The Treasury

Budget 2026 Information Release

September 2026

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[7] 6(e)(ii) - to prevent serious damage to the economy of New Zealand by disclosing prematurely decisions to change or continue government economic or financial policies relating to the regulation of banking or credit

[12] 7(a)(i) - to avoid prejudice to the security or defence of the self-governing State of the Cook Islands

[13] 7(a)(ii) - to avoid prejudice to the security or defence of the self-governing State of Niue

[14] 7(a)(iii) - to avoid prejudice to the security or defence of Tokelau

[15] 7(a)(iv) - to avoid prejudice to the security or defence of the Ross Dependency

[23] 9(2)(a) - to protect the privacy of natural persons, including deceased people

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[27] 9(2)(ba)(ii) - to protect information which is subject to an obligation of confidence or which any person has been or could be compelled to provide under the authority of any enactment, where the making available of the information would be likely otherwise to damage the public interest

[31] 9(2)(f)(ii) - to maintain the current constitutional conventions protecting collective and individual ministerial responsibility

[33] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials

[34] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions

[35] 9(2)(g)(ii) - to maintain the effective conduct of public affairs through protecting ministers, members of government organisations, officers and employees from improper pressure or harassment;

[36] 9(2)(h) - to maintain legal professional privilege

[37] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice

[38] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice

[39] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage

[40] 18(c)(i) - that the making available of the information requested would be contrary to the provisions of a specified enactment

[41] 18(d) - information requested is or will soon be publicly available

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TE TAI ŌHANGA
THE TREASURY

Treasury Report: Fiscal strategy update

Date:	20 March 2026	**Report No:**	T2026/433
		File Number:	MC-1-5-2-2029-M134685

Action sought

	Action sought	Deadline
Hon Nicola Willis **Minister of Finance**	**Discuss** this report with officials.	23 March 2026

Contact for telephone discussion (if required)

Name	Position	Telephone		1st Contact
Melissa van Rensburg	Senior Analyst, Macroeconomic and Fiscal Policy	[39]	n/a (mob)	✓
Alex Hamilton	Unit Manager, Macroeconomic and Fiscal Policy		N/A (mob)	

Minister's Office actions (if required)

Return the signed report to Treasury.

Note any feedback on the quality of the report	

Enclosure: No

Executive summary

This report updates you on progress towards achieving your medium-term fiscal strategy goals. There is significant uncertainty about the potential impacts of the unfolding conflict in the Middle East on the economy, fiscal forecasts, and your fiscal strategy. Key fiscal indicators improved in the preliminary fiscal forecasts, which means that, ahead of the conflict, the economy and fiscal position were in a stronger starting point when compared to the Half Year Update. Based on the preliminary forecasts, your short-term intentions (STIs) were broadly being met.

Your fiscal strategy of a medium-term approach to consolidation, returning to operating surplus, and reducing debt remains appropriate and is robust to a range of scenarios. The objective is to strike the right balance between the need to make progress on fiscal consolidation, and the need to stabilise the macroeconomy, in conjunction with monetary policy. There is a high level of uncertainty, but our current assessment is that the conflict will not have long-lasting impacts on the economic and fiscal position. We expect monetary policy to look through temporary inflation impacts and focus on the medium term.

Automatic stabilisers – such as lower tax revenue and higher benefit expenditure – should be allowed to operate, but we do not recommend further fiscal stimulus from a macroeconomic stabilisation perspective at this stage. If any additional support is provided, it should be timely, temporary, and targeted at alleviating supply chain disruptions or supporting vulnerable households, with these funded from within allowances. Our views on the fiscal stance may change if there were a significant broadening of the impact from the Middle East conflict.

Decisions on operating and capital allowances do not need to be taken now or could be taken indicatively. In line with our advice provided in T2026/109 in February, there is a case to deliver an operating allowance below $2.4 billion p.a. in Budget 2026 to make greater progress towards achieving your fiscal intentions. Doing so would give you more space to respond to the current conflict in the Middle East, if needed. If it turns out to not be needed, you can use it to improve the fiscal position. On balance, we recommend delivering Budget 2026 below $2.4 billion p.a., if possible, and keeping allowances for Budgets 2027-2029 at $2.4 billion p.a.

Advice on capital allowances and the capital pipeline for Budgets 2027-2029 is provided in T2026/471. You are meeting Budget Ministers on 9 April to decide funding for the Transport GPS which will impact the size of your Budget 2026 capital package and fiscal strategy. Your decisions on capital allowances will have flow-on effects on operating expenditure, via interest costs, depreciation, maintenance, and other operating costs.

The 2026 Budget Policy Statement noted that the net worth STI would be reconsidered ahead of this year's Fiscal Strategy Report. We are working with your office on possible changes to your net worth intention and indicator and will provide advice ahead of the Budget Cabinet paper.

We are scheduled to discuss this report with you at Fiscal Matters on 23 March.

Treasury Report: Fiscal strategy update

Purpose of Report

1. This report:

   a updates you on progress towards achieving your medium-term fiscal strategy goals,

   b provides an initial assessment of the potential implications of the ongoing Middle East conflict on your fiscal strategy, and

   c provides advice on your short-term intentions and operating allowances for Budgets 2026-29.

Background

2. Ahead of the 2026 Budget Policy Statement (BPS), in the context of a deterioration in fiscal forecasts we advised a wait-and-see approach, delaying decisions about either a faster or slower consolidation until there was more information in the lead up to Budget 2026 (T2025/2844 refers). This balanced concerns about a faster consolidation exacerbating an already large output gap with the need for continued progress towards a structural operating surplus.

3. You reiterated your commitment to medium-term fiscal consolidation in the BPS. Due to the deterioration in the fiscal forecasts, you decided to push out the intended date for returning OBEGALx to surplus by one year to 2028/29. The Half Year Update had OBEGALx returning to surplus one year later. You kept your other goals unchanged but indicated that the net worth intention would be revisited in this year's Fiscal Strategy Report (FSR), as it was not being met at the time.

4. This report should be read alongside T2026/471, which outlines judgements and trade-offs on your capital pipeline for Budgets 2027-29 and seeks indicative decisions on capital allowances. You have also received weekly advice on Budget 2026 initiatives (T2026/479 refers).

5. This report forms part of the 'Maintain macroeconomic stability' pillar of the all-of-government economic response strategy to the conflict in the Middle East. It provides an initial assessment of the potential impacts of the conflict on the appropriate fiscal stance and your fiscal strategy.

Preliminary fiscal forecasts show an improved position before the conflict

The impact of the Middle East conflict is uncertain…

6. The preliminary fiscal forecasts are based on the preliminary economic forecasts, which were finalised on 5 February, before the start of the conflict in the Middle East.

There is significant uncertainty about the impacts of the conflict on New Zealand. The economic and fiscal impacts will be determined by the duration of the shock and the channels through which it affects the New Zealand economy. Our current view is that it will have a temporary impact before returning to the previously expected economic and fiscal trends. Whether there is long-run economic scarring will depend on the depth, duration, and nature of the shock.

7. Monetary policy is generally better placed to moderate swings in economic activity. It is currently not constrained by the effective lower bound. However, whether demand or supply side factors dominate, and the anchoring of inflation expectations, will be important for the monetary policy response and therefore the path of macroeconomic stabilisation. A longer-lasting supply-side shock with increased inflation expectations would make it harder for monetary policy to provide stimulus to stabilise output.

…but the starting point is better than at the Half Year Update

8. Higher nominal GDP has resulted in upward revisions in tax revenue forecasts that more than offset increased expenditure in the preliminary fiscal forecasts, which were finalised on 5 March, based on unchanged allowances (T2026/385 refers). Increased expenditure is concentrated in a [33] and higher benefit expenses, which is mainly due to higher forecasts for CPI inflation and wage growth.

9. OBEGALx deficits improved by roughly $0.8 billion per annum on average compared to the Half Year Update (Figure 1), reaching close to a balanced position in 2028/29 (-$0.1 billion, or -0.0% of GDP). Net core Crown debt is lower by around 1.5% of GDP by the end of the forecast period (Figure 2), while improved operating balance results and an accounting standard change flow through to higher net worth.

Figure 1: OBEGALx

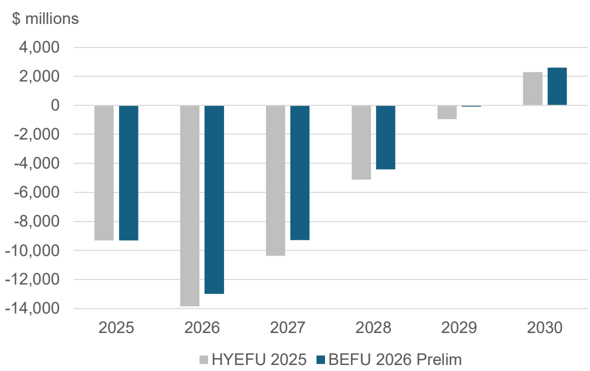
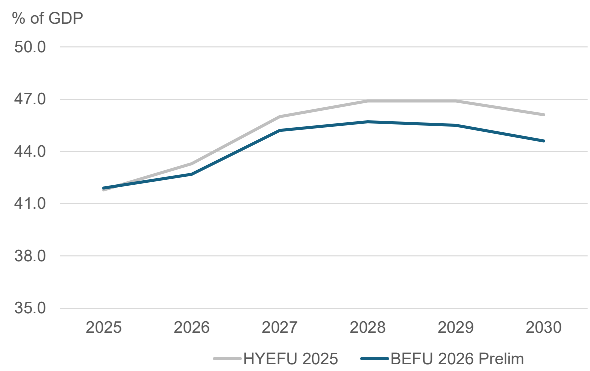


Figure 2: Net core Crown debt



Source: Treasury

Devising an appropriate response and fiscal strategy under uncertainty is challenging

10. Given the starting position, it is important to continue making progress on fiscal consolidation and to ensure your fiscal repair plan remains credible. Fitch Ratings agency have recently revised the outlook on New Zealand’s sovereign credit rating to negative, stating their view that “a substantial debt reduction is becoming more difficult to envisage, as fiscal consolidation has been delayed in the past few days”.

11. Consolidation should be balanced against the need to stabilise the macroeconomy, in conjunction with monetary policy. There are three main considerations in this context:

    a the appropriate fiscal stance given macroeconomic conditions and the monetary policy response,

    b the perceived credibility of your strategy (e.g., by credit rating agencies) to return to surplus over the medium term, and

    c the flexibility of your settings, allowing you to change course quickly based on new information.

12. As you have previously stated, the Government has a deliberate, medium-term approach to fiscal consolidation and will not over-react to movements up or down in the forecasts. This remains appropriate in the current context.

Your fiscal strategy is robust to a range of scenarios

13. There is a high level of uncertainty and the position could change, but our current assessment is that the conflict will not have long-lasting impacts on the economic and fiscal position. We expect monetary policy to look through the immediate inflationary impacts and focus on inflation in the medium term. In this scenario, we recommend no change to the Government's fiscal strategy. We recommend allowing the automatic fiscal stabilisers to operate in the near term (such as lower tax revenue and higher benefit expenditure if output declines or unemployment increases) but providing no further fiscal stimulus for the purpose of macroeconomic stabilisation. Any discretionary interventions should be timely, temporary, and targeted at alleviating supply chain disruptions or supporting vulnerable households and should be delivered within allowances.

14. Our views on the fiscal stance may change in the future if there were a significant broadening of the impact from the Middle East conflict. A fiscal response may be warranted if there are greater impacts, for example financial distress and credit constraints, such that there was significant additional weakness in demand and monetary policy was constrained from fully responding because it had reached the effective lower bound.

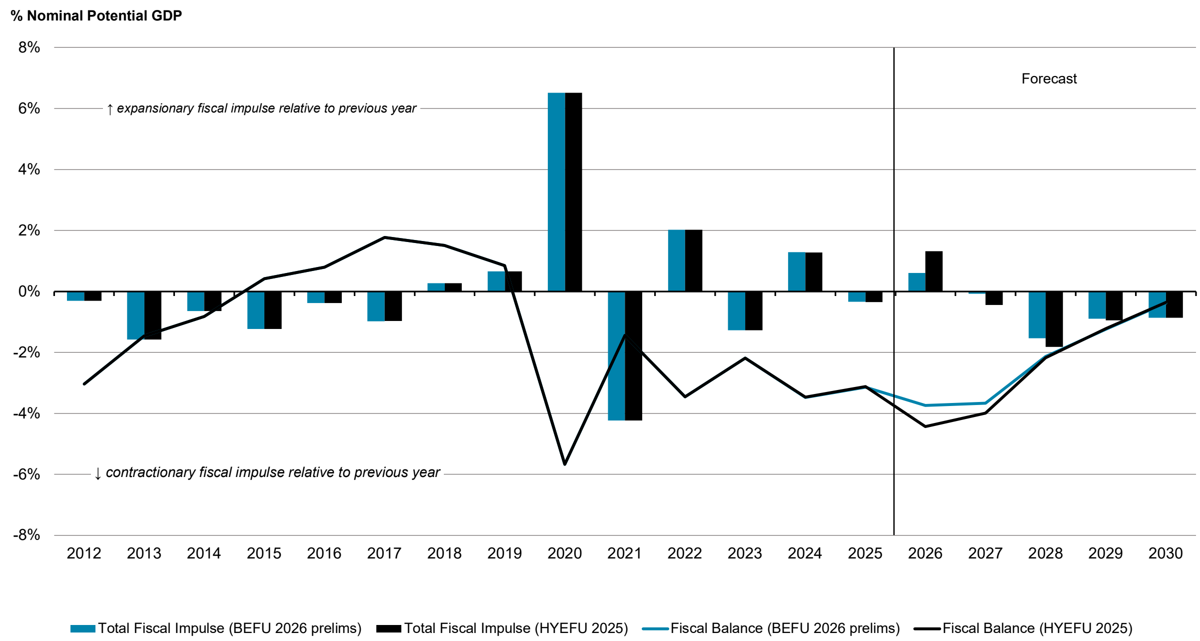
15. If the effects of the conflict lead to a permanent negative impact on the economic and fiscal position, the structural deficit will have deteriorated and greater fiscal consolidation will be warranted. The timing of this additional consolidation would depend on the state of the economy and concerns about exacerbating weak demand in the near term. We are feeding into and drawing from all-of-government work on likely scenarios for the Middle East conflict ahead of the next Ministerial Oversight Group meeting, which will then be used to support the finalisation of forecasts for the Budget Update. We will continue to advise you on the likely economic and fiscal impacts, and the appropriate fiscal response.

The tightening in fiscal policy is gradual in the near term and backloaded

16. The fiscal balance measure has been in deficit throughout the recent economic downturn, indicating that fiscal policy has been counter-cyclical. Over the forecast period, the impact of fiscal policy on aggregate demand is expected to reduce as fiscal consolidation takes effect, with the fiscal balance reaching zero by the end of the forecast period (Figure 3). This reflects both the contribution of automatic stabilisers reducing as the output gap closes and the impact of tighter discretionary policy.

17. The tightening in fiscal policy occurs from 2027/28 onwards, which now approximately coincides with the timing of the output gap becoming positive by the end of 2028. Compared to the Half Year Update forecasts, the total fiscal impulse (TFI) based on the preliminary Budget Update forecasts implies less of an increase in the contribution of fiscal policy to aggregate demand in 2025/26 (compared to 2024/25), and less of a negative impact on aggregate demand in the 2027, 2028 and 2029 years.

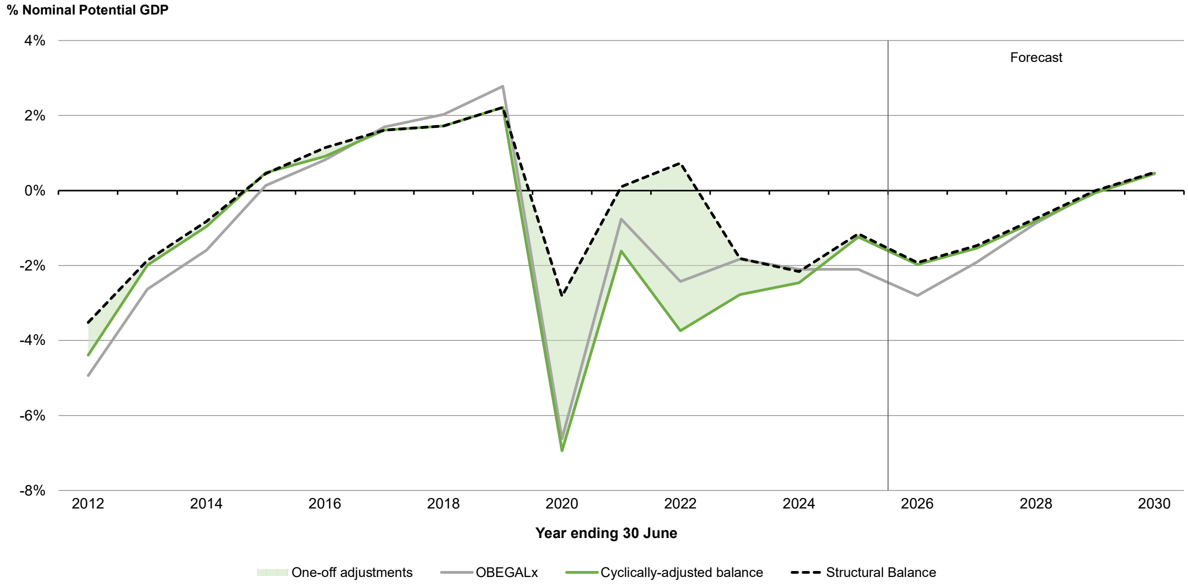
Figure 3: Fiscal balance and total fiscal impulse (TFI) forecast comparison



Your medium-term approach to fiscal consolidation remains appropriate…

18. It is important to close the structural deficit, which we estimate to be about two thirds of the OBEGALx deficit in 2025/26 (Figure 4). Action is needed to rectify the structural part of the deficit, while the remainder will be addressed automatically as the output gap closes. This will help bring down debt and rebuild buffers to ensure the government is able to respond to future shocks.

Figure 4: Preliminary BEFU 2026 OBEGALx, CAB, and structural balance



19. We consider the current broad framework of how the Treasury approaches the calibration of prudent debt to be appropriate. There is a trade-off between high-value investment and prudent debt: in the future it may be appropriate to recommend that we have less of a debt buffer for shocks to allow for a higher level of investment. However, at present, there is still headroom within the existing prudent debt calibration – of approximately $21 billion in 2029/30 based on the preliminary Budget Update forecasts – and there are options available for managing the capital pipeline (including balance sheet options). There is work within the Treasury and across agencies that will support taking a strategic and medium-term perspective to managing the capital pipeline by focusing on strategic policy choices within sectors, system settings, and institutional change.

20. We plan to do further work in the coming months on the prudent debt calibration, including sensitivity analysis on different assumptions, cross-country analysis, and engaging with stakeholders.

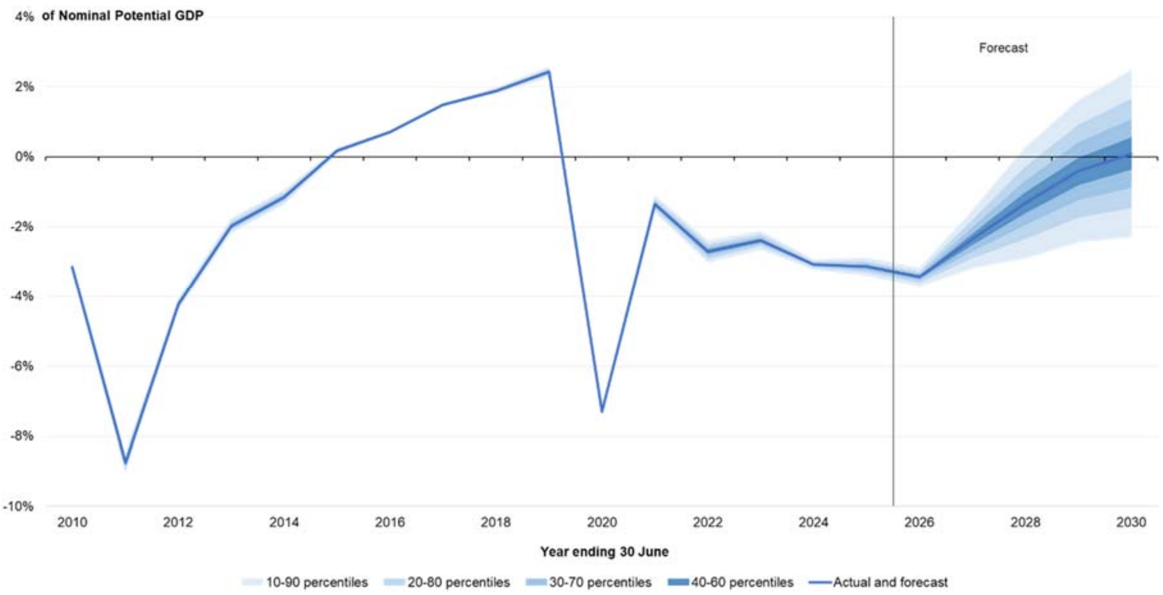
…but there are judgements about the pace of consolidation…

21. Based on the preliminary forecasts, the revisions to the output gap implied a relatively smaller risk of a tightening in fiscal policy exacerbating the economic downturn compared to the Half Year Update. However, there remains spare capacity in the economy, and there is substantial uncertainty around the economic and fiscal outlook, especially given the potential impact of the Middle East conflict. In addition, downward revisions to potential output represent a downside risk to tax revenue over the long term. As a result, macroeconomic considerations continue to support a gradual and backloaded consolidation that avoids significant tightening of fiscal policy in the near term, especially if the current conflict in the Middle East has persistent effects on consumer spending and business investment.

…and significant uncertainty

22. We have analysed the implications of uncertainty around the fiscal forecasts for the likelihood that your short-term intentions are achieved (note that this is not an assessment of the potential impacts of the Middle East conflict, but rather an analysis of uncertainty in 'normal' times.). Forecast variations two to three years out are quite large, reflecting uncertainties about economic activity, revenue, and expenditure decisions (Figure 5). Based on past forecast variations for revenue, we estimate that there is approximately a 50% chance of an OBEGALx surplus in 2028/29. This is higher than estimated using the Half Year Update forecasts, which indicated between a 45% and 50% chance, which is consistent with small upward revisions to the fiscal forecasts. We are doing additional analysis on forecast variations for net core Crown debt, core Crown expenses, and net worth, for potential inclusion in the Budget Update.

Figure 5: Fan chart for OBEGAL



Short-term intentions

Based on the preliminary forecasts, you were broadly on track to meet your STIs…

23. Uncertainty surrounding the situation in the Middle East means that it is difficult to make judgements about whether your STIs are being met. If there are no permanent effects on the economic and fiscal position – our current baseline view – then you should remain broadly on track.

24. In the preliminary forecasts, your operating intention is close to being met, with a very small deficit forecast for 2028/29. Net core Crown debt is now forecast to peak at a slightly lower level and one year earlier – at 45.7% of GDP in 2027/28, compared to 46.9% of GDP in 2027/28 and 2028/29 in the Half Year Update. This means you are on track to meet your debt intention of putting net core Crown debt on a downward trajectory towards 40% of GDP.

…but you could consider changing your net worth indicator

25. In the Half Year Update, the intention to "maintain net worth at around 40% of GDP" was not being met. Your BPS noted that it would be revisited ahead of this year's Fiscal Strategy Report. We are working with your office on possible changes to your net worth intention and indicator and will provide advice ahead of the Budget Cabinet paper.

Operating allowances

There is a case to deliver an operating package below $2.4 billion p.a.

26. As advised previously (T2026/109 in February), there are arguments in favour of delivering the Budget 2026 operating package below $2.4 billion p.a., in line with your approach of using the operating allowance as a ceiling rather than a target. These include:

    a A lower allowance will allow for faster progress towards reaching surplus. The current forecast, which is based on a $2.4 billion p.a. allowance, is for a small deficit in 2028/29, and there is significant uncertainty about the outlook.

    b Delivering below $2.4 billion p.a. will give you more space to respond to the current conflict in the Middle East, if needed. If it turns out to not be needed, you can use it to improve the fiscal position.

    c Delivering below $2.4 billion p.a. will be challenging but remains feasible within current package considerations, with options to scale savings or remove low value-for-money initiatives. More details on this are provided below.

    d The fiscal risks associated with your decision to use baseline reduction savings of 5% each in 2027/28 and 2028/29 to fund the Budget 2026 package can be partially offset by delivering Budget 2026 below $2.4 billion.

    e There are significant pressures outside of allowances, such as the Health NZ forecast deficit. If this is not addressed, delivering below $2.4 billion p.a. would marginally offset some of these risks.

27. There are options to deliver at around $2 billion p.a. for Budget 2026 by scaling savings or cutting some initiatives that we assess to be relatively lower value-for-money. In particular:

    a You are yet to make decisions on potential savings options like ending the final-year fees free scheme (up to $300 million p.a.) or scaling up the reduction in donation tax concessions (up to $41.6 million p.a.). You have also agreed to defer decisions on savings options like an Australian-style bank tax [34]

    b You could also consider removing or scaling the funding for large discretionary spending items like the Council Incentives for Urban Development initiative (currently included in the package at $173 million p.a. and is the largest single initiative).

28. On balance, we recommend delivering Budget 2026 below $2.4 billion p.a. if possible and keeping allowances for Budgets 2027-29 at $2.4 billion p.a. for now, as we do not yet know whether delivering below this would be feasible. The higher inflation track in the near term could result in more of future operating allowances being needed to cover cost pressures from increased prices to ensure core public services can be maintained at the same level.

29. Recommendations on capital allowances for Budgets 2027-2029 are in T2026/471. You are meeting Budget Ministers on 9 April to decide funding for the Transport GPS 2027. These decisions will impact the size of your Budget 2026 capital package and your fiscal strategy. Your decisions on capital allowances will have flow-on effects on operating expenditure, via interest costs, depreciation, maintenance, and other operating costs.

30. Decisions on operating and capital allowances, particularly for Budget 2026, do not need to be made now or can be done indicatively. There will be opportunities to update the forecasts over the course of April to reflect the impacts of the Middle East conflict and your Budget decisions.

Pressures are expected to intensify in the medium to long term

There are quantifiable cost pressures that will materialise and will need to be managed within allowances

31. One way to estimate cost pressures is to look at the trend over past budgets. The cost pressure funding provided over the past three budgets has ranged between $2.2 billion - $3.2 billion. In part, this decrease compared to recent history has been driven by lower inflation and the budgets having a much more targeted approach of only funding critical cost pressures in core areas like health, education, defence, and law and order. If this approach is continued over the next term, we would expect that absent policy change in the services that drive these costs, cost pressures of between $2 billion - $3 billion would be funded in each budget.

32. However, there are several risks to sustaining cost pressure funding to these levels. These include:

   a uncertainty in the level of operating costs associated with current and future capital projects,

   b cost escalations associated with capital projects (including capital to operating swaps),

   c uncertainty around the point at which agencies (primarily for those not invited for cost pressures over past budgets) will have service delivery impacts (this is partly mitigated by Performance Plans),

   d ongoing deficits in key areas like [37] and transport (National Land Transport Fund),

   e policy settings and flow-on impacts within the criminal justice pipeline, and

   f public sector pay agreements.

33. Within health, demographic and price pressures are likely to take up a significant proportion of current operating allowances from Budget 2027 onwards. [34]

Another way to estimate cost pressures is to analyse long-run expenditure trends

34. The expenditure strategy found that higher spending would be required over the next 10 - 15 years to avoid impacts on service delivery, under current policy settings. We estimated in May 2025 that a relative reduction of around 6% of GDP is required to

achieve the fiscal strategy, while offsetting future transfer pressures and demand for public services (T2025/1119 refers). We will provide advice on updated medium-term fiscal projections in mid-May.

35. We consider there are sufficient options available over Budgets 2027-29 to achieve the current fiscal strategy. Delivery within a net operating allowance of $2.4 billion p.a. will likely require ongoing high levels of savings to fund the level of gross spending pressures discussed above.

Meeting cost pressures within tight allowances will become harder over time

36. Managing within tight allowances will become harder over a longer time period in the face of growing pressures, both from known sources as noted above (such as demographic changes driving New Zealand Superannuation payments, and pressures in health, education, and defence), as well as unquantified pressures from climate change and geopolitical change. As such, a sustainable long-term fiscal position will require a mix of expenditure reform, increased efficiency, revenue raisers, and effectively managing the balance sheet.

37. Ensuring a sustainable long-term fiscal position will require a series of responses by successive governments over the next couple of decades as part of a planned durable strategy. There is a strong case for starting sooner rather than later, as this reduces the overall of cost of change and avoid the need for reactive or disruptive changes, allowing a longer transition period.

Next steps

38. We are scheduled to discuss this report with you at Fiscal Matters on Monday, 23 March.

39. You could discuss the level of allowances and short-term intentions at Budget Ministers 3 on 9 April.

40. We will provide advice on medium-term fiscal projections in mid-May.

Recommended actions

We recommend that you:

a **note** that based on the preliminary fiscal forecasts, you were broadly on track to meet the short-term intentions of your fiscal strategy, but there is significant uncertainty, and pressures are likely to intensify in the medium to long term.

b **note** that decisions on operating allowances do not need to be taken now or could be taken indicatively.

c **indicate** the operating allowances you want to include in the Budget Update 2026:

i. Budget 2026: $2.4 billion or specify: ________________

ii. Budget 2027: $2.4 billion or specify: ________________

iii. Budget 2028: $2.4 billion or specify: ________________

iv. Budget 2029: $2.4 billion or specify: ________________

d **note** that we will continue to work with your office and provide advice on changing your net worth indicator and intention ahead of your Budget 2026 Cabinet paper.

e **agree** to leave your other short-term intentions unchanged.

Agree / Disagree

Alex Hamilton
Unit Manager

Hon Nicola Willis
Minister of Finance

_____/_____/_______