13 May 2025

Budget 2025 Preview

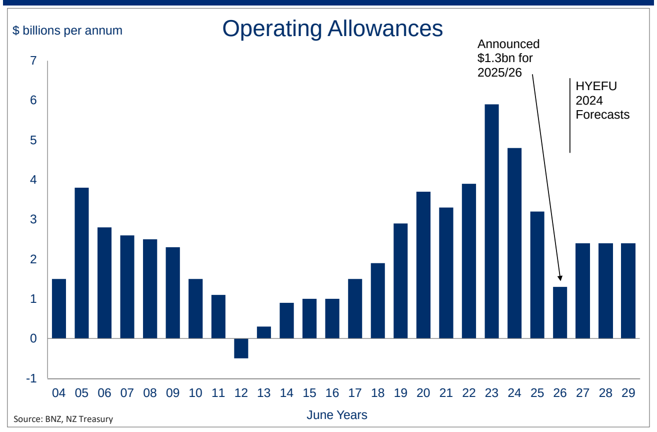
- **Government committed to surplus in 2028/29**
- **Operating allowance for 2025/26 lowered to $1.3bn**
- **These are tight constraints to live within**
- **Softer tax outlook and increased capital spending**
- **Bond programme, no major changes expected**

At the Half-Year Economic and Fiscal Update, a small fiscal surplus was projected in the year to June 2029. Indications from Finance Minister Willis are that Budget 2025 will keep to this target. But the path back to surplus is likely to remain extremely challenging. It is being threatened by downgrades to economic growth forecasts and subsequently the Government's ability to raise revenue.

Minister Willis has already announced a reduced size of the 2025/26 operating allowance from $2.4 to $1.3 billion. This appears very tight, and likely not even enough to cover natural cost increases from population growth and inflation. In addition, the Government has already pre-committed around $1.7 billion of the allowance largely to the health sector. It has indicated new spending on education, law and order, defence, and a small number of critical social investments.

It is important to consider how these spending initiatives will be funded within such a tight operating allowance. Some cost saving measures have been announced such as changes to emerging housing and pay equity negotiations, but further measures would seem to be required on 22 May to fit within the announced constraints.

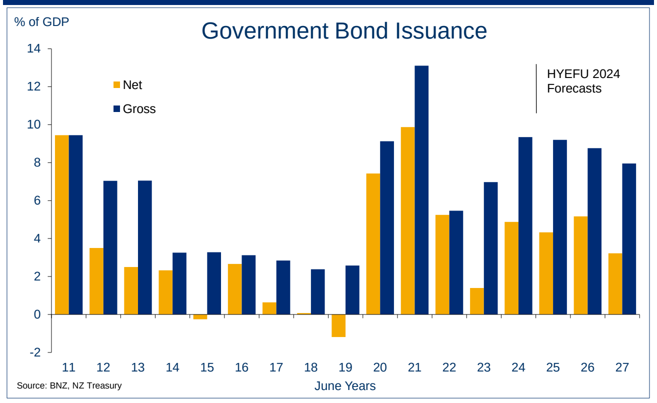
Operating allowance is the smallest in a decade



Turning to capital expenditure, Prime Minister Luxon recently announced the net capital allowance in this year's Budget is $4 billion. This is more than the $3.625 billion in the HYEFU, with spending split across health, education, defence, transport, and other portfolios. It's reasonable to assume the 2025 net capital allowance includes the $2 billion of expenditure earmarked for five new Defence Force helicopters. What is less clear is how the rest of the $12 billion of funding for the new Defence Capability Plan over the next four years has been allocated.

While it's difficult to forecast specific changes to the bond programme with any certainty, we can get a sense of where the pressures lie.

A lot to digest



While our best guess for the bond programme is for no significant change, there are lots of moving parts. There is significant pressure from the softer tax outlook, higher interest costs and higher capital allowances. These pressures will be at least partly offset by some pre-funding, reduced spending in other areas and the associated lower operating allowances. Pulling it altogether, it is possible that the various factors roughly balance out such that borrowing requirements are broadly unchanged relative to HYEFU.

1. Softer tax outlook

In the wake of recent global tariff turmoil, Minister Willis noted that Treasury has reduced its forecasts for economic growth in 2025 and 2026. This should translate into a weaker tax intake for the fiscal accounts. If nominal GDP growth were to be (say) 0.5% lower than forecast at HYEFU for the next two fiscal years, this would lower the total tax intake by around $5.5 billion over the four-year forecast horizon.

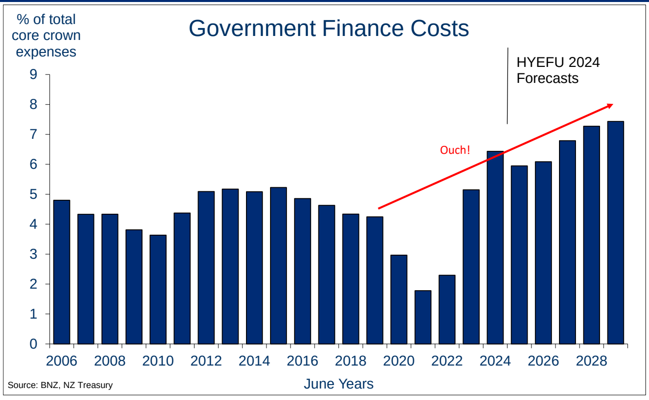
2. Higher capital allowance

Given the Government's focus on delivering infrastructure for growth, and with the PM's recent guidance, it's reasonable to expect a small uplift in capital expenditure. For example, net capital allowances after 2025 could also increase from $3.625 to $4 billion, or more. This uplift has to be balanced alongside the Government's objective to target net core Crown debt below 40% of GDP. While our debt position is low relative to other countries (currently 42.6%), its trajectory over recent years has been clearly upward. Lower GDP growth won't help this either.

3. Higher interest servicing costs

In the details of HYEFU, Treasury assumed the NZ 10-year bond rate would fall to 4.0% by 2028. If projections were closer to the current yield of around 4.6% it would have a material upward influence on projected debt servicing costs. This would be on top of the significant lift in costs which have already been forecast.

Crowding out



4. Lower operating allowance

Assuming the operating allowances after 2025 remain at $2.4 billion, the lower operating allowance of $1.3 billion for 2025 will save a cumulative $4.4 billion over the next four years.

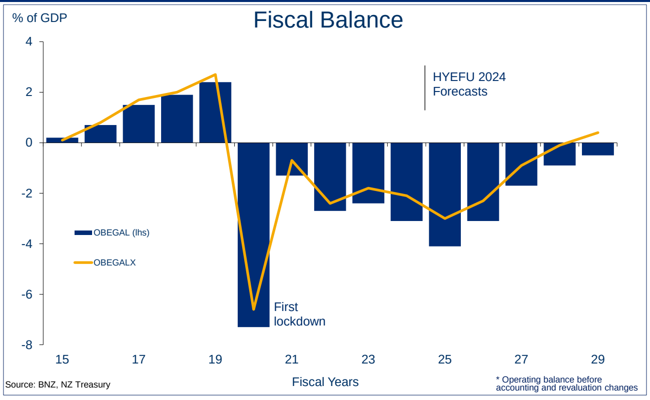
5. Pre-funding

If the NZ$450 million per week tender volumes are maintained through June, there will be around $2 billion of pre-funding from New Zealand Debt Management (NZDM). All else equal, this implies $2 billion less would be required from the bond programme in Budget 2025.

6. Smaller operating deficit

Preparing the Budget, we suspect Treasury used the Crown Financial Statements for February to assess how the operating deficit was tracking against HYEFU baselines. At this time, the operating deficit excluding ACC (OBEGALx) was $1.6 billion smaller expected, but not all of this was expected to persist. Indeed, the underlying outperformance all but disappeared in the recently released figures up to March.

Long-road ahead



7. Alternative funding arrangements

Even if we were accurate in our forecasts of the Government's funding needs, we can't rule out NZDM using T-bills rather than bonds as a funding mechanism. Additionally, there will be a smoothing overlay applied to any funding programme.

There is considerable uncertainty across many of these estimates and assumptions. While we can estimate some magnitude of the changes, their timing is also important e.g. the increase in defence spending. Material deviation in magnitude or timing of the many moving parts could have material implications for the bond programme. But our best guess is for no major changes. No matter what the Government estimates for its forthcoming bond programme, current economic uncertainty will raise significant questions as to the likelihood of such forecasts being achieved.

matt_brunt@bnz.co.nz

Contact Details

BNZ Research

Stephen Toplis
Head of Research

Doug Steel
Senior Economist

Matt Brunt
Economist

Jason Wong
Senior Markets Strategist

Stuart Ritson
Senior Interest Rate Strategist

Mike Jones
BNZ Chief Economist

Main Offices

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

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

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