ECONOMIC BULLETIN

New Zealand Government Budget 2025.

22 May 2025 | **Darren Gibbs**, Senior Economist | +64 9 367 3368 | +64 21 794 292 | darren.gibbs@westpac.co.nz

Bending the curve (just).

- As expected, Budget 2025 revealed a slightly weaker fiscal outlook than depicted in the HYEFU. A softer near-term growth outlook and a new tax incentive to encourage investment have driven a further downward revision to the revenue forecasts.
- Following a small downward revision to the current year's forecast deficit, an OBEGALx deficit of $12.1bn is forecast in the '25/26 year, up from $10.5bn in the HYEFU.
- The OBEGALx deficit in the five years to '28/29 is around $9bn larger than in the HYEFU, with a wafer-thin surplus of just $0.2bn forecast for '28/29.
- Core Crown spending is on average $0.6bn lower than forecast in the HYEFU, with the reduced operating allowance for Budget 2025 partially offset by higher benefit and debt financing costs. The capital allowance for future budgets is little changed from the HYEFU.
- Forecast NZGB issuance in '25/26 and '26/27 has been reduced by $2bn per year. However, cumulative issuance over the full four-year forecast period has been raised by $4bn, including a $6bn increase to the programme for '28/29.
- Subject to market conditions NZDM expects four bond syndications in '25/26 – three taps of existing lines and one new 20 September 2050 inflation indexed bond (IIB).
- Net core Crown debt is forecast to increase from an estimated 42.7% of GDP in '24/25 to a peak of 46.0% of GDP in '27/28, before declining modestly in '28/29.
- We think that the ratings agencies will remain comfortable with the outlook for the public finances given New Zealand's relatively low debt, with a significant narrowing of the current account deficit likely to offer further support to the sovereign credit rating.
- The Treasury's estimates continue to imply that the fiscal policy settings will be a cyclical drag on growth, although on net slightly less than estimated in the HYEFU.
- We doubt that Budget 2025 will have much bearing on next week's RBNZ policy review. Changes to the RBNZ's outlook are much more likely to be driven by the global outlook.
- The Treasury's forecasts for nominal GDP growth are less optimistic than our own. At face value this would suggest upside risks to the revenue outlook. That said, we also see upside risks to the outlook for spending.
- Key policy initiatives announced for the first time today include a sizable tax incentive to encourage investment and a staged increase in default employee and employer contributions to KiwiSaver (together with a reduction and means testing of the Government contribution).

In contrast to last year's Half-Year Economic and Fiscal Update (HYEFU), at the macro level Budget 2025 provided no major unpleasant surprises. As the Minister of Finance had indicated earlier this month, the Budget continues to project an operating surplus (on the Government's preferred OBEGALx measure) in '28/29, albeit wafer thin and accumulating larger deficits over the intervening period. The revised level of forecast government bond issuance over the next four years ($4bn) is in line with our forecast and our sense of market expectations. That said, the market may react positively to the near-term reduction in the forecast borrowing programme.

As had been foreshadowed, the Treasury's view of the underlying fiscal outlook has weakened since the HYEFU. In part this reflects a further downward revision to the near-term outlook for (nominal) economic growth and thus tax revenue. This reflects both the impact of weaker trading partner growth and the impact of recent changes in pay equity legislation, which in aggregate is expected to lead to slower domestic wage growth than forecast in the HYEFU. Revenue has also been impacted by the Government's decision to offer a tax-based incentive to encourage investment (in year one, firms will be able to deduct 20% of a new assets value, in addition to normal depreciation). This policy will cost about $6bn over the next four years, which the Government hopes will lift GDP by 1% over a 20-year period).

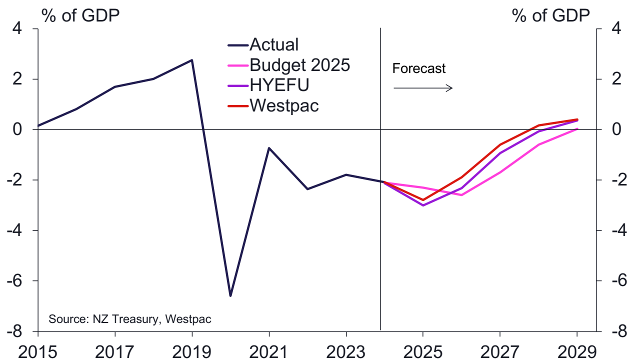
The impact on the public finances has been mitigated by the Minister's decision to cut this year's operating allowance to just $1.3bn – the least since 2015 – and other savings, including a $0.6bn per year reduction in the Government's contribution to KiwiSaver. In addition, the recently announced changes to pay equity legislation are estimated to save the Government $2.7bn per year relative to what had been assumed in the HYEFU. Looking ahead, after a period of softer growth in the near-term relative to the HYEFU, the economy is expected to grow a touch faster later in the forecast period. This leads to a slightly stronger growth in revenues.

In this note we review the key fiscal metrics and what these mean for the Government's borrowing programme; the economic forecasts on which these forecasts are based; and how today's information might be interpreted by the RBNZ. We also note some of the key policy announcements that were made (or confirmed) in Budget 2025.

Fiscal retrenchment delayed.

Table 1 sets out the key fiscal metrics revealed in Budget 2025, comparing these to the forecasts made in the HYEFU and to our own recently updated forecasts. An OBEGALx deficit of $10.2bn is now forecast for the current '24/25 fiscal year, compared to $10.9bn in the HYEFU. Moving forward, the Treasury's forecasts for core Crown tax revenue are lower than forecast in the HYEFU. However, the hit to the bottom line is mitigated by the Government's pre-Budget decision to set itself a very skinny operating spending allowance of just $1.3bn in Budget 2025. Thereafter, the Government continues to assume operating spending allowances of $2.4bn in subsequent Budgets. As a result, core Crown spending over the four years to '28/29 is on average $0.6bn lower than forecast in the HYEFU.

Operating balance (OBEGALx), % of GDP



On that basis, the Treasury forecasts an OBEGALx deficit of $12.1bn (2.6% of GDP) in '25/26, compared to the $10.5bn deficit forecast in the HYEFU. Thereafter, with core Crown spending expected to decline by around 2.0ppts of GDP, a gradual pickup in revenues is forecast to drive a sustained improvement in the fiscal position.

Budget 2025 forecasts a wafer thin OBEGALx surplus of $0.2bn in '28/29, compared with the $1.9bn surplus that was forecast in the HYEFU. The cumulative OBEGALx deficit over the four years to '28/29 is about $10bn larger than forecast in the HYEFU.

The Budget 2025 forecasts are less favourable than the forecasts contained in our recent *Economic Overview*. As discussed later in this note, the Treasury's forecasts for nominal GDP growth are weaker than Westpac's, largely reflecting a weaker outlook for general inflation and the terms of trade. At face value this would suggest upside risks to the Treasury's revenue outlook. That said, we also see upside risks to the outlook for spending, including upside risks to the cost of debt financing.

It is worth emphasising that the error bounds around any fiscal forecast are large, especially beyond the near term, as small differences in assumptions can quickly compound to drive vastly different outcomes. For example, the Treasury's analysis has shown that the historical 90% confidence interval around a five-year ahead forecast for revenue equates to a whopping ±$20bn.

On that score, as usual the Treasury also published some alternative scenarios to illustrate how the fiscal outlook might evolve if the economy turns out to be stronger or weaker than the baseline economic forecast (which we discuss later in this note). In the downside scenario, in which trade tensions lead to even weaker world growth, OBEGALx is forecast to remain in deficit in '28/29 (-0.9% of GDP) and net core Crown debt is forecast to rise to

Table 1: Key Fiscal Metrics

	23/24	24/25f	25/26f	26/27f	27/28f	28/29f
Core Crown spending $bn						
Budget 2025	139	142	150	153	157	162
HYEFU	139	145	150	153	158	163
Westpac	139	145	149	153	160	167
Core Crown tax revenue $bn						
Budget 2025	121	121	125	133	140	148
HYEFU	121	121	128	137	144	151
Westpac	121	122	129	138	147	156
OBEGALx $bn*						
Budget 2025	-8.8	-10.2	-12.1	-8.1	-3.1	0.2
HYEFU	-8.8	-10.9	-10.5	-4.4	-0.3	1.9
Westpac	-8.8	-12.2	-8.8	-3.0	0.8	2.2
OBEGALx % of GDP*						
Budget 2025	-2.1	-2.3	-2.6	-1.7	-0.6	0.0
HYEFU	-2.1	-3.0	-2.3	-0.9	-0.1	0.4
Westpac	-2.1	-2.8	-1.9	-0.6	0.2	0.4
OBEGAL % of GDP*						
Budget 2025	-3.1	-3.4	-3.4	-2.5	-1.3	-0.6
HYEFU	-3.1	-4.1	-3.1	-1.7	-0.9	-0.5
Westpac	-3.1	-3.8	-2.7	-1.4	-0.6	-0.4
Net core Crown Debt (% of GDP)						
Budget 2025	41.7	42.7	43.9	45.7	46.0	45.5
HYEFU	42.4	45.1	45.1	46.5	46.1	45.2
Westpac	41.7	44.0	43.5	44.5	43.6	42.4

* ex minority interests, OBEGALx excludes ACC spending and revenues.

Source: NZ Treasury, Westpac

49.3% of GDP. An upside scenario, in which productivity growth and net migration is assumed to be stronger than in the baseline forecast, sees OBEGALx return to surplus a year earlier in '27/28 (in line with the Government's target) and net core Crown debt ends the period at 43.1% of GDP.

As regards capital spending, as the Prime Minister announced ahead of the Budget, the net allowance for new capital spending in '25/26 was set at $4.0bn, up from $3.6bn in the Budget. In subsequent years the allowance for new capital spending has been set at $3.5bn, essentially unchanged from the HYEFU. This implies that the Defence Capability Plan will largely be funded within the existing pool of as-yet unallocated spending.

Forecast bond issuance increased slightly, but backloaded.

The slight deterioration in the near-term operating balance together with the small lift in projected capex spending has necessitated a further modest backloaded increase in the Government's forecast borrowing programme (see Table 2). The funding requirement for the coming fiscal year ('25/26) has been reduced by $2bn to $38bn, and for '26/27 has been reduced by $2bn to $36bn. However, the forecast programme for '27/28 has been raised by $2bn to $30bn and that for '28/29 has been raised by $6.0bn to $28bn. Hence, the cumulative increase in the programme across the four years to '28/29 has been revised up by $4bn, in line with our expectations. The cumulative increase over the full five years – including the overfunding of this year's deficit – is $7bn. Given upcoming maturities and repurchases associated with the $5bn per year winding down of the RBNZ's Large Scale Asset Purchase programme (LSAP), the revised bond programme implies a cumulative $59bn of net bond issuance over the next four years.

Table 2: NZ Government Bond Programme ($bn)

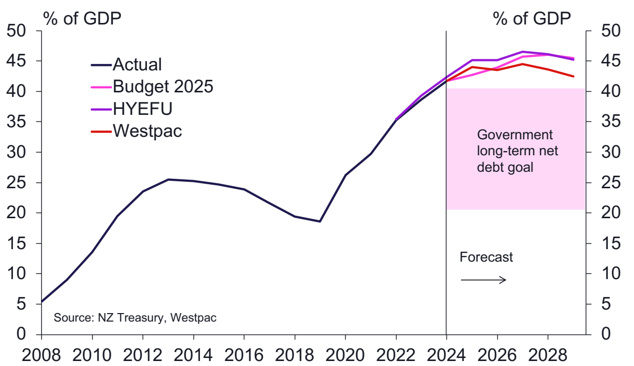
	24/25	25/26	26/27	27/28	28/29	Cumulative
Budget 2025	43	38	36	30	28	175
HYEFU	40	40	38	28	22	168
Difference	**3**	**-2**	**-2**	**2**	**6**	**7**

Source: NZ Treasury

According to NZ Debt Management (NZDM), short-term borrowings (Treasury Bills and Euro-Commercial Paper) at the end of '24/25 are forecast to be $15bn, which would be $5bn less than forecast in the HYEFU. These borrowings are expected to rise in the near-term to a peak of $18bn, before declining to a medium-term assumption of $13bn, although NZDM notes that it will take a flexible approach to borrowings intra-year. Subject to market conditions NZDM expects four bond syndications in '25/26 – three tap syndications of existing lines and a new 20 September 2050 inflation index bond (IIB). The first syndication is expected to be a tap of the 15 May 2031 bond and take place by 31 August 2025.

Given the borrowing requirement, net core Crown debt is forecast to remain above the Government's long-term goal of 20-40% of GDP throughout the forecast period. From an estimated 42.7% of GDP in the current year, the Government's favoured debt measure is expected to peak at 46.0% of GDP in '27/28 (a year later than forecast previously), before declining to 45.5% of GDP in '28/29. We expect that international credit rating agencies will be satisfied with that outlook, especially with the sovereign rating now also likely to be supported by a substantial narrowing of the current account deficit this year to less than 4% of GDP.

Net core Crown debt, % of GDP



Budget unlikely to feature prominently in RBNZ deliberations next week.

Considering the current global situation, we suspect that the stance of fiscal policy sits well down the list of issues that the RBNZ's MPC will be pondering as it puts the finishing touches on next week's May *Monetary Policy Statement* (MPS). In any case, we expect that the MPC will continue to regard the stance of fiscal policy as imposing a contractionary influence on the economy across the forecast period provided that the Government delivers the spending restraint indicated in the Budget.

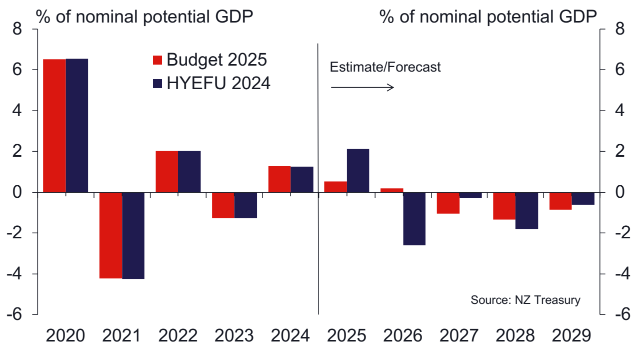
In judging the impact of fiscal policy, the RBNZ tends to focus on developments in Government spending as a share of GDP, which as noted is expected to decline over time. A more complete proxy of the first-round impact of fiscal policy on aggregate demand can be obtained from the Treasury's estimate of the Total Fiscal Impulse (TFI), which is set out in Table 3. The TFI is a cash-based measure of both fiscal outlays and revenues, that adjusts for some items that do not directly affect aggregate demand (such as defence spending on imported equipment). Noting that there have been some very large revisions to recent estimates, the Treasury's updated TFI estimates imply that the overall degree of looming fiscal restraint is modestly less than forecast in the HYEFU, reflecting the weaker near-term outlook for the economy. However, the Government's changes to KiwiSaver may encourage greater saving by some people, exerting an offsetting dampening influence on the economy. It is possible that the RBNZ may regard the Government's "Investment Boost" policy as having a moderately favourable impact on the economy's potential growth rate, although it will also boost investment spending.

Table 3: Fiscal Impulse (% of Nominal Potential GDP)

	23/24	24/25	25/26	26/27	27/28	28/29	Cumulative (24/25-28/29)
Budget 2025	1.27	0.52	0.18	-1.06	-1.34	-0.86	-2.55
HYEFU	1.26	2.13	-2.60	-0.27	-1.80	-0.62	-3.15
Difference	**0.01**	**-1.61**	**2.78**	**-0.79**	**0.46**	**-0.24**	**0.60**

Source: NZ Treasury, Westpac

Fiscal Impulse



Near-term economic forecasts downgraded as expected.

The key economic assumptions used by the Treasury to generate the baseline fiscal outlook are set out in Table 4, comparing these with the assumptions made in the HYEFU and Westpac's own recently updated forecasts.

The Treasury is assuming weak trading partner growth of just 1.9% in 2026 and 2.1% in 2027, rising to 2.3% in 2029. In the near-term that leads to slightly weaker real GDP growth than forecast in the HYEFU, with the impact on the tax base compounded by weaker growth in the terms of trade (albeit coming off a higher base given the strong growth in export prices over the past year). As a result, nominal GDP growth is expected to be weaker than forecast in the HYEFU and weaker than Westpac's forecast.

The unemployment rate is expected to track slightly higher than the HYEFU forecast and higher than Westpac's forecast, and it is expected to peak over coming quarters.

In the near-term the Treasury's forecasts for inflation are notably weaker than Westpac's forecast. The Treasury's favourable view of the inflation outlook is reflected in its forecasts for interest rates, which imply a decline in the Official Cash Rate (OCR) to around 2.5% sometime in the '26/27 year. The Treasury's forecast for the 10-year bond rate has been lifted since the HYEFU, but at 4.3% remains well below the Westpac's forecast.

Table 4: Key Economic Assumptions (June years)

	23/24	24/25f	25/26f	26/27f	27/28f	28/29f
Real GDP growth (ann. avg.)						
Budget 2025	0.6	-0.8	2.9	3.0	2.9	2.8
HYEFU	-0.2	0.5	3.3	2.9	2.8	2.4
Westpac	0.6	-0.8	2.8	2.8	2.8	2.8
Nominal GDP growth (ann. avg.)						
Budget 2025	4.8	3.5	4.9	4.7	4.8	4.6
HYEFU	4.7	3.4	5.4	5.0	4.7	4.5
Westpac	4.8	3.8	5.7	5.5	5.5	5.2
Unemployment (June qtr)						
Budget 2025	4.6	5.4	5.0	4.8	4.5	4.3
HYEFU	4.6	5.4	4.8	4.5	4.3	4.3
Westpac	4.6	5.3	4.8	4.2	4.0	4.0
CPI inflation (ann %)						
Budget 2025	3.3	2.2	2.1	2.0	2.0	2.0
HYEFU	3.3	1.8	2.1	2.0	2.0	2.0
Westpac	3.3	2.5	2.5	2.0	2.1	2.3
90-day rate (June qtr)						
Budget 2025	5.6	3.5	3.0	2.6	2.6	2.5
HYEFU	5.6	3.6	3.0	2.9	2.9	2.9
Westpac	5.6	3.2	3.1	3.9	3.9	3.9
10-yr bond rate (June qtr)						
Budget 2025	4.7	4.3	4.3	4.3	4.2	4.3
HYEFU	4.7	4.4	4.2	4.1	4.0	4.0
Westpac	4.7	4.6	4.8	5.0	5.0	5.0

Source: NZ Treasury, Westpac

Key Budget Policy Initiatives.

Finally, turning to the micro side of what the Minister of Finance has described as her "Growth Budget", the Government announced two key policy initiatives:

- **"Investment Boost"**: Starting today, businesses can deduct 20% of a new asset's value from that year's taxable income, on top of normal depreciation. According to the Budget, Investment Boost is expected to lift GDP by 1% over the next twenty years, with half these gains in the next five years. In direct terms, this policy is expected to cost the Government around $1.5bn per year (although if successful in lifting growth, this policy will generate some offsetting revenue over time). It seems reasonable to think that this policy will encourage greater investment spending, especially by cash-constrained smaller businesses.
- **KiwiSaver**: The default rate of employee and employer contributions for KiwiSaver will rise from 3% of salary and wages to 4% in two steps. From 1 April 2026, the rate will go to 3.5% and, from 1 April 2028, it will go to 4%. Employees will be able to temporarily opt down to the current 3 per cent rate, if they choose. The Government will extend the government contribution to 16 and 17-year-olds from 1 July 2025, and extend employer matching to 16- and 17-year-olds from 1 April 2026. However, the annual government contribution will be halved to 25 cents for each dollar a member contributes each year, up to a maximum of $260.72 from 1 July 2025. And members with an income of more than $180,000 will no longer receive the government contribution from 1 July 2025. This policy will save the Government $0.6bn per year.

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