a roughly corresponding decrease in those with moderate levels of trust or distrust.

Community and individual support

Disabled people and sole parents experience lower average levels of wellbeing across several domains, including incomes and rates of home ownership. Unemployed people also report higher rates of loneliness and lower average levels of life satisfaction. The Government continues to work to lift the wellbeing of all three of these groups.

The establishment of Whaikaha – the Ministry of Disabled People will help to deliver transformational change for the approximately 1.1 million disabled people who live in New Zealand. And the ongoing implementation of the Enabling Good Lives approach to disability support services across the country will continue to give disabled people more choices about how to live good lives.

As our recovery from the COVID-19 pandemic continues, the Government is maintaining its support for low-income individuals and communities. Our improved support for families and whānau has helped to bring 21,900 children out of material hardship since 2017. Changes to the Working for Families scheme and associated supports made in Budget 2022 will make 346,000 families better off by an average of $20 a week. An additional $166.5 million of funding (over four years) announced in Budget 2022 has secured the future of Whānau Ora, which will continue to support vulnerable whānau and communities. The Government has also lifted the income limits for hardship assistance eligibility, and increased support to beneficiaries and low-income families for immediate and essential dental treatment.

Getting New Zealanders into employment remains our priority, with 13,122 fewer work-ready people on Jobseeker support in September 2022 than a year ago.

Safety

Recent events around retail crime and youth offending in particular communities around New Zealand have led to greater national attention on issues of public safety. Overall rates of youth crime are much lower than in the past; however, some communities have seen an increased frequency of offending in categories such as ram raids. The Government has taken a range of steps to support communities that have been the victims of these offences and for which public safety is an increasing concern.

Surveys by the Ministry of Justice and Stats NZ between 2018 and 2021 found that New Zealanders' overall feelings of safety and concerns about crime were relatively stable during that time. In the most recent New Zealand Crime and Victims Survey, 29 per cent of adults reported that they had been victims of crime during the year to November 2021. This figure was largely unchanged from previous years. People who were young (aged 15–29), unemployed and not seeking work, or living in accommodation provided by central or local government all reported comparatively higher rates of victimisation.

About 2 per cent of New Zealanders reported experiencing sexual assault in the 12 months to November 2021, but this figure was much higher among people with diverse sexualities (11 per cent) and females aged 15–19 (9 per cent) and 20–29 (7 per cent). The number of young people (aged 0–19) who reported acts intended to cause injury to the police increased by 14 per cent in the year to June 2021.

The Government has invested heavily in improving the safety of New Zealanders, with the Justice Cluster announced at Budget 2022 enabling more effective, long-term investment in our justice system. This and other recent investments include:

- **growing our police:** nearly 1,800 new officers (above attrition) have joined the police since 2017. The diversity of the police is also increasing at record levels, with females now comprising a quarter of our police service. This enables our officers to better represent the communities in which they serve
- **new police powers to seize criminal assets:** in September 2022 the Government introduced legislative changes to make it harder for criminals to organise their affairs to avoid assets being seized
- **the Better Pathways package:** the Government is supporting work within communities to place more young people into education, training, and/or work, to drive down youth crime by creating more opportunities for young people to earn and learn
- **preventing and responding to family and sexual violence:** the Government is on track to deliver all 40 actions in the first action plan for *Te Aorerekura: National Strategy to Eliminate Family Violence and Sexual Violence*
- **tackling retail crime:** the Government has announced a multi-million dollar package to tackle retail crime and offending, including providing $4,000 to all small shops and dairies that want a fog cannon installed, and expanding access to the Retail Crime Prevention fund.

FINANCIAL AND PHYSICAL CAPITAL: OUR BUILT AND FINANCIAL ASSETS

Financial and physical capital refers to our human-made assets (eg, infrastructure), knowledge-based assets (eg, research and development), and financial assets.

Firms and supply chains

New Zealand's goods exports continue to grow and were nearly $7 billion (11.5 per cent) higher in the year to June 2022 than in the year prior. The value of services exports remained approximately $12 billion less in the year to June 2022 than in the equivalent period pre-pandemic. While China's borders remain closed, the partial resumption of global travel has improved the outlook for our tourism and international education sectors.

International sea freight delays and congestion, and high shipping prices, appear to be gradually easing, but both remain well above pre-pandemic levels. International air connectivity is also improving. The Government continues to support New Zealand's freight connectivity and remove bottlenecks in businesses' supply chains. This work includes extending critical government support to the aviation sector until March 2023 and making long-term investments to enhance coastal shipping.

Workforce shortages remain an ongoing, global symptom of the economic recovery from the COVID-19 pandemic. Online job advertising grew by 9.5 per cent in the year to September 2022. The Government has responded to the concerns of businesses by making changes to our immigration settings to ease workforce pressures in the most affected sectors. We also remain committed to developing our locally trained workforce, including via ongoing investments in apprenticeships and the Mana in Mahi programme.

The Government continues to work to build a flexible and supportive business environment that promotes quality investment – a core part of our economic plan. Levels of real business investment have proven resilient to rising interest rates, and remain high. The Government's work to lift New Zealand's research and development performance – another part of the economic plan – is also progressing well, with businesses' research and development expenditure as a proportion of GDP increasing from 0.79 per cent in 2019 to 0.87 per cent in 2021.

Provisional results from the Stats NZ Annual Enterprise Survey found that pre-income tax surpluses among surveyed businesses rose by $24.5 billion (31 per cent) between the 2020 and 2021 financial years. This increase was highest in the financial and insurance services (up $10.6 billion), rental, hiring and real estate services (up $3.7 billion), and construction (up $1.7 billion) industries.

Financial markets

Financial markets are vital to New Zealand's economy and wellbeing. Global financial markets have been increasingly volatile, and there is uncertainty about the extent to which economic activity will slow in response to higher interest rates. While there are increasing risks to the global and New Zealand economic outlook, our financial system remains resilient and is well positioned to support the economy in the face of these challenges. New Zealand's banks have strong capital and liquidity positions, and our insurance market remains resilient overall.

Prices have fallen across a broad range of financial assets in recent months. Consistent with this global trend, the NZX 50 has fallen from its record highs in early 2021. Households have been resilient to rising interest rates and falling house prices, with vulnerabilities concentrated in borrowers who took out loans in late 2020 and in 2021. However, rising mortgage rates will dampen consumption, as households with mortgages have less to spend on discretionary spending.

Housing

Levels of residential investment have recovered well from the pandemic and remain high. Despite higher costs for construction materials and labour, more than 50,000 homes were consented in the year to September 2022. This represented an increase of 7 per cent from the year prior. House prices are declining in the rising interest rate environment. The Real Estate Institute of New Zealand House Price Index indicates that housing market values nationwide dropped 10.9 per cent in the year to October 2022. This included a 14.4 per cent decrease in Auckland. Housing affordability remains a key challenge to New Zealanders' wellbeing and the Government is committed to improving it, particularly for first-home buyers. Our changes to the house price caps for First Home Grants, the launch of a fund to secure affordable housing in developments that would not otherwise go ahead, and making certain types of build-to-rent developments exempt from the interest limitation rules enacted in March 2022 are all core parts of this work.

On average, renters rate their housing affordability lower than homeowners do. Prices for newly advertised rentals increased by 1.5 per cent in the year to October 2022. The Government remains committed to providing a safety net for people who need public housing. While 10,688 homes have been added to the public housing stock since June 2017 (including more than 8,844 new builds), we know there is more work to do to ensure that all families have safe, healthy, and affordable homes with secure tenure.

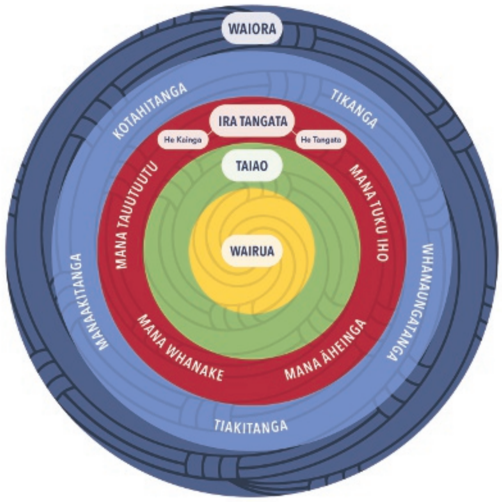
Infrastructure

Te Waihanga – the Infrastructure Commission assesses that New Zealand has a public infrastructure deficit of approximately $104 billion. The Government is committed to addressing this shortfall and will invest a further $62.7 billion in infrastructure (in health, transport, housing, and education in particular) in the next five years. New spending is not the Government's only lever to address our infrastructure needs. We are also strengthening the infrastructure system to more effectively deliver what is needed to support the Government's economic plan and respond to changes in our population size and demographics. Key planks of this work include our resource management reforms and setting up the new Three Waters system.

Te Waihanga analysis also found that the size of the construction workforce needs to increase by about 140 per cent in the next 30 years. The Government is using its available levers to help achieve this increase. They include requiring government agencies to consider how they can create quality construction jobs when procuring goods and services, working in partnership with industry (via the Construction Sector Accord) to boost the skills and diversity of our construction labour force, and making changes to our immigration system to smooth the path for highly skilled migrants to take up positions in our construction and engineering sectors.

HE ARA WAIORA: TE TAIAO AND TE IRA TANGATA

He Ara Waiora is a tikanga-based framework for considering waiora (wellbeing), developed by Ngā Pūkenga (an expert group of Māori thought leaders) with the support of the Treasury. He Ara Waiora takes a te ao Māori and uniquely New Zealand approach to assessing wellbeing.



He Ara Waiora demonstrates the interrelationship of the elements of waiora, as depicted by the takarangi (connecting spiral pattern) that is overlaid on the framework. The 'means' (kotahitanga, tikanga, whanaungatanga, manaakitanga, tiakitanga) are the tikanga values or principles that help us to achieve the 'ends' of wairua (spirit), Te Taiao (the natural world – the environment), and Te Ira Tangata (the human domain).

While the principles in He Ara Waiora are derived from mātauranga Māori, the framework is relevant to lifting the intergenerational wellbeing of all New Zealanders. The Government is committed to embedding He Ara Waiora in our decision making, including for Budget 2023.

TE TAIAO

Te Taiao (the natural world) is at the centre of He Ara Waiora, reflecting the environment's centrality to a te ao Māori perspective on wellbeing. The natural world's value runs deeper than the benefits that humans yield from it. But the proximity of Te Taiao and Te Ira Tangata in He Ara Waiora also illustrates the importance of the natural world to human wellbeing.

Biodiversity is a key indicator of Te Taiao. Invasive species (eg, stoats, possums, and rats) are a threat to native plants and animals, and are responsible for most of the estimated 26.6 million native bird egg and chick losses every year. This lost link to Tupuārangi (plants and animals, including birds) diminishes our connection to the environments in which we live, as well as our sense of identity and mana. The *Aotearoa New Zealand Biodiversity Strategy 2020* sets out the Government's plan to meet these challenges.

Climate change also poses a major threat to Te Taiao. Sea level rise, a warmer climate, and more frequent extreme weather events present serious threats to our natural world. The Government's platform for Māori Climate Action will make it easier for Māori communities to engage with the Government's mitigation and adaptation work and contribute a tikanga-based perspective.

TE IRA TANGATA

Mana tuku iho

Mana deriving from a strong base of identity and belonging.

Mana tuku iho encompasses a sense of identity and belonging to community. It is foundational to waiora (wellbeing). The 2021 Stats NZ General Social Survey found that 80 per cent of New Zealanders found it easy or very easy to express their identities. But the proportion of respondents who found it easy was lower among several groups, including recent migrants (62 per cent) and people of Asian (63 per cent), Pacific (75 per cent), and Māori (77 percent) ethnicity.

A sense of cultural belonging is another key part of mana tuku iho. The use of te reo is central to this belonging for Māori. *Maihi Māori* – the Māori language strategy developed by and for iwi and Māori – supports the use of te reo as a first language. The proportion of Māori who reported speaking te reo as one of their first languages rose from approximately 17 per cent in 2018 to nearly 23 per cent in 2021.

Mana tauutuutu

Mana found in knowing and fulfilling one's rights and responsibilities to the community, and in the participation and connectedness of an individual in their community.

Mana tauutuutu is a considerable community asset in both times of plenty and times that require resilience. Community cohesion and strength have been vital to New Zealand's response to the COVID-19 pandemic, with iwi and community organisations providing manaakitanga for those most in need.

Trust in other people and institutions is central to mana tauutuutu. In the 2021 Stats NZ General Social Survey, people rated their trust in most New Zealanders at an average of 6.7 on a scale of 0 (no trust at all) to 10 (complete trust). This response was similar to that received to an identical question asked in 2018. However, these results were not distributed evenly across the population, with 15- to 24-year-olds and Māori and Pacific peoples reporting lower average levels of trust in others.

Mana āheinga

Mana in the individual's and the community's capability to decide on their aspirations and realise them in the context of their unique circumstances.

Access to high-quality healthcare is a vital plank of mana āheinga, as it provides a foundation for people to realise their aspirations. In the 2021/22 New Zealand Health Survey, the proportions of New Zealanders who reported being unable to access general practice (GP) services due to cost or wait times being too long were 10.7 per cent and 11.5 per cent respectively. The Government's Budget 2022 $102 million funding boost for community healthcare providers and $86 million funding increase (over four years) for GPs in high-need areas will improve this access.

Income adequacy is another indicator of mana āheinga, as it provides a foundation for growing other aspects of wellbeing. The proportion of New Zealanders who report not having enough money to meet their everyday needs has nearly halved in roughly the past decade, from 16.6 per cent in 2010 to 8.8 per cent in 2021. These rates are higher for disabled people (12.0 per cent), 15- to 24-year-olds (11.6 per cent), sole parents (17.5 per cent), and people of Māori (15.6 per cent) and Pacific (21.4 per cent) ethnicity.

Mana whanake

Mana in the form of the power to grow sustainable, intergenerational prosperity.

Ensuring that our rangatahi have access to a high-quality education is central to mana whanake. It underpins our strategy to lift regular school attendance and literacy and numeracy skills across Aotearoa New Zealand, as well as recently announced changes to ensure that children with the highest needs have those needs met.

The success of the Māori economy is an important lever for enhancing the mana whanake of Māori communities in particular. Te Puni Kōkiri research indicates that Māori-owned business – particularly those with wāhine Māori shareholders – employ more Māori than non-Māori businesses do. And while growth in the number of Māori-owned businesses has been slower in the past decade than it has been for non-Māori-owned business (11 per cent versus 18 per cent in the same 10-year period), there are signs that the pace of growth in the Māori economy has accelerated in recent years.

WELLBEING OBJECTIVES

The Public Finance Act 1989 requires the Government to set wellbeing objectives through the Budget Policy Statement and explain how they are intended to support long-term wellbeing.

Our wellbeing objectives for Budget 2023 are:

1. **Just Transition:** supporting New Zealanders to transition to a climate-resilient, sustainable, and low-emissions economy.
2. **Physical and Mental Wellbeing:** supporting improved health outcomes for all New Zealanders, particularly the mental wellbeing of our young people.
3. **Future of Work:** equipping New Zealanders and enabling New Zealand businesses to benefit from new technologies, and lift productivity and wages through innovation.
4. **Māori and Pacific Peoples:** lifting Māori and Pacific peoples' incomes, skills, and opportunities, including through access to affordable, safe, and stable housing.
5. **Child Wellbeing:** reducing child poverty and improving child wellbeing, including through access to affordable, safe, and stable housing.

Reflecting the intergenerational nature of many of the challenges to New Zealanders' wellbeing, these objectives are intended to be relatively enduring. The Budget 2023 objectives continue to focus on broad areas where there are the best opportunities to improve New Zealanders' wellbeing, as outlined in the first Wellbeing Budget in 2019. They are informed by extensive wellbeing analysis, and also incorporate advice from sector experts and the Government's Chief Science Advisors.

In its recently published Wellbeing report (*Te Tai Waiora: Wellbeing in Aotearoa New Zealand 2022*), the Treasury identified areas important for improving New Zealand's wellbeing that are broadly consistent with past budgets' wellbeing objectives. These include safe and affordable housing and Māori and Pacific skills and opportunities. We have made slight revisions to the objectives for Budget 2023 to reflect an increased emphasis on improving our young peoples' foundational literacy and numeracy skills, educational experience, and mental health outcomes (see next section).

How the wellbeing objectives are intended to support long-term wellbeing in New Zealand

1 Just Transition – supporting New Zealanders to transition to a climate-resilient, sustainable, and low-emissions economy

Our wellbeing objective to achieve a just transition means we will actively support households and businesses through major structural changes in our economy. In particular, we will move away from fossil fuels towards a low-carbon, circular economy in a way that supports workers, businesses, and communities to make changes to how they live and work. This protects the long-term wellbeing of New Zealanders.

Achieving a just transition protects our natural environment and enhances Te Taiao, while increasing financial capital through new economic opportunities. It also enhances social cohesion by ensuring the transition is fair, and ensures the pace of change protects and grows human capability and mana whanake.

2 Physical and Mental Wellbeing – supporting improved health outcomes for all New Zealanders, particularly the mental wellbeing of our young people

Good physical and mental health, and timely access to care and support when they are needed, are fundamental to the long-term wellbeing of all New Zealanders. Those who suffer from poor health find it difficult to build their own skills so that they can achieve in the workforce and engage in society.

Rates of psychological distress among New Zealanders – particularly young people – have been increasing in the past decade, and poor mental health is the factor most strongly associated with below-average life satisfaction. Poor physical and mental health undermines both our human capability and social cohesion. It also has run-on effects for financial capital, as investing in a healthier population now reduces health costs in the future.

3 Future of Work – equipping New Zealanders and enabling New Zealand businesses to benefit from new technologies, and lift productivity and wages through innovation

Innovation enables the creation of new industries and decent jobs, which in turn helps to improve productivity, lift wages, and meet society's needs in new ways.

Improving the foundational literacy and numeracy skills and educational experiences of all young people, and ensuring access to high-quality training and work opportunities, are central to New Zealanders' long-term wellbeing. They are key to enabling New Zealanders to be resilient to the societal changes that new technologies will bring, and benefit from the changing nature of work. Investing in our technology infrastructure, advancing our sustainable and inclusive trade agenda, and lifting the digital and critical thinking skills of New Zealanders are similarly important.

Our work towards this objective will improve the ability of the labour force to meet changing requirements and increase the capacity of firms to engage with dynamic markets. Adapting to the future of work boosts New Zealand's human capability and in turn improves resilience and lifts incomes, building our financial and physical capital for the long term.

4 Māori and Pacific Peoples – lifting Māori and Pacific peoples' incomes, skills, and opportunities, including through access to affordable, safe, and stable housing

Māori and Pacific peoples have a high sense of belonging to New Zealand, but experience lower levels of wellbeing across several measures, including income and housing. Investing to lift incomes, skills, and opportunities for Māori and Pacific peoples will accordingly have significant impacts on enhancing their wellbeing over time, particularly given the younger age structure of these populations.

For example, the proportion of Māori and Pacific peoples who report living in homes that are always or often cold and damp is higher than for European and Asian New Zealanders. These living conditions adversely affect the wellbeing of Māori and Pacific peoples across several domains, including labour market participation, health, educational outcomes, and cultural wellbeing (including a sense of tikanga and turangawaewae).

5 Child Wellbeing – reducing child poverty and improving child wellbeing, including through access to affordable, safe, and stable housing

The experiences we have as children lay the foundations for healthy development and positive wellbeing throughout our lives. Good material standards of living (including access to warm and dry housing) provide children with a good start in life, and this been shown to contribute to lasting wellbeing outcomes in areas like health, housing, and education.

Investing in a good start in life for our children is one of the most important ways we can ensure the wellbeing of New Zealanders for the long term. It will strengthen our social cohesion and human capability, leading to better economic and financial capital outcomes.

FOCUS AREAS FOR BUDGET 2023

This will be our fifth Wellbeing Budget. The wellbeing approach is designed to drive investments to improve New Zealanders' living standards by tackling long-term challenges as well as addressing the pressures immediately in front of us.

The Public Finance Act 1989 requires the Government to outline the overarching goals that will guide its Budget decision-making, and the policy areas it will focus on in the relevant year. These goals and focus areas will support the Government in making the choices and trade-offs required to produce a Budget that achieves our wellbeing objectives.

Overarching goals

The overarching goals set for the parliamentary term are:

1 continuing to keep New Zealand safe from COVID-19

2 accelerating the recovery and rebuild from the impacts of COVID-19, and

3 laying the foundations for the future, including addressing key issues such as our climate change response, housing affordability, and child poverty.

The Government's economic plan is for New Zealand to become a high-wage, low-emissions economy that provides economic security in good times and bad. As we shift away from the COVID-19 emergency response, the Government has become primarily focused on creating a high-wage, low-emissions economy, helping New Zealanders to face the global cost of living spike, and consolidating our fiscal position.

Our plan recognises that the global economy is in a period of structural and geopolitical change, with the impacts of climate change being increasingly felt. There are risks to New Zealand from inaction in this context, but also major opportunities for New Zealand's people and businesses to build a high-wage, low-emissions economy.

To lay the groundwork for New Zealand to seize these opportunities, our economic plan identifies five broad areas of effort:

- **unleashing business potential** to facilitate innovation and deliver the productivity gains required to build a high-wage, low-emissions economy
- **strengthening international connections** to enhance our flows of knowledge, capital, and skills with the world and build on our existing and emerging sectoral strengths
- **increasing capabilities and opportunities** by delivering quality education, training, and upskilling in partnership with businesses and communities
- **supporting Māori and Pacific aspirations** to leverage their unique strengths and potential through inclusive, mana-enhancing partnerships that, in the case of Māori, honour the Treaty, and
- **laying strong foundations** that support public and private investment in quality, future-focused infrastructure and institutions.

Budget 2023 will continue the Government's progress on the implementation of the economic plan across these five areas.

Budget 2023 decisions will also be guided by the Government's ***Child and Youth Wellbeing Strategy***, continuing our work to make New Zealand the best place in the world to be a child. There is no silver bullet to fix the long-term disadvantages faced by many children. But our decisions at Budget 2023 will be guided by our ambition to reduce child poverty, address family and sexual violence, and improve education outcomes and housing quality – all key determinants of child wellbeing.

Policy areas of focus

Budget 2023 will be put together in a challenging global economic environment. In the past few years, the New Zealand economy has endured a significant number of shocks. The economy is now being buffeted by global supply shocks, geopolitical tensions, and a global skills shortage. At the same time, sectors like tourism and international education continue to be affected by global disruption, while employment in other sectors such as construction has grown considerably.

Fiscal policy through Budget 2023 will continue to be contractionary, meaning that government spending will be constrained so as to not unnecessarily add to demand in the economy. The Reserve Bank has tightened the Official Cash Rate considerably since late 2021, and the current economic conditions require fiscal policy to work in concert with monetary policy, rather than pushing in the opposite direction.

The mix and phasing of spending require a careful balance in order to ensure that the Government continues to deal with the issues that are important to New Zealanders and supports them with the cost of living. Our focus will be on supporting families experiencing cost of living pressures while continuing to position New Zealand to seize the advantages of a low-emissions economy.

Budget 2023 will accordingly require difficult trade-offs. The Government will be closely examining existing spending to identify opportunities to reprioritise spending towards higher-value initiatives. This is in line with the Government's fiscal management approach throughout our term. Over the past six months, more than $3 billion of unused spending – mainly from COVID-19 measures – has been returned, including $1.6 billion in October 2022. This has created space to fund emerging priorities like the fuel tax cut and half price public transport, while also keeping a lid on our low levels of public debt.

The Government has identified four policy areas of focus for Budget 2023:

1 Supporting Kiwi families and households with cost of living pressures

Higher prices for food, fuel, and other necessities, as well as higher mortgage repayments, will affect New Zealand families into 2023. It is clear that low- and middle-income households will continue to be the most acutely affected by the challenges that rising prices cause.

Wage growth will continue to support New Zealanders to meet the cost of living. Annual growth in hourly earnings has largely exceeded consumer price inflation since 2017, except for between September 2021 and June 2022. Real wages grew again in the year to September 2022, and the Treasury's *Half Year Economic and Fiscal Update* (HYEFU) 2022 forecasts wage growth to remain higher than inflation over the forecast period.

Budget 2023 will continue our work to support households and businesses in a targeted manner. This is what we have done throughout this period of high global prices, including recent changes to improve access to childcare assistance.

We will continue work to fight the drivers of high prices by ensuring that markets function competitively and deliver good outcomes for consumers. The Government has introduced legislation to prevent supermarkets blocking their competitors' access to land, and to create a Grocery Commissioner with regulatory powers to give smaller retailers and new market entrants a leg up. We have also made changes to the wholesale market for fuel – including giving the Commerce Commission the power to set fair wholesale prices if necessary – to ensure that all petrol retailers can access cheaper fuel and pass on the benefits to consumers. And in the first half of 2023 the Government will outline our response to the Commerce Commission's recently released study of the residential building supplies industry.

2 Careful and balanced fiscal policy, including returning to surplus in the 2024/25 year

After a period of expansionary fiscal policy to support businesses and households through COVID-19, it is now time for fiscal policy to be contractionary to take pressure off inflation by targeting expenditure to where it is needed most in the economy.

This *Budget Policy Statement* confirms the plan set out in Budget 2022 that fiscal policy will be contractionary from the current 2022/23 year which began on 1 July. This means that the Government's contribution to aggregate demand in the economy is set to reduce relative to each preceding year. The Treasury's advice is that this will dampen inflation pressures in support of the Reserve Bank's independent monetary policy, taking pressure off interest rates versus a scenario where fiscal policy provided a neutral or positive impulse.

A key driver of our forecast contractionary fiscal stance is our target to return the books back to surplus earlier than the previous Government did following the Global Financial Crisis, with five years of deficits forecast as a result of the COVID-19 response, averaging 2.5 per cent of GDP, compared to the six deficits following the Global Financial Crisis averaging 3.6 per cent of GDP.

Ahead of the forecast surplus in the 2024/25 fiscal year, the deficits forecast in 2022/23 and 2023/24 have also reduced by a combined $5.1 billion compared to the *Budget Economic and Fiscal Update* (BEFU) 2022 forecast, further taking pressures out of the economy.

3 Getting the basics right

The Government has a strong record of investing in the public services on which New Zealanders rely. But just as high prices are putting pressure on some households and businesses, high global inflation also risks affecting the delivery of some of our core public services. Budget 2023 will continue the Government's work to ensure that the delivery of these services is maintained through this period.

Our careful fiscal management means we can continue to target investment to where it is needed most, including ongoing investment in health, education, and housing. To ensure spending is targeted to where it is needed most, the preparation of Budget 2023 will involve public agencies examining what needs can be met by reprioritising existing funding. This process will ensure ongoing value for money from government spending, and that we remain focused on those services most vital to maintaining and enhancing New Zealand's wellbeing.

4 Delivering on our economic plan, including through investment in infrastructure that drives growth, productivity, and reduces emissions

While we support New Zealanders through a difficult period, we need to continue to look to the future. Budget 2023 will deliver on the Government's economic plan to support a high-wage, low-emissions economy that provides economic security in good times and bad.

We will strengthen the foundations that underpin our wellbeing, with capital investment central to this. The Budget will continue the work to address our long-term infrastructure shortfall to boost productivity and growth, while recognising that investment needs to be carefully prioritised and sequenced to ensure there is capacity for the most value-for-money investments to be delivered.

The Budget will also invest to unleash business potential and innovation. The Government's Industry Transformation Plans are an important part of this approach.

Budget allowances and the Climate Emergency Response Fund

Budget allowances

The operating allowance is the pool of net new operating funding available at each Budget for the Government to meet its fiscal priorities. The Government has decided to keep the operating allowances signalled at Budget 2022 unchanged. These were set at $4.5 billion average per annum for Budget 2023 and $3.0 billion average per annum for Budgets 2024 and 2025. The Budget 2026 operating allowance is now included in the forecast period and has also been set at $3.0 billion average per annum.

The economic context for Budget 2023 remains challenging, with high inflation and strong wage pressures driving up the cost of delivering government services. We are keeping the operating allowances unchanged at the *Budget Policy Statement 2023* to ensure that fiscal policy remains contractionary and continues to support the Reserve Bank's monetary policy direction, while still ensuring sufficient new funding to maintain essential government services.

Some of the Budget 2023 operating allowance of $4.5 billion average per annum has already been allocated at Budget 2022, largely in part to the Government introducing a multi-year funding approach in a number of areas, including the 2023/24 health budget. The multi-year funding approach provides greater funding certainty to agencies, which will help to address complex, multi-generational challenges and facilitate long-term investments and strategic planning. This approach brings forward the funding decision rather than any costs, but reduces the overall size of funding available for future Budgets. This emphasises the importance of finding reprioritisation opportunities within existing baselines. Ministers are exploring options for reprioritisation to fund cost pressures and new spending priorities at Budget 2023, which will support the wellbeing objectives for this Budget as well as the Government's overarching policy goals.

Given the considerable global economic uncertainty, the Government will continue to monitor the need for any changes to the Budget 2023 allowance based on economic, tax, and fiscal forecasts, and as more information becomes available on the scale of cost pressures relative to the reprioritisation that is achieved.

Table 1 – Budget allowances before pre-commitments

<table>
<tr><th>$ billions</th><th>Budget 2023</th><th>Budget 2024</th><th>Budget 2025</th><th>Budget 2026</th></tr>
<tr><td>Operating allowances (per year)</td><td>4.5</td><td>3.0</td><td>3.0</td><td>3.0</td></tr>
<tr><td>Multi-year capital allowance after Budget 2022</td><td colspan="3">5.1</td><td></td></tr>
<tr><td>Multi-year capital allowance (as at 28 November 2022)</td><td colspan="3">2.9</td><td></td></tr>
<tr><td>Multi-year capital allowance at Budget Policy Statement 2023</td><td colspan="4">12.0</td></tr>
</table>

Source: The Treasury

The multi-year capital allowance (MYCA) is a four-year rolling envelope for new capital investment that enables a longer-term approach to capital investment. Since Budget 2022, pre-commitments of $2.2 billion have been charged against the Budget 2022 MYCA allocation of $5.1 billion. The MYCA tends to be increased at the Budget Policy Statement, as the Treasury adds a new year to its forecast period. The Government has agreed to increase the MYCA to $12 billion at the *Budget Policy Statement 2023*, which represents an increase of $9.1 billion to the remaining balance of $2.9 billion. The increase in the MYCA in part reflects the inclusion of Budget 2026 within the forecast period, and signals the Government's capital pipeline through to Budget 2026. The Government acknowledges that capacity constraints will be a factor in determining the size of the capital investment package at Budget 2023.

These allowances have been incorporated into the Treasury's HYEFU 2022 fiscal forecasts.

Climate Emergency Response Fund

At Budget 2022 the Government established the Climate Emergency Response Fund (CERF) as a permanent feature of the annual Budget process to support our climate change objectives. The CERF is an enduring, multi-year fund that was set up based on the cash proceeds from the New Zealand Emissions Trading Scheme (NZ ETS). The CERF is able to support either operating or capital expenditure as required, and helps enable the Government to effectively manage the pipeline of investments we need for the climate transition.

To date the CERF has supported $3.8 billion in climate-related spending, including a $2.9 billion package at Budget 2022 to support the Government's first Emissions Reduction Plan. For Budget 2023 we have refreshed the criteria to include climate change adaptation as well as mitigation. An initiative is eligible to seek funding from the CERF if it:

a is included in an Emissions Reduction Plan or directly supports emissions reductions (domestically or internationally)

b is included in a National Adaptation Plan or directly reduces vulnerability or exposure to the impacts of climate change

c supports a te ao Māori approach to the climate response

d addresses the distributional impacts of climate change or the climate policy response, and/or

e supports the development of any initiatives meeting these criteria in the future.

The balance of the CERF is updated regularly at Economic and Fiscal Updates to reflect changes to the four-year forecasts of NZ ETS cash proceeds. In HYEFU 2022 the CERF has been topped up by $2.1 billion, which reflects the addition of forecast NZ ETS cash proceeds from the 2026/27 financial year and updated forecasts of NZ ETS cash proceeds between 2022/23 and 2025/26. This brings the current balance of the CERF to $3.6 billion. At the time of finalising the forecasts the Government was due to consider updates to price and unit supply settings for the NZ ETS, which could affect forecasts of NZ ETS cash proceeds. The balance of the CERF may be adjusted in the future to reflect these decisions.

Table 2 – Climate Emergency Response Fund

$ billions	Budget 2023	Budget 2024	Budget 2025	Budget 2026
Climate Emergency Response Fund	←	3.6	→	

Source: The Treasury

ECONOMIC AND FISCAL FORECASTS

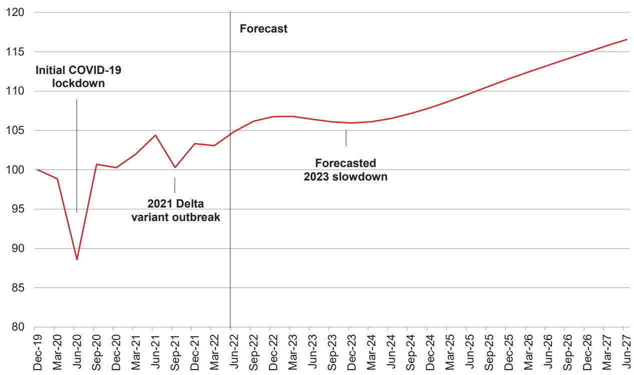
Economic outlook and forecasts

The Government's actions to grow the economy and support Kiwis mean New Zealand is well positioned to face the global economic slowdown currently underway.

In real terms the economy was 4.8 per cent larger in June 2022 than it was pre-COVID-19. The Treasury's HYEFU 2022 forecasts are for the economy to grow by a further 11.2 per cent across the forecast period – an average of 2.1 per cent per year – off the back of the strong foundations that the Government has been building under our economic plan.

Over the medium to long term, New Zealand's economic prospects will be supported by a range of factors, including a growing skilled workforce, a shift towards the digital and high-tech economy, investment in transforming industries under our economic plan, and benefits to our exporters flowing from the six new trade agreements or upgrades signed by the Government since 2017.

Figure 4 – Real GDP growth (indexed to Q4 2019)



Source: The Treasury

In the shorter term, the economic outlook will fluctuate slightly as the Reserve Bank acts to reduce inflation pressure over 2023, and as the global downturn affects confidence and activity around the world. The Treasury is forecasting a period in 2023 where growth will slow and fall slightly across three quarters. GDP is expected to decline by 0.8 per cent in the 2023 calendar year, to sit just above its June 2022 level.

New Zealand will enter the shallow slowdown from a stronger starting point than many of the countries to which we compare ourselves. Ahead of the 0.8 per cent forecast drop, the Treasury expects real GDP will have increased by 1.8 per cent across the second half of 2022. This growth provides a buffer ahead of the shallow forecast slowdown.

Real GDP at the end of 2022 is forecast to be 6.8 per cent higher than before the COVID-19 pandemic. Economic activity is expected to remain more than 5.9 per cent above pre-COVID-19 levels through 2023. By 2027, the economy is forecast to be 16.6 per cent larger than it was in December 2019, adjusted for inflation.

Unemployment is at historically low levels at 3.3 per cent. While this has put pressure on businesses and wages, it has meant that many groups that have often been on the fringes of the labour market have entered employment at greater rates than at any time in recent decades, providing social and economic benefits for New Zealand. The Treasury's forecast shows unemployment rising to 5.5 per cent in mid-2024, as a result of the global slowdown and actions to reduce inflation.

The Reserve Bank's efforts to reduce demand and return inflation to its target range mean that many households will face increasing mortgage rates in the coming months, with an associated decline in consumer spending and investment. The Treasury forecasts that wages are set to rise faster than inflation every year across the forecast period, providing further support for households.

The significant tightening of monetary policy is coming at a time when global growth in 2023 is likely to be the lowest since the early 1990s, outside of the COVID-19 pandemic and Global Financial Crisis. The global outlook is highly uncertain and will depend on the effectiveness of central banks' monetary policy tightening and the absence of further negative shocks.

Table 3 – Summary of the Treasury's Half Year Update economic forecasts

Year ending 30 June	2022 Actual	2023 Forecast	2024 Forecast	2025 Forecast	2026 Forecast	2027 Forecast
Real GDP growth (annual average % change)	1.0	3.5	-0.3	2.1	3.3	3.0
Real GDP per capita (annual average % change)	0.7	3.2	-1.0	1.1	2.2	1.8
Unemployment rate (June quarter)	3.3	3.8	5.5	5.2	4.6	4.3
Consumers Price Index (annual % change)	7.3	6.4	3.5	2.5	2.0	2.0
Wage growth (annual % change)	6.4	6.8	6.1	4.7	4.0	3.8
Current account (annual, % of GDP)	-7.8	-7.6	-5.6	-4.8	-4.6	-4.6

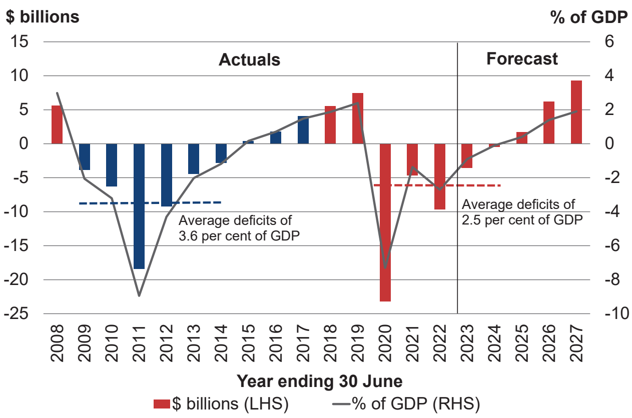
Fiscal outlook and forecasts

The Government has decided to maintain a contractionary fiscal policy through the forecast period, to assist the Reserve Bank in its monetary policy approach. This will require prioritisation of new spending to where it is needed most, and making trade-offs in expenditure to maintain public service levels, particularly in health, education, and housing.

The strong economy in 2021 and 2022 meant that the final results for the 2021/22 fiscal year were better than forecast at BEFU 2022. The operating balance before gains and losses (OBEGAL) deficit of $9.7 billion in 2021/22 was $9.3 billion less than forecast at BEFU 2022.

Looking ahead, the Government is forecast to run smaller deficits in the current 2022/23 year and 2023/24 than forecast at BEFU 2022, by a combined total of $5.1 billion. The 2023/24 deficit is reduced to just $461 million. We have maintained a return to surplus in the 2024/25 year, forecast at $1.7 billion.

Figure 5 – OBEGAL during the COVID-19 pandemic and the Global Financial Crisis



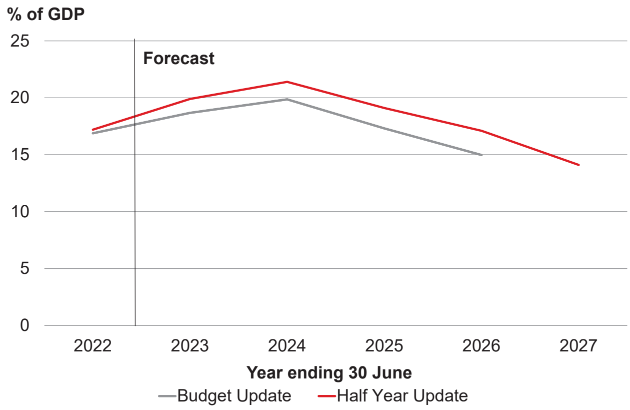
Source: The Treasury

This will mean the Government will have run five years of deficits following the COVID-19 economic shock, averaging 2.5 per cent of GDP per year, compared to six deficits run after the Global Financial Crisis averaging 3.6 per cent of GDP (see Figure 5).

As we move away from the COVID-19 emergency response, real government consumption is forecast to fall by 8.2 per cent between the September 2022 and December 2024 quarters. While this is a significant decline, it follows the temporary increase in spending to support the economy through the pandemic. In fact, the Treasury advises that real government consumption as a share of GDP returns to pre-pandemic levels over the forecast period.

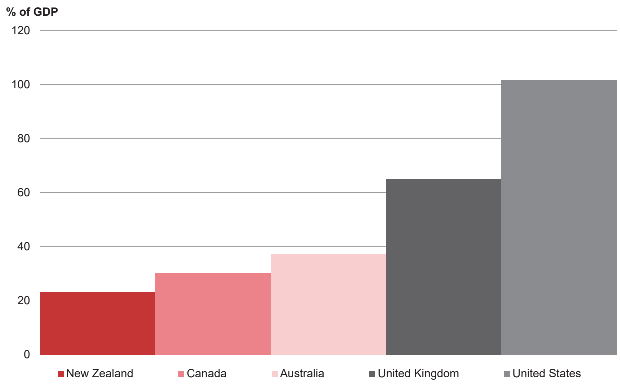
Delivering lower deficits across the next two years, and surpluses from 2024/25 onwards, will give the Government options to prioritise spending in areas that support our wellbeing objectives and overarching policy goals.

Figure 6 – Net debt forecast comparison



Source: The Treasury

Figure 7 – IMF-forecasted general government net debt in 2024



Source: IMF World Economic Outlook, October 2022

At Budget 2022 the Government adopted a new net debt indicator to bring New Zealand's debt measure more closely in line with international reporting. We also adopted a net debt ceiling of 30 per cent of GDP. The volatility in the valuation losses of the New Zealand Superannuation Fund, which are included in the new net debt indicator, means that the starting position of net debt is higher compared to Budget 2022, but remains well below the ceiling of 30 per cent of GDP. Net debt is now forecast to peak at 21.4 per cent of GDP ($88.2 billion) in the 2023/24 year before falling by $20 billion to 14.1 per cent of GDP by 2026/27 ($68.2 billion) (see Figure 6).

The New Zealand Government's net debt position remains considerably favourable compared to other advanced economies. The International Monetary Fund's (IMF's) general government net debt indicator (which is similar to New Zealand's net debt measure) forecasts New Zealand's debt at 23.1 per cent of GDP in 2024, compared to 30.2 per cent in Canada, 37.4 per cent in Australia, 65.1 per cent in the United Kingdom, and 101.6 per cent in the United States (see Figure 7).

Table 4 – Summary of the Treasury's Half Year Update fiscal forecasts

Year ending 30 June	2022 Actual	2023 Forecast	2024 Forecast	2025 Forecast	2026 Forecast	2027 Forecast
% of GDP						
Core Crown tax revenue	30.2	29.9	30.3	30.3	30.7	30.8
Core Crown expenses	35.0	32.8	32.6	32.2	31.5	30.9
Total Crown OBEGAL	(2.7)	(0.9)	(0.1)	0.4	1.4	1.9
Core Crown residual cash	(7.5)	(6.4)	(4.3)	1.7	1.0	1.3
Net debt[1]	17.2	19.9	21.4	19.1	17.1	14.1
Net worth attributable to the Crown	46.5	42.1	41.5	41.1	41.6	42.9

1 Net debt is the 'new' net debt fiscal indicator that includes core Crown advances, Crown entity borrowings (excluding Kiwi Group), and the New Zealand Superannuation Fund.

FISCAL STRATEGY

Our fiscal rules adopted at Budget 2022 take a balanced approach to supporting current and future generations by ensuring that the Government is able to fund operating expenses out of revenue over time, so that new day-to-day spending is not adding to net debt. The Government's commitment to prudent fiscal management and planned return to an OBEGAL surplus means that credit rating agencies have maintained their world-leading ratings on the Government's fiscal position.

The Treasury's HYEFU 2022 is forecasting a deteriorating global economic outlook with greater uncertainty compared to in BEFU 2022, partly due to the sharp increases in global and domestic interest rates in recent months. High inflationary pressures and a tight labour market have contributed to higher-than-forecast tax revenue in 2022/23, but have also increased the cost of delivering essential government services. As the Reserve Bank increases the Official Cash Rate to bring inflation back to target, economic activity is forecast to slow down.

In the uncertain global context, the risk that monetary and fiscal policy does not do enough to ease capacity constraints within the economy must be balanced against the risk that a global slowdown results in an overcorrection and a deeper economic downturn than is necessary. The Government's contractionary fiscal stance balances supporting the Reserve Bank's job to reduce inflation and meeting our fiscal rules with ensuring essential government services continue to be delivered through targeted and prioritised spending decisions.

The Government is meeting its fiscal rules

In the current macroeconomic context, we consider that our short-term intention at Budget 2022 to return OBEGAL to a surplus by 2024/25 remains appropriate. Consistent with the HYEFU 2022 forecasts, returning OBEGAL to a surplus in 2024/25 ensures a contractionary fiscal stance across the next four years, to support the Reserve Bank's efforts to reduce inflation and position New Zealand well to respond to medium-term challenges once the economy has greater capacity to absorb new investment.

Once OBEGAL returns to a surplus, our objective is to run surpluses in the range of 0 per cent to 2 per cent of GDP on average over time. This will ensure that, over time, operating expenses do not add to net debt as a share of GDP. Net debt is now forecast to peak at 21.4 per cent of GDP in the 2023/24 year and reduce to 14.1 per cent of GDP by 2026/27 (see Figure 6), and will remain well below the net debt ceiling of 30 per cent of GDP.

The fiscal projections at HYEFU 2022 show that the Government is on track to meet its long-term objectives of maintaining an average OBEGAL surplus in the range of 0 per cent to 2 per cent of GDP, and keeping net debt below the ceiling of 30 per cent of GDP.

The Government's short-term intentions and long-term objectives for fiscal policy remain unchanged from Budget 2022

The short-term intentions and long-term objectives remain fit for purpose, and have not changed since the *Fiscal Strategy Report 2022*. The Government's strategy for managing expenditure, assets, and liabilities is also unchanged from the *Fiscal Strategy Report 2022.*

Budget 2023 is expected to accord with our current short-term intentions and long-term objectives for fiscal policy by ensuring that OBEGAL returns to surplus in 2024/25 and thereafter maintains a surplus in the target range of 0 per cent to 2 per cent of GDP on average from 2024/25 onwards, while maintaining total debt such that net debt remains below the ceiling of 30 per cent of GDP.

Table 5 – Short-term intentions and long-term objectives for fiscal policy

	Short-term intention	Long-term objective
Debt	Maintain total debt at prudent levels. Maintain net debt at below 30 per cent of GDP based on the new net debt measure including the New Zealand Superannuation Fund, subject to significant shocks. Gross debt is forecast to be 39.9 per cent of GDP at the end of the forecast period. Net debt is forecast to peak at 21.4 per cent of GDP in 2023/24 and reduce over the forecast period to 14.1 per cent of GDP in 2026/27.	Maintain total debt at prudent levels. Maintain net debt at below 30 per cent of GDP based on the new net debt measure including the New Zealand Superannuation Fund, subject to significant shocks.
Operating balance	Our intention is to return to an operating surplus (before gains and losses) by 2024/25, subject to economic and fiscal conditions. The operating balance (before gains and losses) is forecast to be 0.4 per cent of GDP in 2024/25. The operating balance is forecast to be 3.3 per cent of GDP in 2026/27.	Once the operating balance (before gains and losses) has returned to a surplus, our long-term objective is to maintain an average surplus in the range of 0 per cent to 2 per cent of GDP, subject to economic and fiscal conditions. This will ensure that, on average, over a reasonable period of time total operating expenses do not exceed total operating revenue.
Expenses	Our intention is to ensure expenses are consistent with the operating balance objective. Core Crown expenses are forecast to be 30.9 per cent of GDP in 2026/27. Total Crown expenses are forecast to be 39.4 per cent of GDP in 2026/27.	The Government will ensure operating expenses support a responsible and proportionate role for the Government in maintaining a productive, sustainable, and inclusive economy, consistent with the debt and operating balance objectives.
Revenue	Our intention is to ensure revenue is consistent with the operating balance objective. Total Crown revenue is forecast to be 41.4 per cent of GDP in 2026/27. Core Crown revenue is forecast to be 33.4 per cent of GDP in 2026/27. Core Crown tax revenue is forecast to be 30.8 per cent of GDP in 2026/27.	The Government will ensure a progressive taxation system that is fair, balanced, and promotes the long-term sustainability and productivity of the economy, consistent with the debt and operating balance objectives.
Net worth	Our intention is to maintain net worth consistent with the operating balance objective. Total net worth attributable to the Crown is forecast to be 42.9 per cent of GDP in 2026/27. Total Crown net worth is forecast to be 44.4 per cent of GDP in 2026/27.	The Government will use the Crown's net worth to maintain a productive, sustainable, and inclusive economy, consistent with the debt and operating balance objectives.