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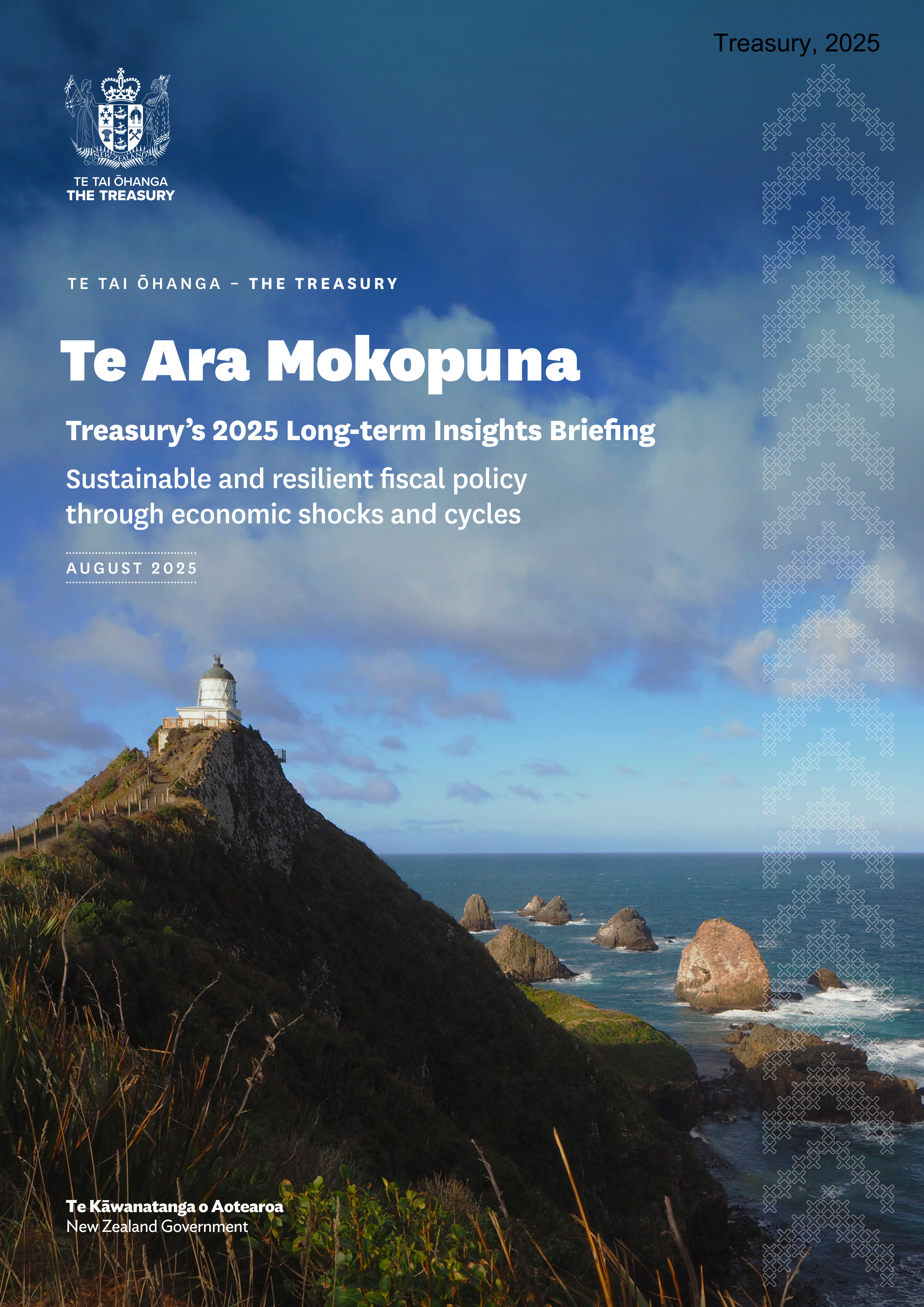

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Te Ara Mokopuna

Treasury's 2025 Long-term Insights Briefing

Sustainable and resilient fiscal policy through economic shocks and cycles

AUGUST 2025

Te Kāwanatanga o Aotearoa
New Zealand Government

Te Ara Mokopuna is a vision for a future where the choices we make today lift the living standards of everyone. It's about building a resilient, sustainable economy that ensures a better life for all generations to come, creating pathways of prosperity that honour our descendants and the world we leave behind.

It's a promise to nurture, strengthen and pave the way for a brighter tomorrow.

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A summary of feedback we received on the scope can be found on the Treasury website: https://www.treasury.govt.nz/news-and-events/reviews-consultation/long-term-insights-briefing

A summary of feedback we received on the draft Briefing can also be found on the Treasury website: https://www.treasury.govt.nz/publications/ltib/te-ara-mokopuna-2025-submissions

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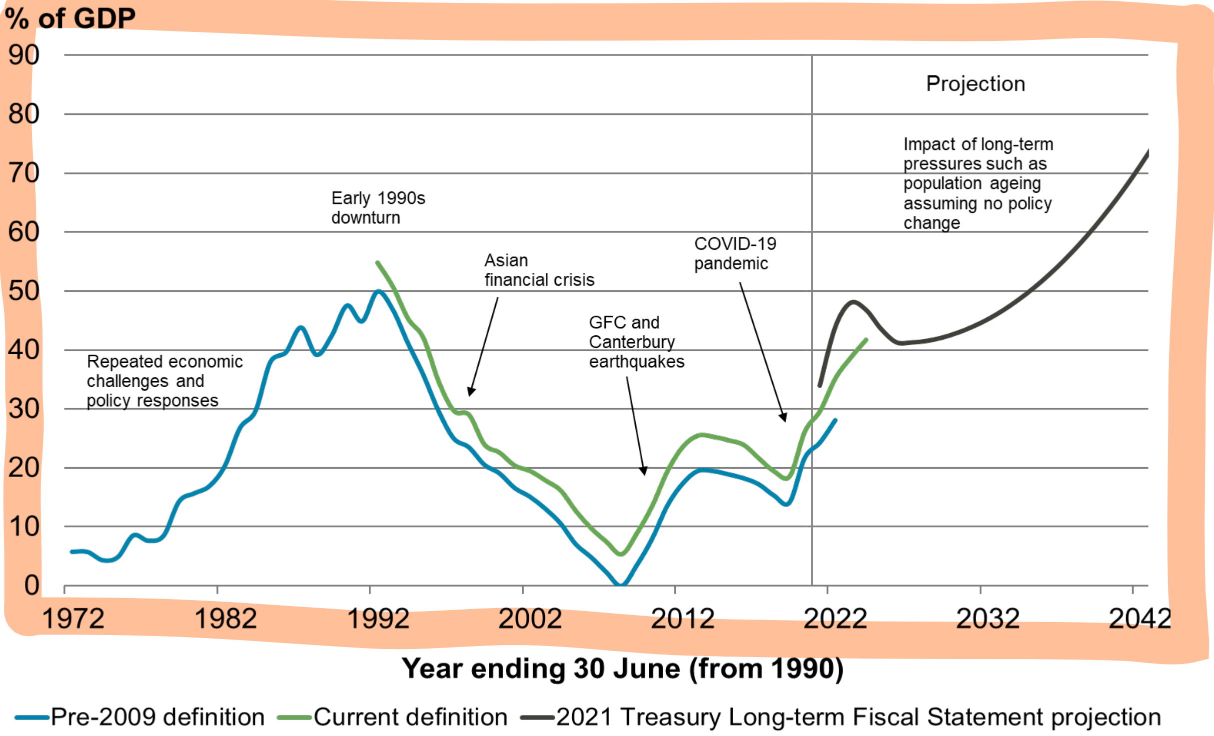
Executive summary

The focus of this Long-term Insights Briefing (the Briefing) is the role of fiscal policy through shocks and business cycles. Fiscal policy – the level and mix of government revenue and spending – has significant impacts on the living standards of all New Zealanders. It drives the level of tax that New Zealanders pay and the services they get from government. The level of debt, and other assets and liabilities on the government's balance sheet, determine what we bequeath to future generations.

This Briefing explores if, when and how fiscal policy can be used to buffer society from shocks and cycles and how to do so in a sustainable way. Governments can use fiscal policy to reduce the volatility in economic activity by increasing spending or reducing taxes when the economy is weak (fiscal loosening) and vice versa when the economy is strong (fiscal tightening). Governments can also choose to provide support to people that are directly impacted by shocks such as earthquakes. However, experience across many countries shows that **fiscal policy is easy to loosen in a downturn or shock but difficult to tighten in an upturn. This can lead to debt ratcheting upwards over time**.

New Zealand has seen debt rising in recent decades, partly because responses to adverse shocks have not been matched by savings between shocks (see Figure ES.1). Major events have included the COVID-19 pandemic, the 2023 North Island weather events, the Canterbury and Kaikōura earthquakes and the global financial crisis (GFC). Since the late 1980s, the cost of government responses to economic shocks has averaged about 10% of GDP per decade.

Figure ES.1: Net core Crown debt



Source: The Treasury

Note: The measure of net core Crown debt adopted in 2009 is restated back to 1992. The earlier measure for the period before 1992 included advances. Years prior to 1990 are reported using a 31 March basis.

It was the largest fiscal response to a shock in New Zealand in recent decades, with an estimated discretionary fiscal response of approximately 20% of GDP.[4] The International Monetary Fund and Organisation for Economic Co-operation and Development (OECD) estimated it to be among the largest COVID-19 responses globally. About half of the response interventions were tied directly to the shock such as the health response and the Wage Subsidy Scheme. These measures accounted for most of the fiscal cost in the early stages of the pandemic. However, a significant component of the response had broader objectives such as stimulating the economy or achieving distributional goals. These measures, particularly increases in government consumption and investment, were notably more lagged.

The response to COVID-19 required coordination between the monetary and fiscal interventions in a rapidly evolving context with high uncertainty. For instance, some AMP tools created a risk of, and subsequently resulted in, fiscal losses to the Crown.[5] Coordinated responses included information shared about intended responses and factored into forecasts and policy decisions.

The impacts of the fiscal response on the economy

The New Zealand economy recovered faster from COVID-19 than anticipated when the virus started to spread and more quickly than most other OECD economies. The effective containment of the virus lifted lockdown measures for most of 2020, and fiscal and monetary interventions boosted domestic demand and asset prices. The strong initial recovery took place despite disruptions to the productive capacity of the economy associated with border closures and global supply chain disruptions.

In subsequent months, it became increasingly apparent that there had been a persistent rise in inflationary pressures. Rising inflation in part reflected excess demand, which was driven by stimulatory monetary and fiscal policy. Supply-side factors also played a role. Disruptions to productive capacity in New Zealand contributed to domestic inflation, while inflation overseas led to increases in the cost of imported goods.[6] From late 2021, interest rates rose sharply to curtail inflationary pressures, with slowing demand contributing to declines in output per capita in the following years.

The impacts of the fiscal response on government finances

In the early stages of the pandemic, the Government, supported by the Treasury, prioritised economic objectives above fiscal ones. The Government suspended its fiscal rules in the May 2020 Budget and established the COVID-19 Response and Recovery Fund (CRRF) to support a timely economic response and public confidence.[7] As the economy recovered in the second half of 2020 and into 2021, the Treasury advised shifting towards more targeted fiscal support and recommended against further stimulus from Budget 2022 onwards.

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4 This is based on appropriations tagged to the COVID-19 response through the COVD-19 Response and Recovery Fund and available data on how much of those appropriations have been spent.

5 This is because balance sheet tools such as the Large Scale Asset Purchase programme alter the government's exposure to interest rate risk. The fiscal impacts of AMP tools are discussed further in Chapter 4 and Annex 1.

6 Treasury, 2023c. This research indicates that approximately one-third of the rise in inflation since COVID-19 can be attributed to demand-side factors, with another third being attributable to supply-side factors and the remainder not explained by the model.

7 The CRRF enabled qualifying expenditure to occur outside allowances, which may have reduced the amount of fiscal scrutiny applied. The CRRF had an initial value of $50 billion and was later topped up to $61.6 billion.

Table 2.1: Identifiable estimates[14] of cost of shocks in New Zealand 1987-2023

Event	Cost of identifiable direct fiscal response (% of starting year's GDP)	Key fiscal costs	Selected wider non-fiscal costs (to the private sector or total economy)
North Island weather events (2023)	1.7%	Estimated $6.65 billion allocated to fund operating and capital expenditure including Natural Hazards Commission costs and Crown reimbursement of local authority response and recovery costs.	Estimated physical asset damage to the total economy of ($9-14.5 billion), equal to around 3% of GDP.
COVID-19 pandemic (2020-2022)	20.4%	Estimated $66 billion of fiscal costs over the 2020-2026 fiscal years.	No comprehensive study yet available for New Zealand.
***Mycoplasma bovis* (2017-2024)**	0.3%	$0.7 billion costs to government, predominantly eradication costs and compensation payments.	$0.2 billion eradication costs to industry.
Kaikōura earthquake	0.9%	$2-3 billion total costs to the Crown including Earthquake Commission (EQC) costs.	Gross costs to private insurers estimated at $2.3 billion.
2013 drought	*Not available*	-	Drought lowered 2013 GDP by 0.6%.
Canterbury earthquakes (2010-11)	11.3%	EQC costs gross of reinsurance ($12 billion), other costs to the government ($11 billion).	Gross costs to private insurers estimated at $22.9 billion.
Finance company failures (2006-11)	0.4%	$0.6 billion retail deposit scheme payouts, net of expected receivership proceeds and fees.	Estimated $3.0 billion gross losses for deposit holders.
2008 drought	*Not available*	-	Drought lowered annual GDP by 0.5%.
1998 drought	*Not available*	-	Drought lowered annual GDP by 0.9%.
1992 drought	*Not available*	-	Drought contributed to 1991-92 downturn.
BNZ bank failure (1989-91)	1.0%	Gross cost of recapitalising BNZ.	
Edgecumbe earthquake (1987)	0.2%	Approximately $120 million EQC payouts.	Total losses estimated at $430 million.
Total losses from floods/storms aside from the North Island weather events (1987-2023)	*Not available*	-	Estimated total economy property damage averaging 0.03% of GDP per year.
Annual average 1987-2023	**1.0%**		

14 This table covers shocks with quantifiable fiscal and wider economic costs. It does not cover recessions, which are expected to be offset by periods of economic expansions.