

Research Economy Watch

29 May 2026

Fiscal fortitude

- **NZ budget returns to balance one year earlier**
- **Debt peak brought forward**
- **Rating agencies should be mollified**
- **Debt programme reduced**
- **Growth forecasts at threat**

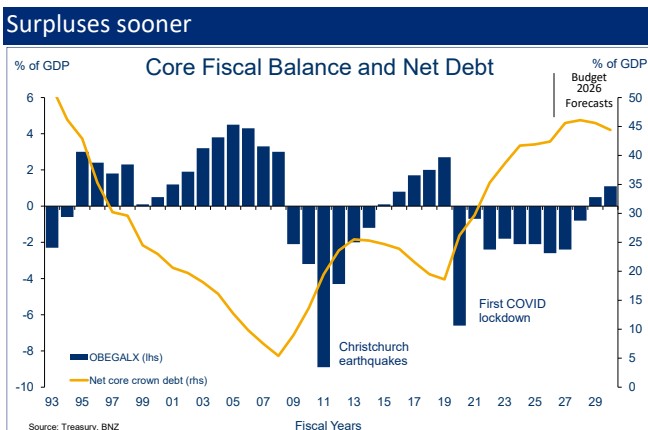
Surpluses sooner . . .

The government went into this Budget hell-bent on proving to the electorate, and the rating agencies, that it could return its core operating balance (OBEGALx) to surplus and, in so doing, start lowering the debt track in a meaningful way. In this regard the 2026 Budget fully delivers.

The Prime Minister Chris Luxon effectively let slip a week or so ago that the accounts would return to the black when he stated that the Government was still targeting a 2028/2029 surplus despite its last published forecast being a deficit for the period. Why would you do that ahead of the Budget unless you were fairly certain that would be the case. And so it was!

So the Minister of Finance has proudly announced a 0.5% of GDP forecast surplus for the year ended June 2029 rising to 1.1% of GDP the year after.

This improvement now means that the forecast drop in net debt occurs a year earlier than previously expected. Net core crown debt now peaks at 46.1% in fiscal 2028 falling to 45.6% and 44.4% in the following two years.



From an electoral position the Government can certainly claim that it is delivering what it promised so should be judged as capable managers of the state’s finances. This is an important benchmark for any government but whether the public buys into this or not is moot especially when part of the government’s success relies on very tight expenditure control at a time when all and sundry are clamouring for more.

Debt rating agencies appeased . . .

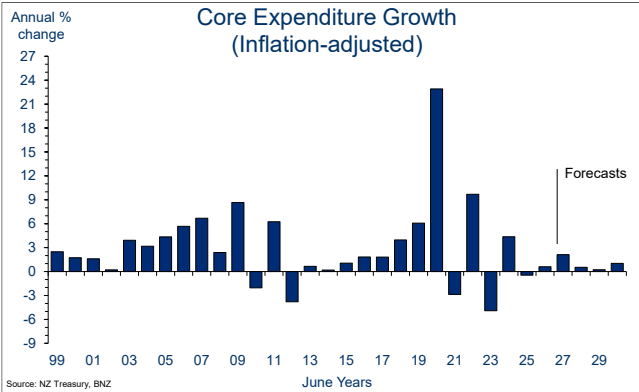
The debt rating agencies should be happy with this set of forecasts. The agencies had been giving New Zealand credit for the fact that the government was focusing on targeting fiscal balance. However, recent moves to negative credit watch were based on concerns that the surplus target was being delayed and looked increasingly untenable. Had their concerns played out moves from negative watch to a full downgrade were looking increasingly likely. For now, though, the Government has probably done enough to delay that proposition.

The big question is whether the economic forecasts on which this analysis is based, and the ensuing fiscal forecasts are credible? And, will they survive the next election.

Expense growth contained . . .

Key to achieving surplus will be keeping to the Government’s expense path. The last two years provide evidence that the Government has been able to deliver very low real expense growth largely by redistributing available funds. There is an expectation that there will be a stronger lift in expenditure in 2026/27 but then a return to only very modest growth. Time will tell whether this can be managed.

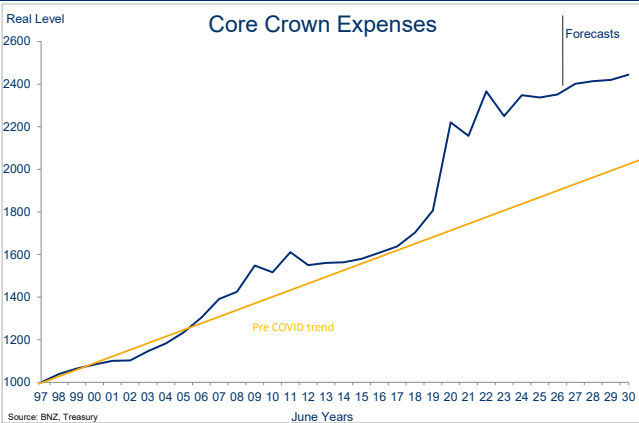
Spending constrained



The election may well play a part here in determining what happens to spending. Based on current polling it is reasonable to assume that the shape of government will be different to what it now is. Either we will get a change of colour to Labour or, potentially, a modest shift in emphasis if National has lesser weight in a return of the current coalition government.

One thing that everyone should be questioning is why is government spending still so far away from trend? The upward shift that has occurred in this series has never really been explained. Sure, the increase largely reflected COVID spending but why is it still there?

Mind the gap

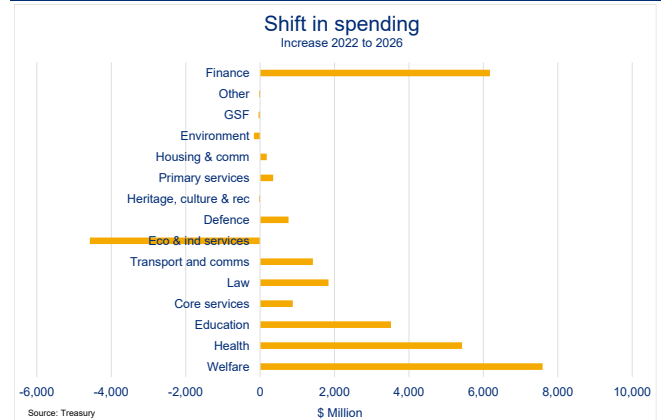


A super problem . . .

A bothersome aspect of the fiscal outlook, and it is not a new one, is the extent to which the biggest cost impost on the government over the forecast period will be growth in welfare spending focussed on superannuation. If future government's want to free up money one of the few places they will be able to get those funds in a meaningful amount will be from this source. This is an issue that New Zealand really needs to face into. We don't have sufficient detail to provide a true picture of the pressure coming from welfare during the forecast horizon but a look at

what has happened over the last four years provides a good insight.

Welfare costs soaring



Eco forecasts optimistic? . . .

With regard to the economic forecasts, we think there is a clear risk that growth ends up lower than Treasury is currently picking and unemployment higher. Treasury has lowered its near term forecasts in light of the Middle Eastern chaos but we wonder whether they have lowered them enough. Treasury sees the economy growing 2.3% in the year ended June 2027 rising to 3.2% in fiscal 2028 and 2.7% the year after. Our forecasts for the same period are 1.7%, 2.5% and 2.6% respectively.

We are quick to note, however, that it is unwise to be critical of anyone's forecasts in the current environment. There are simply too many moving parts and even slight changes in assumptions about key variables, such as oil prices, can have disproportionate impacts on outcomes.

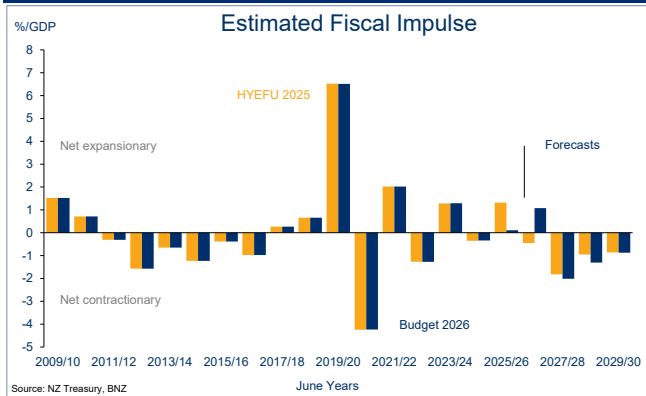
Additionally, to the extent that we think there are downside risks to Treasury's growth forecasts there are upside risks to its inflation outlook. Given that it is the nominal economy that produces tax revenue then it may well be that higher inflation completely offsets lower growth in the revenue stakes.

All that said, the risks are clear and will need to be monitored closely.

Minimal monetary policy implications . . .

For the central bank there should be little in today's announcement that will dissuade them from their projected course of action. The fiscal impulse in the year ended June 2027 is stronger than previously expected and but the years thereafter largely offset this impact and reveal broadly contractionary fiscal policy.

Fiscal policy to turn contractionary



Be that as it may, Treasury does not appear to have the same views as the Reserve Bank or perhaps more aptly doesn't have the same views as the Monetary Policy Committee. Treasury assumes that there is just one rate hike between now and June 2027 and then another one in each of the following two years. We certainly don't buy into this. And, if our more aggressive track comes to fruition this would go some way to explaining the difference between our and Treasury's growth forecasts.

Debt demands diminish . . .

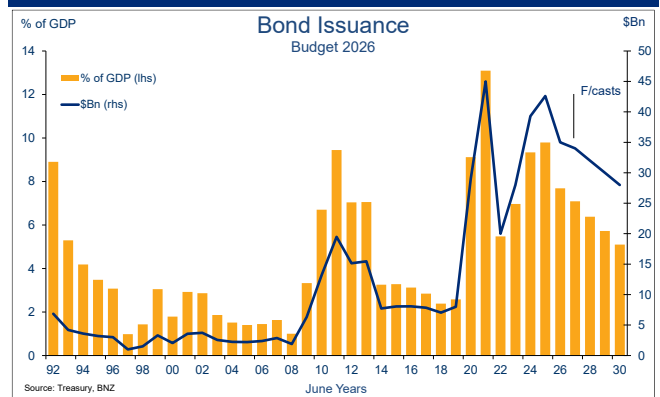
The most interesting thing from this Budget for financial markets will be the fact that New Zealand Debt Management was able to announce no change in the year ahead bond programme and a reduction in the programme of \$2.0 billion per annum in each of the June years 2028, 2029 and 2030.

Additionally short term borrowings on issue have been reduced by \$3.0 billion in the June years 2026 and 2027.

While these changes are not big they will, for now at least, quash concerns of a pre-election spend up (not that there was any evidence of this anyway). More generally it provides comfort that the risk of a sharp increase in supply is diminished.

For the record a syndication of a new May 2038 bond before the end of this calendar year is proposed. And gross inflation-indexed bond issuance is expected to be less than \$1.0 billion in 2026/27.

Bond issuance shrinks



Summary tables on next page

Economic Forecasts (Annual average % change, June years)	BNZ						Treasury (Budget 2026)					
	2025 Actual	2026 Fcast	2027 Fcast	2028 Fcast	2029 Fcast	2030 Fcast	2025 Actual	2026 Fcast	2027 Fcast	2028 Fcast	2029 Fcast	2030 Fcast
Private consumption	0.6	1.1	1.5	2.6	2.8	2.9	0.6	1.0	2.4	3.0	3.0	3.0
Public consumption	-0.8	4.1	0.3	-0.5	-0.1	0.1	-0.8	2.7	-1.3	1.1	0.2	0.0
Residential investment	-12.3	0.9	7.7	1.0	2.5	3.1	-12.3	-1.9	8.5	10.4	4.9	3.0
Business investment	-2.5	2.0	4.8	4.2	5.3	5.5	-2.4	0.8	1.3	7.4	5.2	3.6
Exports	2.9	4.3	3.9	3.8	3.6	4.6	2.9	3.6	3.0	2.2	2.2	2.3
Imports	2.0	6.3	4.9	2.7	3.7	4.9	1.9	4.0	0.5	3.7	2.9	2.5
GDP (expenditure measure)	-0.9	1.5	1.7	2.5	2.6	2.7	-0.9	1.4	2.6	3.3	2.8	2.6
GDP (production measure)	-1.1	1.4	1.7	2.5	2.6	2.7	-1.1	1.2	2.3	3.2	2.7	2.5
Employment	-1.0	0.2	1.4	2.2	2.3	2.4	-1.0	0.3	2.0	2.3	1.8	1.5
Unemployment	5.2	5.4	5.7	5.5	5.4	5.1	5.2	5.5	5.0	4.5	4.4	4.3
CPI inflation	2.7	4.0	2.2	2.1	2.3	2.1	2.7	4.0	1.6	2.1	2.1	2.0
Current account balance - % of GDP	-3.7	-3.8	-4.0	-3.0	-3.0	-2.8	-3.8	-4.1	-3.5	-2.9	-2.6	-2.5
TWI (June qtr avg)	69.2	66.5	70.3	69.5	69.1	71.2	69.1	66.8	67.6	68.8	69.7	70.3
90-day bank bill rate (June qtr avg)	3.4	2.5	4.0	4.1	3.7	3.7	3.4	2.5	2.8	3.1	3.3	3.3

Budget 2026	2022	2023	2024	2025	2026	2027	2028	2029	2030
	actual	actual	actual	actual	f/cast	f/cast	f/cast	f/cast	f/cast
(June years, % of GDP)									
Core Crown Revenue	32.2	30.7	31.7	30.9	30.4	30.7	30.9	31.2	31.4
Core Crown Expenses	34.4	31.7	33.0	32.6	32.6	32.6	31.5	30.7	30.3
OBEGAL	-2.7	-2.4	-3.1	-3.2	-3.3	-3.0	-1.5	-0.1	0.5
OBEGALX	-2.4	-1.8	-2.1	-2.1	-2.6	-2.4	-0.8	0.5	1.1
Gross Debt	32.6	33.8	41.8	46.8	49.5	52.7	53.0	52.5	51.3
Net Core Crown Debt	35.3	38.6	41.7	41.9	42.4	45.6	46.1	45.6	44.4
Domestic Bond Programme (\$NZm)	20,000	28,000	39,300	42,600	35,000	34,000	32,000	30,000	30,000
(June years)									
Real GDP (annual average % change)	0.4	4	1.1	-1.1	1.2	2.3	3.2	2.7	2.5
Consumer Price Index (annual % change)	7.3	6	3.3	2.7	4.0	1.6	2.1	2.1	2.0
Unemployment rate (June qtr)	3.3	3.7	4.7	5.2	5.5	5.0	4.5	4.4	4.3
90-day Bank Bill Yield (March qtr. av.)	2.2	5.6	5.6	3.4	2.5	2.8	3.1	3.3	3.3
Trade Weighted Index (March qtr. av.)	72.2	70.9	71.4	69.1	66.8	67.6	68.8	69.7	70.3

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