

NZ Insight: The Middle East conflict – NZ's fiscal policy response to surging fuel prices

23 March 2026

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Key points

- The nature of oil price shocks significantly complicates the macroeconomic policy response (both fiscal and monetary). It's a global supply shock, with potentially net negative medium-term demand implications for NZ, but with a near-term inflation surge that could morph into higher medium-term inflation expectations. The wrong policy response could add to our economic woes over the medium term.
- *Targeted, timely, and temporary* are all important elements of any discretionary fiscal response, but given the risk this shock poses to medium-term inflation, we think that even *temporary* support should be **fiscally neutral**.
- Fiscally neutral doesn't mean doing nothing – it means ensuring you're helping those who need it most, while finding a way to pay for that other than by adding to debt. It means not adding to the inflation impulse, which could cause the RBNZ to hike the OCR more aggressively than otherwise – broad-based, debt-funded, discretionary government support today would mean higher interest costs tomorrow: not a good deal for households and businesses. Fiscal policy needs to account for the fact that the RBNZ potentially has a large inflation problem on its hands.
- As a preliminary line in the sand, and assuming the response is fiscally neutral (i.e. it's just economic impacts driving a deterioration in the fiscals), our initial estimate is that the cumulative impact on the bond programme to June 2030 could be an increase of around \$10bn. The bulk of the additional funding pressure is front loaded, meaning NZDM could opt to put a fourth syndication (for June 2026) back on the table, but they could also opt for more stability in their guidance (they have plenty of buffer to get them through). We show a potential issuance profile for both scenarios. We'll firm these numbers up closer to Budget – there's plenty more information to come!

Preliminary estimate of the implication for the bond programme

Year to June	Jun-25	Jun-26	Jun-27	Jun-28	Jun-29	Jun-30	Total (26-30)
HYEFU 2025	42.6	35	34	34	32	30	165
Budget 2026 (ANZ expectation no June 2026 syndication)	42.6	35	38	36	34	32	175
Budget 2026 (ANZ expectation with June 2026 syndication)	42.6	40	36	35	34	30	175

Source: NZ Treasury, ANZ Research

- Based on the above and our updated GDP forecasts, a fiscally neutral response should also mean the forecast peak for net core Crown debt will just sneak in under 50% of GDP.

- While our working assumption is that this shock isn't large enough to derail New Zealand's economic recovery, it does highlight our fiscal vulnerabilities, which are higher than otherwise because of the lack of fiscal consolidation following the pandemic. And now the next shock has arrived before the first post-pandemic surplus – the number of times we can get away with that is finite.
- As the NZ Treasury has been highlighting for a long time, the long-run fiscal trajectory is not sustainable. The impact of this shock on the fiscal position means the road we have been kicking the fiscal can down has just gotten shorter.

Policy making under uncertainty

For households and businesses across New Zealand, the global oil price shock is a nasty cocktail with:

- its impact on fuel prices,
- spillovers to other prices and costs,
- the impact on confidence,
- the impact on real household incomes,
- and therefore spending and business profits,
- which feeds into lower investment and employment appetite,
- and let's not overlook the recent impact on wholesale interest rates, adding upwards pressure to fixed mortgage rates,
- and therefore putting downwards pressure on house prices.

No doubt policy makers wish they had an easy solution to all that. They don't! The best they can hope for is to avoid unnecessary pain overall and make things a bit fairer in terms of how the pain is shared. Fiscal policy absolutely can take the edge off for some. It just needs to do it carefully because supply shocks are different!

Indeed, assuming fiscal policy cares about coordination with monetary policy (which is to the benefit of all current and future New Zealanders), then one of the major difficulties policy makers face right now is how to best deliver support to those who really need it, while remaining cognisant that the medium-term economic implications of this shock are still very uncertain. There's a real risk that the policy response could end up adding fuel to the inflation fire – a risk that would intensify the more the Government used extra borrowing to fund its response. Of course, there are risks on the other side too, just as for monetary policy. If the inflation surge proves temporary the economy could end up in a more disinflationary state than otherwise over the medium term, and an opportunity would have been missed to knock the roughest corners off the shock. Policy makers need to be ready for all scenarios, but until we know which is more likely to play out, the path of least regrets is to tread cautiously.

Just as we saw with the post-COVID inflation surge with "Team Transitory" making its case against "Team Persistent", economists are starting to diverge in their views over what this shock means for medium-term inflation: "Team Inflationary" (the initial inflation spike morphs into something persistent and broad-based) versus "Team Disinflationary" (the initial inflation spike subsides quickly while the demand hit is persistent).

Take that as a sign of how uncertain the potential medium-term implications are. We freely admit that we don't know how the situation is going to evolve, and how the potentially offsetting impacts on inflation expectations and economic slack are going to land. And nor do the NZ Treasury, RBNZ, or Government know which team is right. But if policy makers pick the wrong team, their initial response (fiscal and monetary) could end up making outcomes worse in the longer run.

The business cycle lens: fiscal-monetary policy coordination.

As we've highlighted above (and as a lesson from the not-too-distant past, [in this note](#)), fiscal policy, if implemented out of sync with broader economic conditions, has the potential to create as many economic problems as it is trying to solve. There's a reason fiscal-monetary policy coordination is a theme in the Public Finance Act.

Government absolutely has a role in supporting a productive economy. But as a general rule it cannot conjure economic resources (people and capital) out of thin air, meaning a fiscal expansion when capacity constraints are already biting tends to add to inflation pressures more than it lifts real activity. In that environment, the additional demand is more likely to show up in higher prices, forcing the RBNZ to move interest rates higher than otherwise, intentionally squeezing households and businesses to make room for the extra demand from fiscal settings. In aggregate, the stimulus therefore achieves less than it would if there were spare capacity to accommodate it. Equally importantly, expanding fiscal policy during such times leaves fiscal authorities with fewer options when support to demand is eventually needed. And that's applicable to the current situation – we didn't make hay when the sun was shining and fiscal policy now has fewer options than otherwise because of that.

In 2022 the economy was seriously overheated. The output gap was significantly positive, CPI inflation was accelerating towards 7.3%, the unemployment rate was unsustainably low (wage-price spiral dynamics had taken hold), the current account deficit (figure 2) was heading to 9% of GDP (showing that the domestic economy was significantly out of balance) and the RBNZ was kicking off a hiking cycle in order to get the New Zealand economy on a more sustainable trajectory. In the past, when macroeconomic conditions were in a similar cyclical position, fiscal deficits were flipping into surplus – making hay. But this time was different: fiscal deficits were trending wider – even as the booming economy meant tax receipts consistently outperformed expectations and unemployment fell – as discretionary fiscal policy choices added more fuel to the fire (figure 1).

Figure 1. RBNZ output gap vs OBEGAL

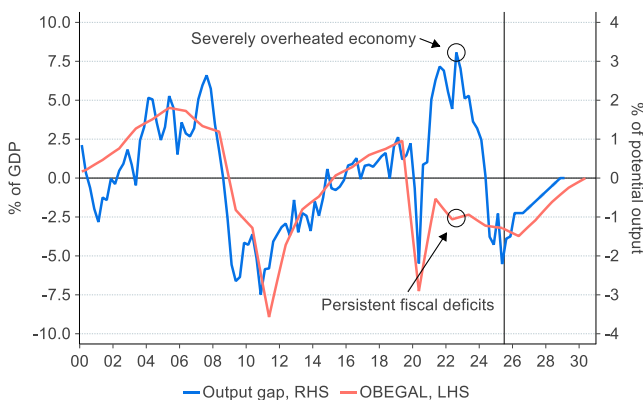
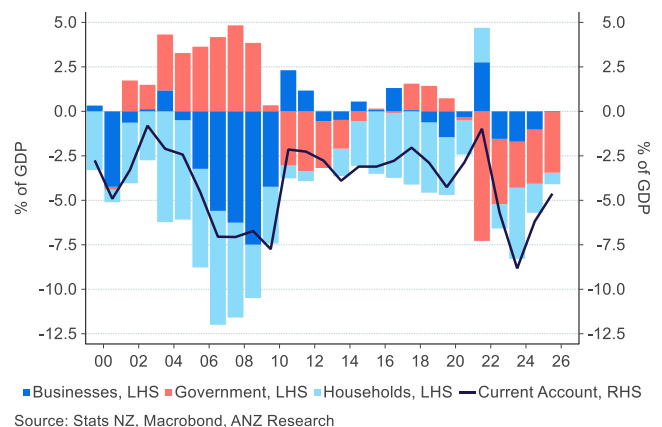


Figure 2. Net savings contribution to current account deficit by sector



Ultimately, that bout of pro-cyclical expansion contributed to the entrenchment of CPI inflation pressures and a bigger boom-bust cycle in the economy. Thus, as we stare down the barrel of yet another possible significant inflation threat, fiscal policy needs to tread cautiously. That doesn't mean there isn't room to help – support just needs to focus on those most affected and be ready to adapt as the medium-term implications start to become evident in the data.

It's clear as mud how this is all going to play out. But here and now, given it's not yet clear how big of an inflation battle the RBNZ is going to have on its hands, we think it's appropriate that the Government rules out any broad-based transfers or tax relief to households and/or businesses. The gold standard in any fiscal response to a crisis is that it's **targeted** to those who

really need it, **timely** (it reaches those who need it quickly), and **temporary** (it doesn't get locked into baseline government spending/revenue, putting Government debt onto an unsustainable trajectory).

And while it's reassuring to hear the Minister of Finance flaunting the "golden Ts", at the current juncture, given the uncertainty about the medium-term inflation implications of this shock, we would add an 'FN': that even *temporary* support should also be **fiscally neutral**. That is, it should be paid for from either the \$2.4bn operating allowance already set aside for Budget 2026, reprioritised spending from within existing baselines, or even paid for via revenue initiatives (higher taxes or levies on those not as negatively impacted).

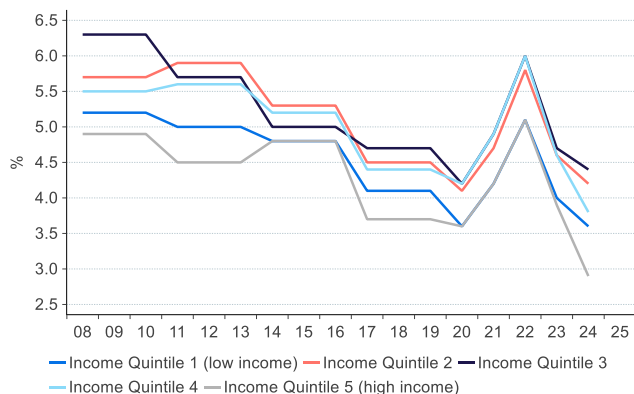
All of this isn't to say that the Government has its hands tied. There are certainly options to provide temporary relief (e.g. transfers) to households that need it most. The main balancing act is to ensure that the response doesn't end up adding to the medium-term inflation impulse, increasing the chances that the RBNZ has to clobber the economy again – while also pushing NZ government debt closer towards unsustainable levels (potentially eventually requiring costly fiscal adjustment – see page 8).

What about fuel tax cuts?

The Minister of Finance appears to have ruled out broad-based fuel tax cuts. Here's why that makes sense:

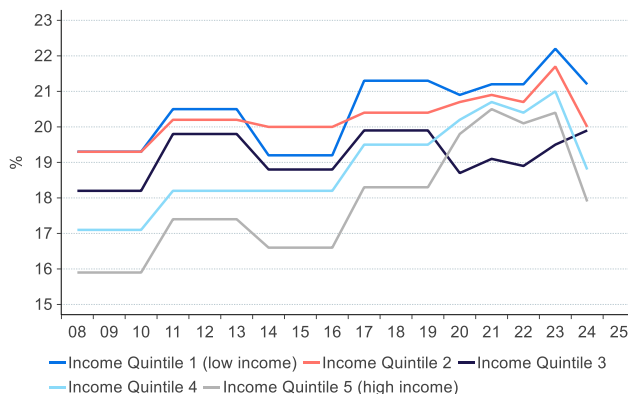
- While it would temporarily result in lower-than-otherwise CPI inflation in the very near term, it would also be stimulus (household demand would be higher than otherwise), meaning the underlying state of demand is stronger than otherwise. And because this is a shock to both supply and demand, that could leave underlying inflation pressures higher than otherwise. So if the RBNZ finds itself needing to lower demand by hiking the OCR into contractionary territory, then households and businesses will ultimately end up substituting lower fuel costs in the near term for higher interest costs later.
- Lower fuel taxes would not be targeted to those who need support the most. High-income earners are relatively insulated from this shock because fuel expenditure is a small share of their income (figure 3) and they have resource to buy electric vehicles; why give them tax relief? But importantly, while low-income households have the second-lowest direct exposure to fuel prices (vehicle ownership rates are lower), they are more likely to feel the pain of the second-round inflationary impacts via the likes of public transport and food prices (Figure 4). Kids going hungry can have significant human capital and productivity consequences over the long run, and targeted support for this cohort is important.
- Price is a highly effective – if hardly equitable – rationing mechanism. Lower fuel taxes imply higher fuel consumption than otherwise (see [this paper from Motu](#) that suggests a 10% sustained rise in fuel prices may reduce demand in the near term by 1-2%, with larger impacts over the longer run). In other words, if we find ourselves having to ration fuel, we may end up regretting past policy choices that reduced the reduction in how much gets consumed.
- We don't know how long this shock will persist for, and politically, a tax cut is much easier to put in place than reverse, even if it's described as "temporary" from the get-go.
- We need to fund our roads somehow. This was looking like a challenge before this shock.
- Fiscal bullets are scarce, so we should use them more effectively than cutting fuel taxes.

Figure 3. Petrol income weights by income quintile



Source: Stats NZ, Macrobond, ANZ Research

Figure 4. Food income weights by income quintile



Source: Stats NZ, Macrobond, ANZ Research

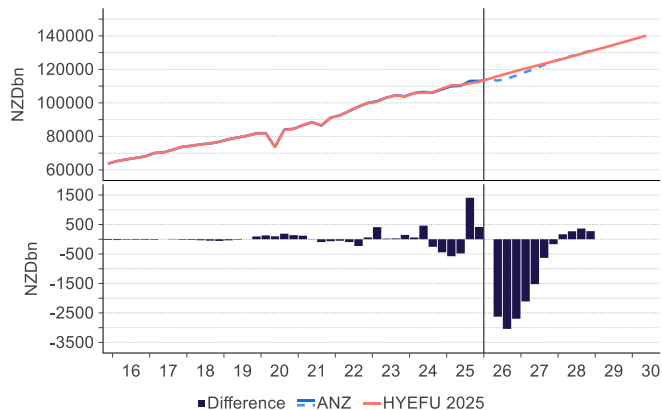
All up, in addition to targeted, timely, temporary, and fiscally neutral support, the most significant thing the Government can do to limit the economic fallout is focus on containing the supply shock itself: fuel security. And if worst does come to worst (our forecast assumes it's only prices that do the fuel rationing), having a clear framework in place to ensure that critical industry and workers get prioritised over leisure fuel users with the means to pay exorbitant prices. For the sake of protecting jobs we need to make sure the fuel we do get goes to those who really need it.

Potential impact on the Government's books and bond programme

Markets are focused on the implication of these events for bond issuance guidance, where it's looking like bond issuance will be higher than signalled at December's HYEFU. And that implies higher government debt and wider-for-longer operating deficits (even if the discretionary policy response is fiscally neutral).

The NZ Treasury will publish a fresh set of economic and fiscal forecasts on 28 May alongside Budget 2026. The economic forecasts will likely be finalised in early April, the tax forecasts around a week later, and the fiscal forecasts in late April or early May.¹ That is, the Treasury is only a couple of weeks away from starting to lock down the Budget forecasts – so their outlook, like ours, will be uncertain and at risk of going out of date quickly, potentially by the time they are published. Our updated outlook suggests the Treasury's nominal GDP forecasts is in for a downgrade, and that will have implications for the fiscals.

Figure 5. Nominal GDP forecast: ANZ vs HYEUFU



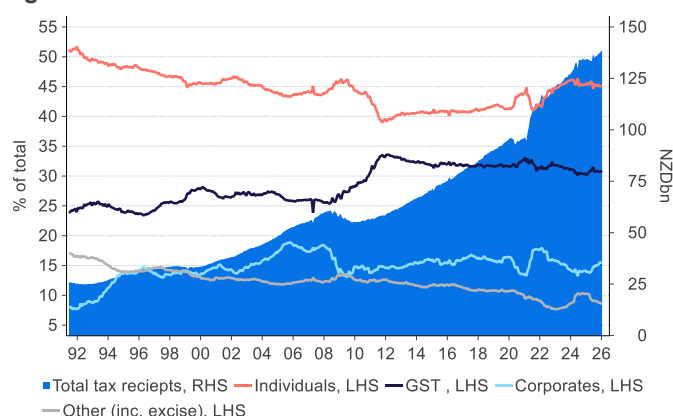
Source: NZ Treasury, Stats NZ, Macrobond, ANZ Research

¹ The next full set of forecasts after that will be the Pre-election Economic and Fiscal Update, around a month before November's general election.

When it comes to the implications for tax revenues and expenses, there's a lot to weigh up:

- With the power still on the employer side of the table so early in the recovery, households are unlikely to be fully compensated for the near-term inflation spike. So while source deductions (e.g. PAYE) will increase with nominal wages, it may lag CPI inflation. Employment is also likely to be weaker than otherwise. Overall, this leans towards weaker tax revenue from individuals than otherwise.
- It's nominal spending that matters for GST. Prices will rise but people are likely to buy less. Given this offset, the GST revenue outlook might not change much.
- Corporate tax is likely to be lower than otherwise too (for a time) given the near-term rise in costs is likely to weigh on margins and therefore profits. Lower-than-otherwise demand for goods and services will impact corporate profitability and thus tax bills too.
- There are some parts of the tax basket that may be higher than otherwise (resident withholding tax might be higher if both nominal interest rates and savings rise). But this is a small share of the total tax take compared to the big three: source deductions (primarily PAYE), GST and company tax.

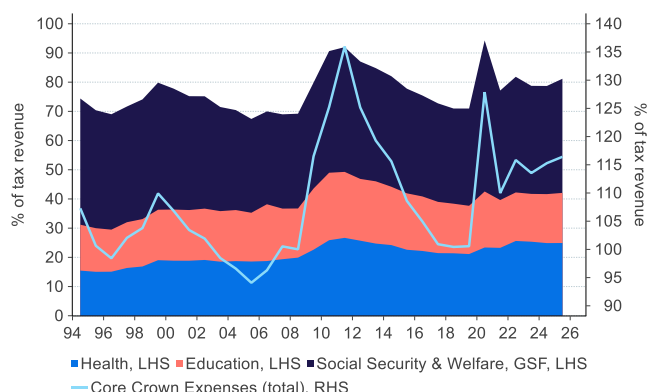
Figure 6. Annual unconsolidated tax outturns



Source: NZ Treasury, Macrobond, ANZ Research

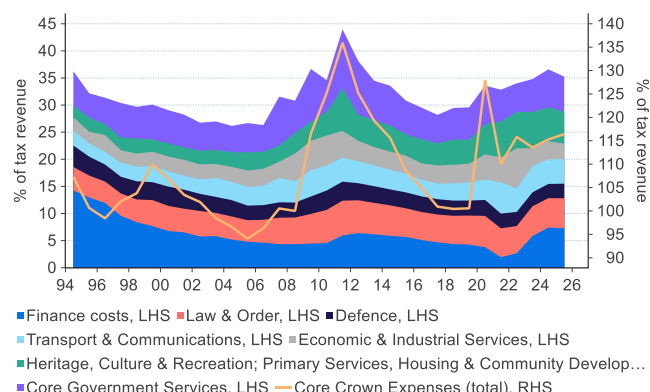
On the expenditure side, automatic stabilisers (i.e. social security and welfare, which is the largest expense as it also includes NZ Superannuation) could be higher than otherwise if the shock proves persistent enough to weigh on employment. Likewise, higher yields and more borrowing than otherwise could add to interest expenses (which have grown meaningfully as a share of tax revenue in recent years, figure 7b). Transport subsidies are another obvious expense that could also come under pressure. But there are also the broader inflationary impacts to account for: the more the rise in fuel prices spills over to prices for other goods and services, the higher the cost to Government of delivering a fixed quantum of government services.

Figure 7a. Core Crown expenses as a share of tax revenues – big-ticket items



Source: NZ Treasury, Macrobond, ANZ Research

Figure 7b. Core Crown expenses as a share of tax revenues – smaller ticket items



Source: NZ Treasury, Macrobond, ANZ Research

The above charts present expenses as a share of tax revenues rather than as a share of GDP as this is better for demonstrating fiscal sustainability: any significant shortfall between the two will need to be funded with debt. The line in figures 7a and 7b show that for every \$1 the Government is collecting in taxes it's currently spending around \$1.16. And now, that shortfall is at risk of widening (note: while there are forms of Crown revenue other than tax, tax is the lion's share and these charts capture the fundamental issue at hand).

Putting all of the above together suggests that even if we see a fiscally neutral response, economic factors are likely to drive a deterioration in the Government's books than had this shock not happened. And while the economy was starting to look a little rosier than the Treasury's December forecast before this shock², changes to the Treasury's outlook as a result are likely to more than offset that. That means a likely upgrade to bond issuance guidance come Budget.

Assuming the response is fiscally neutral and based on our updated economic outlook (and the change in bond yields since HYEFU), our initial estimate is that the cumulative impact on the bond programme to June 2030 could be around \$10bn. Most of the additional funding pressure occurs at the very end of the current fiscal year and the 2027 fiscal year. We assume NZDM will smooth that pressure out across the forecast horizon to achieve a stable profile.

We provide two scenarios on how this could play out:

- NZDM stick to their HYEFU guidance that there will be no further syndications in the current fiscal year.
- NZDM add a June syndication to the current fiscal year (we assume a \$5bn deal).

Preliminary estimate of the implication for the bond programme

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Source: NZ Treasury, ANZ Research

The above options each have their pros and cons. On the one hand, given uncertainty around the outlook it could be prudent to opt for a June 2026 syndication and get some prefunding in the door (hedge your bets in case the Treasury's Budget forecast turns out overly optimistic). Conversely, NZDM prefer to give plenty of notice about an upcoming deal (and markets prefer a decent heads-up too). Further, it wouldn't be ideal to announce a deal without also providing the full context of the projected borrowing task at hand (that is, fully updated fiscal forecasts), meaning they might want to wait until Budget (28 May) to announce anything. That would be a relatively short timeframe for a June deal (but markets would likely understand). The other reason to pre-fund is the fact it's an election year. It could take time for coalition negotiations to conclude, during which time NZDM would rather not be undertaking syndications.

² Monthly Government statements to January show key fiscal indicators were slightly healthier than forecast (although much of that looks like timing, i.e. delayed expenses). The February Statements will provide some further insight into the state of the Government's books heading into this shock (out 2 April), and the March statements (out 12 May) may show some early impacts of it.

Picking the bond programme is always a bit of a mug's game given all the moving parts. This shock adds to the uncertainty. We'll firm these numbers up closer to Budget – there's still plenty of information to come!

A vulnerability exposed: Adding to our long-run fiscal challenges

We've covered a lot of ground, but when it comes to fiscal policy there's a lot more to think about than just the business cycle! In fact, as we've hinted at already, the government doesn't actually have a lot of control over near-term business cycle dynamics – in that respect the best fiscal stance is one that isn't working against monetary policy. At the end of the day, if the Government wants to stimulate the economy when the RBNZ needs it to slow down, the RBNZ will always win – they get to move last, more often, and there's no limit on how high the OCR can go! But that dynamic is not symmetrical – there could come a day when the RBNZ wants to stimulate the economy, but the OCR is at the effective lower bound (monetary policy has run out of runway). In that instance, monetary policy might need a fiscal friend, so it's not a bad idea for Government to always ensure there's enough fiscal headroom for a big shock or two.

The good news is that right now, there is fiscal headroom to respond to a shock if things go south sharply and the RBNZ needs a hand. But because the fiscal war chest wasn't restocked when the economy was running hot, government debt has ratcheted higher, meaning once the Government has responded to the next big shock (not necessarily this one), the eventual fiscal adjustment is going to have to be sharper (and potentially more economically painful) than otherwise.

It's also important to note that fiscal policy settings are going to need to adjust towards higher taxes and/or lower spending eventually anyway – it's not an *if*, it's a *when*. That's largely due to an aging population (but also rising interest expenses). As the [Treasury's Long-Term Fiscal Statement](#) states "if no policy action is taken, the fiscal position would become increasingly unsustainable and net core Crown debt would rise to around 200% of gross domestic product (GDP) by 2065".

Knowing exactly where "sustainable" thresholds lie for government debt is not an exact science. But past NZ Treasury estimates have suggested that once net core Crown debt starts to exceed 50% of GDP in "normal times", we will have crossed the "prudent" boundary. Based on our preliminary estimates of what this shock might mean for government debt – which assumes a fiscally neutral response, so it's just economic factors driving changes in debt – and our updated GDP forecasts (subject to change for obvious reasons), we estimate the possible debt to GDP ratio at Budget 2026 should still peak just under 50% of GDP. But it'll be close.

Figure 8. Net core Crown debt HYEFU vs our preliminary estimate for Budget 2026



Source: NZ Treasury, Macrobond, ANZ Research

It's also worth noting that the 50% "prudent limit" is based on the idea that the Government should maintain a buffer of around 20% of GDP (about the size of the pandemic response) for when the next inevitable shock (or shocks) comes along. But the main point worth noting here is that if you do

exceed 50% of GDP (because a shock has come along), tax (higher) and spending (lower) will need to adjust if we want the Government to quickly restore its ability to support businesses and households when the shock after that happens (e.g. a natural disaster, pandemic or economic crisis). Combine this worthwhile pursuit of preserving fiscal headroom with the long-run costs of an aging population and now much higher debt, and the need to have some tough conversations about tax settings (e.g. a broad-based capital gains tax) and spending (e.g. addressing superannuation costs) is more urgent than ever.

But here's the kicker; it won't be the Treasury's analysis that tells us when we've pushed it too far, it'll be the bond market. And in the absence of a fiscal course correction, it could also be the bond market that forces fiscal discipline. Here's how that scenario could play out, a couple of 'shocks' down the track:

- As NZDM issue more and more bonds to fund the shortfall, government yields rise (they'll need to in order to ensure all the bonds can be sold).
- Government funding costs increase because of higher yields and debt levels. And if the Government signals they are not willing to correct the trajectory by changing fiscal settings (tax and spending), investors will start requiring additional compensation for the insolvency risk. It's important to remember that the many global investors buying NZ bonds have a choice – we're a marginal market that they could choose not to participate in if the fundamentals change. We're not the most liquid market in the world – and never will be because of the relative size of the NZ economy compared to other advanced economies – which adds to this risk. In other words, investors put value on being able to sell bonds at a pinch, which is why a large economy like the US can get away with higher government debt than a small open economy like New Zealand.
- The higher risk premia in NZ government bonds flow through to higher interest rates across the broader economy, weighing on investment and growth and therefore the tax base.
- Leave it long enough (noting this threshold could be above 100% of GDP for all we know) and it could get tricky to find investors willing to fund the government at all (even if we're offering eye watering high yields). Cue a funding crisis.
- At this point, the temptation would be to have the RBNZ step in and monetise the debt (but that would carry long-lasting consequences, raising questions around central bank independence while letting CPI inflation shoot higher). And if we wanted to avoid that kind of damage, then we'd have to take the hit elsewhere: sharply cut back government services (health, education, welfare etc, hurting our most vulnerable) while also sharply increasing taxes.

We are a long, long way from the above scenario playing out, but with the Treasury forecasting a decade of deficits and now another economic shock arriving before the eventual surplus does, we think it's more important than ever that New Zealanders understand this stuff. We can be relatively agnostic about whether we pursue fiscal sustainability with higher or new taxes versus containing growth in spending, but the 'kicking the can' approach could one day no longer be an option. As the [Treasury's Long-Term Fiscal Statement](#) suggests, we have options now to address these challenges before the need to do so is forced upon us.

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