



SALT INSIGHT

By: **Bevan Graham**, Economist
20 May 2026

New Zealand Budget 2026 Preview: A Difficult Backdrop for Fiscal Policy

This month's New Zealand Budget arrives at a delicate juncture for the economy and for fiscal policy. Growth has been soft but is showing tentative signs of stabilisation, inflation remains uncomfortably sticky in parts, and monetary policy, while still supportive, is operating in an environment of heightened uncertainty.

Adding to that uncertainty is the ongoing war in Iran, which is already feeding through into higher energy prices and inflation risks, while adding another layer of near-term complexity to an already challenging policy environment. Layered on top of this is a recent sovereign rating downgrade to our economic outlook, which has sharpened the focus on the Government's fiscal position. In an election year, that combination creates a difficult backdrop: the need to demonstrate fiscal discipline sits uneasily alongside the political instinct to support households and signal economic momentum.

Credibility matters

At its core, this Budget is less about near-term stimulus and more about building credibility. The downgrade has not fundamentally altered New Zealand's debt metrics in a global context, but it has changed the narrative. The direction of travel of persistent deficits, rising debt servicing costs, and limited evidence of a sustained consolidation path, has come under scrutiny. As a result, the Government is likely to place significant emphasis on

signalling a credible return to a more sustainable fiscal footing. The challenge, of course, is doing so without derailing what remains a fragile economic recovery.

This tension speaks to a broader theme we have highlighted for some time - the amplitude of New Zealand's economic cycles. Periods of policy, be it monetary or fiscal, that are either too stimulatory or too restrictive tend to exacerbate volatility, undermining business confidence and, ultimately, productivity. This Budget risks falling into that same pattern if the balance is not carefully managed. Tightening fiscal settings too aggressively may support credibility in the eyes of ratings agencies and bond markets, but it would also risk reinforcing the stop-start nature of the recovery. Conversely, leaning too heavily into pre-election support measures risks further eroding confidence in the fiscal trajectory, with implications for long-term interest rates.

More broadly, persistent macroeconomic volatility carries long-term consequences for investment behaviour. Businesses are less likely to commit capital in an environment where policy settings swing sharply between stimulus and restraint, and where inflation, interest rates, and funding costs become increasingly unpredictable. Over time, this risks reinforcing one of New Zealand's core structural challenges - weak capital deepening and persistently low productivity growth.

A softer fiscal outlook

The fiscal projections themselves are likely to reflect this increasingly difficult balancing act. Prior to the escalation in the Iran conflict, there had been tentative signs that the fiscal outlook was beginning to improve, albeit modestly. However, higher energy prices, weaker global growth, and the associated hit to revenues and expenses are likely to reverse much of that progress in the near term. While the Government has moved to constrain new discretionary spending, a range of pressures outside the recently lowered core operating allowance are still likely to push deficits higher over the next few years. As a result, operating balances are expected to remain in deficit for longer than previously envisaged, with only a gradual return toward surplus later in the forecast horizon.

Debt projections are also likely to deteriorate modestly relative to earlier forecasts. Increased borrowing requirements, alongside ongoing infrastructure commitments and softer revenue and higher expenditure growth, point to a higher near-term debt track before stabilisation eventually occurs late in the projection period. Importantly, however, markets and ratings agencies are likely to focus less on the absolute level of debt and more on whether there is a credible medium-term strategy to stabilise and ultimately reduce debt relative to the size of the economy. In that sense, the signalling around the fiscal trajectory may matter as much as the numbers themselves.

The trade-off economy

In that context, we expect the Budget to lean heavily on reprioritisation rather than meaningful new spending. The scope for large-scale fiscal expansion is non-existent and the political optics of restraint are more important than usual. This is likely to manifest as a reallocation of existing spending, with savings identified through programme cuts, delays, or efficiency gains. While this approach allows the Government to present a narrative of discipline without pursuing outright austerity, its credibility will ultimately depend on the quality and durability of those savings.

More fundamentally, when the fiscal position is tight, policy choices become less about what governments would like to do and more about what they are willing to trade off. Every dollar of spending carries an opportunity cost. That was a central theme in our recent Insights on retirement income policy, where we highlighted the trade-offs embedded in maintaining current arrangements for New Zealand Superannuation. The fiscal cost of universal provision is not abstract - it directly shapes what is feasible elsewhere, whether that is infrastructure investment, public services, or targeted support for households. In that sense, the Budget is not just a statement of priorities, but a reflection of the constraints that force those priorities into sharper relief.

Cost of living versus inflation risks

There will, however, likely be targeted measures aimed at addressing cost-of-living pressures. These are likely to be narrow in scope, focused on specific cohorts or policy areas, rather than broad-based stimulus. From a macroeconomic perspective, that is a sensible compromise. Broad fiscal support at this stage would risk working against monetary policy and could reintroduce inflationary pressures just as the economy is fretting over higher inflation. Targeted support, by contrast, allows the Government to respond to political realities without materially shifting the overall fiscal impulse.

Infrastructure and growth initiatives are also likely to feature prominently in the narrative. New Zealand's structural challenges of low productivity, weak capital deepening, and infrastructure deficits are well understood, and an election-year Budget provides a natural platform to address them. However, the constraint is not the identification of projects, but the capacity to fund them. This reinforces a key tension in the current environment - the need to invest to lift potential growth sits alongside the imperative to consolidate the fiscal position. In practice, this suggests a greater emphasis on delivery frameworks, private sector involvement, and longer-term commitments rather than immediate, large-scale spending increases.

Fiscal dominance and market discipline

Stepping back, this Budget also highlights an increasingly important dynamic - the growing influence of fiscal policy on overall macroeconomic conditions. As fiscal settings come under greater scrutiny, and as markets become more sensitive to sovereign risk, the interaction between fiscal and monetary policy becomes more pronounced. In this sense, we are seeing early signs of what is often described as fiscal dominance, where fiscal credibility, or the lack thereof, plays a key role in shaping financial conditions. If markets demand a higher term premium to compensate for fiscal uncertainty, longer-term interest rates will remain elevated regardless of the path of the official cash rate. That, in turn, has implications for investment, housing, and the broader economic outlook.

This matters because higher long-term interest rates increasingly act as a disciplining mechanism on fiscal policy itself. Governments may still control short-term political decisions, but bond markets ultimately influence the cost of financing them. In that sense, fiscal credibility is no longer simply an accounting exercise - it is becoming an increasingly important driver of financial conditions and asset market behaviour.

Setting the boundaries for the election

Importantly, this Budget does not sit in isolation. It effectively establishes the fiscal starting point for the election. While the constraints it imposes on the

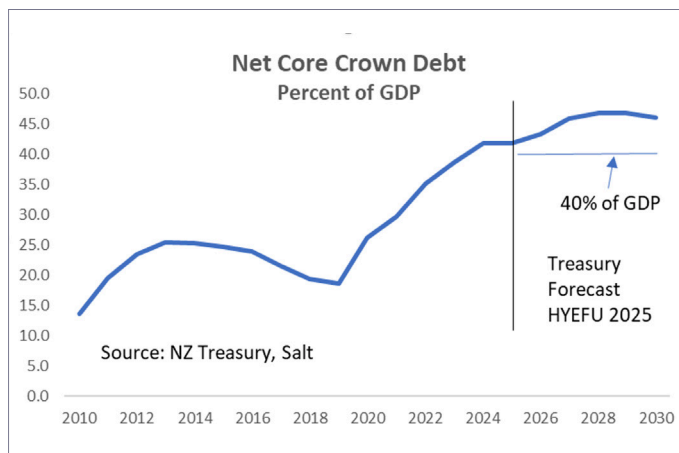
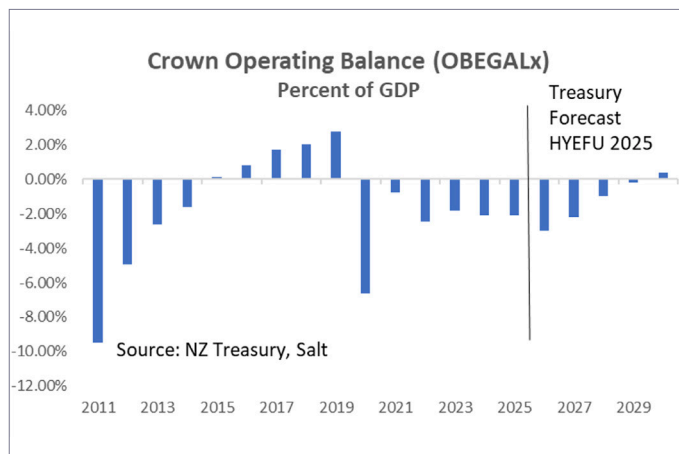
Government are clear, they apply just as forcefully to opposition parties as they frame their policy platforms. Any commitments made in the lead-up to the election will be judged against the same fiscal backdrop of limited headroom, elevated debt dynamics, and heightened sensitivity from ratings agencies and bond markets. In that sense, the hurdle for credible policy is higher across the political spectrum. Promises of new spending, tax relief, or structural reform will need to be matched with equally credible funding and prioritisation decisions.

The bottom line

The broader takeaway is that this Budget is unlikely to resemble a traditional pre-election fiscal expansion. Instead, it is shaping up as a careful balancing act - an attempt to support households and articulate a growth narrative, while simultaneously reassuring markets that fiscal discipline remains intact. Whether it succeeds will depend less on the headline announcements and more on the credibility of the underlying fiscal strategy.

In that sense, the Budget should be viewed not as an endpoint, but as part of a broader process of rebuilding trust and confidence. New Zealand has long benefited from a reputation for prudent fiscal management. The recent downgrade is a reminder that such credibility cannot be taken for granted. The task now is to re-establish it, without amplifying the very economic volatility that has contributed to the challenge in the first place.

In many respects, this Budget is less about what New Zealand can afford to promise, and more about what it can realistically afford to sustain.



Disclaimer: The information in this publication has been prepared from sources believed to be reliable and accurate at the time of preparation but Salt Funds Management Limited, its officers, directors, agents, and employees make no representation or warranty as to the accuracy, completeness, or currency of any of the information contained within, and disclaim any liability for loss which may be incurred by any person relying on this publication. All analysis, opinions and views reflect a judgment at the date of publication and are subject to change without notice. This publication is provided for general information purposes only. The information in this publication should not be regarded as personalised advice and does not take into account an individual investor's financial situation or goals. An individual investor should, before making any investment decisions, seek professional advice. Past performance is not a reliable indicator of future performance and no representation or warranty, express or implied, is made regarding future performance. Salt Investment Funds Limited is wholly owned by Salt Funds Management Limited and is the issuer of units in the Salt Investment Funds Scheme. A Product Disclosure Statement can be found at www.saltfunds.co.nz

More information is available at: www.saltfunds.co.nz.