

2026 advice on NZ ETS settings: FAQ

April 2026

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1. How does the NZ ETS work and what does it do?

- The NZ ETS requires certain companies and entities to give units (New Zealand Units, or NZUs) to the Government for their emissions every year.
- These units can be bought from government auctions, earned by forests, and in some circumstances are available for free.
- For the NZ ETS to work well, the units in the scheme need to decline in line with the declining emissions reduction targets.

2. What is the scope of this advice?

- Every year, the Government needs to review how many units can be auctioned over the next five years, so that the NZ ETS auction regulations can be updated.
- Before it does this, we advise the Government how many units to auction as well as on the price guardrails that apply at the government auctions. Our advice aims to help line up the units in the scheme with the declining emissions reduction targets.
- Auctioned NZUs, which this advice focuses on, form only a small part of the total units in the system. Our other work (such as our upcoming annual report monitoring emissions next due in July 2026, and previous advice on emissions reduction plans) addresses broader prospects for reducing emissions through the NZ ETS and other mechanisms.

3. Does the Government have to accept this advice?

- The Commission's role is to provide independent, evidence-based advice to the government-of-the-day.
- The Government can choose what to do in response when it updates the settings. If the Government decides on settings that differ from our advice, it needs to be clear about why, so this is transparent.
- The Government's choices need to add up. It must meet the requirement of the Climate Change Response Act 2002 (the Act) that the NZ ETS settings accord with emissions budgets and the 2050 target. If it adopts different settings, it will have to show how its settings fulfil those statutory requirements.

4. What happens next?

- The Government will consider our advice and run a public consultation on proposals, led by the Ministry for the Environment on behalf of the Minister of Climate Change. This consultation is expected in the second quarter of 2026.
- The Government must make decisions on NZ ETS unit limits and price control settings in time for the regulations to be updated by 30 September 2026. The new settings regulations will come into force on 1 January 2027.

5. How is the 2026 advice similar or different to last year?

- Similar to last year, we have identified that the stock of surplus units in the market is reducing faster than anticipated.
- This is happening mainly because over the past year no NZUs have sold at auction. As fewer units have flowed into the market from auctions than expected, more of the units already in the market are being used up.

- Like last year, we have again assessed that there may be a shortage of units later in the 2020s, and the Government could choose to adjust auction volumes over 2028–2030 to address this.
- However, it is uncertain whether this unit shortfall will occur, so we recommend keeping the unit limits and price control settings over 2027–2030 the same for now. The risk of a unit shortfall can be reassessed in the next NZ ETS settings update in 2027. There will still be time then to adjust the settings to mitigate the risk of a unit shortfall in 2028 if that is still of concern.
- We are proposing this approach, which is different from our advice last year, because over recent months the NZ ETS market has been unsettled, with significant price volatility. Given the state of the market, we think it's important to take a cautious approach to making changes. We advise the Government to take the time to test and signal with market participants the potential for changes to the settings well in advance.

6. What are surplus units and are they are problem?

- There are roughly 140 million NZUs in the NZ ETS market (the stockpile). A stockpile of banked NZUs is necessary so that NZ ETS participants can hedge and manage their surrender obligations.
- However, units can accumulate in the stockpile beyond what is needed for the smooth operation of the market. This excess volume of units is what we consider to be surplus. These surplus units can present risks to achieving emissions budgets, unless they are taken into account in the design of the unit limits and price control settings.
- We estimate a surplus range because the surplus is dynamic and uncertain – it can change over time depending on market participants' behaviour. After accounting for units in the stockpile that are needed for other uses, this year our central estimate of the surplus units in the market is around 30 million units, within an uncertainty range of 17 to 42 million units.
- This is a reduction of about 20 million units on our central surplus estimate of around 50 million units last year (within an uncertainty range of 28 to 68 million units). The surplus was expected to reduce by 12.5 million units by December 2025, but we assess that it has declined by a further 8 million units, mainly due to 6 million units not selling at 2025 auctions.
- The Government has a goal of fully depleting the surplus units by 2030, and the current unit limits in regulations are designed to do this. Since no units have been bought at auctions since late 2024, it is now possible that the surplus will run out before then – perhaps as early as 2028. This could cause another problem: a unit shortfall.

7. Why is a unit shortfall a problem?

- For an ETS to be effective, the amount of units available should decline in line with emission reduction targets and the emissions price should rise steadily over time to encourage the shift to low emissions options.
- A unit shortfall could cause emissions prices to rise too rapidly, outpacing the ability of people and businesses to respond.
- Too rapid increases and volatility in NZU prices could lead to:
 - Disruptive economic impacts, by forcing emissions reductions to occur through lower production or factory closures, rather than by decarbonisation.
 - Pressure on the Government to make unplanned interventions in the market.
 - Delays to investments in reducing emissions, due to the risk created by highly volatile emissions prices.

8. Units offered at government auctions have not sold – does that mean the market doesn't need any more?

- Not necessarily. As noted above, we estimate that there is still a significant number of surplus units in the market (our central estimate of the surplus is 30 million, and our high-end estimate is 42 million units). This means that there are enough units for the market to function for the time being.
- The scale of the surplus may have played a role in auctions declining over the past two years. However, this does not necessarily mean the market will be well-supplied with units across the full five-year period covered by this advice.
- We assess that the surplus, along with other sources of unit supply (forestry, industrial allocation and auctions), could be sufficient to cover demand out to 2030 – but only if the surplus is at the high end of our estimated surplus range and if all available units sell at 2026 auctions.
- If this is not the case, under current NZ ETS settings there may not be enough units to meet demand in the latter years of the 2020s. For example, if no units are bought at 2026 auctions and the surplus is closer to our central estimate, the market could be short of units as soon as 2028.
- It is possible that this potential unit shortfall is not being priced in by the market now because of the uncertainty and price volatility experienced in the NZ ETS recently. Market participants we have engaged with have indicated that this is limiting their ability to assess how NZU prices may develop in future.

9. What is the NZ ETS emissions cap and what is your advice on it?

- The NZ ETS emissions cap is the intended constraint on emissions from sectors covered by the NZ ETS. It is key to the function of the NZ ETS, as it is what creates scarcity and therefore helps create the market price of the units in the scheme.
- In this advice, we propose emissions caps for the second and third emissions budget periods (2026–2030 and 2031–2035 respectively) and combine those to give the NZ ETS emissions cap for the period covered by the recommended settings (2027–2031).
- These emissions caps in our advice are lower than those announced by the Government in August 2025. Those 2025 caps no longer align with emissions budgets due to updated projections showing an increase in agricultural emissions and greater carbon dioxide removals by forestry, meaning the NZ ETS will have to deliver more reductions overall.

10. How has the removal of the requirement to accord NZ ETS settings with NDCs affected your advice?

- Nationally determined contributions (NDCs) are Aotearoa New Zealand’s international emissions reduction targets under the Paris Agreement. The country has set two NDCs so far – the first for 2021–2030, and the second for 2031–2035.
- For last year’s advice, legislation required NZ ETS settings to accord with domestic emissions budgets and the 2050 target, and with NDCs. Government forecasts showed an 84–89 MtCO₂e gap to meeting the first NDC. Our 2025 advice recommended settings aligned with domestic emissions budgets, conditional on the Government acquiring offshore mitigation to bridge that gap.
- Now the Act has been amended to remove the requirement to accord with NDCs, our advice aligns with domestic budgets and is not conditional on the Government acquiring offshore mitigation. But we still consider NDCs in this year’s advice where relevant.
- The Government has indicated it intends to prioritise domestic emissions reductions, and these decrease the amount of offshore mitigation needed to achieve NDCs. Our advice this year considers what contribution the NZ ETS might be able to make to the first and second NDCs, in line with matters the Act requires us to consider.
- To maximise the contribution of domestic reductions to meeting NDCs, the NZ ETS needs to be accompanied by targeted measures to unlock the full range of emissions reduction opportunities. Analysis of these policies is beyond the scope of this advice.

11. How has your advice been affected by the Government's announced plan to change NZ ETS settings updates to every two years?

- Our 2026 advice is based on the Climate Change Response Act 2002 as it is currently in force. Our recommendations are conditional on the next update to the NZ ETS settings regulations occurring in 2027, as currently required by the Act, and which the Government recently confirmed would proceed.
- In 2025 (while we were preparing this advice), the Government announced its intention to amend the Act so NZ ETS settings updates occur every two years instead of annually. At that time, it expected that this would shift the next settings update to 2028 and so we considered this potential timing change in our advice.
- The annual reviews of the NZ ETS settings provide the ability for timely adjustments to the auction settings to keep the NZ ETS on track as circumstances change. This is useful in the NZ ETS where other key sources of unit supply are uncertain (industrial allocation, forestry units).
- Updates every two years may reduce the frequency of regulation changes, but would also reduce the ability to course correct for new information. When this legislative amendment is being progressed, it will be important for Parliament and NZ ETS market participants to consider this trade-off.

12. Has the Government's change to the 2050 biogenic methane target affected your advice?

- The change to the biogenic methane target has not directly affected the advice this year. Changes in projections of agricultural emissions over the coming years are more relevant to what the NZ ETS needs to deliver.
- The NZ ETS only covers a small amount of biogenic methane and cannot target reductions in biogenic methane directly.
- The Act requires that the NZ ETS settings accord with emissions budgets, which cover all gases including biogenic methane – and these have not changed. What's more relevant is that projected agricultural emissions over the second (2026–2030) and third (2031–2035) emissions budgets have gone up. This has increased the overall reductions needed from the sectors covered by the NZ ETS over the period to 2035, to enable the budgets to be met.
- The Commission will provide updated advice on the fourth emissions budget, and any revisions to the second and third budgets, in March 2027. The Government's decisions on those budgets will be due at the end of that year. This means that revised or new budgets likely will not be in place until after the Government's decision on the 2027 NZ ETS settings update has been made.

13. Does the NZ ETS need to be tightened further, given the country is not on track to meet the third emissions budget or either of its NDCs?

- The Government has chosen to use the NZ ETS as its main tool for reducing emissions and meeting emissions budgets and targets. We have considered this in our development of this 2026 NZ ETS settings advice.
- The central role of the NZ ETS in the Government’s climate strategy was noted in the letters exchanged by the Minister of Climate Change and the Commission’s Chair in December and January, which are available on our website: climatecommission.govt.nz/nz-ets-2027-2031. In his letter, the Minister set out the Government’s interest in settings options that better position New Zealand to achieve emissions budgets and go further towards meeting the first NDC, while balancing risks to the proper functioning of the NZ ETS.
- To help get on track to meet the third emissions budget, our advice proposes a net emissions cap for the NZ ETS over 2031–2035 which is around 12 MtCO₂e lower than the provisional emissions cap announced by the Government in August 2025 for that period.
- The lower emissions cap is necessary as projected emissions from agriculture are now higher than those on which the Government based its provisional emissions cap. This NZ ETS settings advice only covers one year (2031) of the third emissions budget period. Our recommended settings for that year are based on our proposed lower net emissions cap.
- There would still be gaps to meeting the first and second NDC under the NZ ETS emissions caps we propose in our advice. We considered options for lowering the NZ ETS emissions caps, but based on the Government’s emissions reduction plan, we are not confident that the NZ ETS alone could drive more reductions without significant impacts beyond those contemplated by the plan.
- The NZ ETS needs to be accompanied by complementary measures to be effective at unlocking the full range of emissions reduction opportunities to meet Aotearoa New Zealand’s emissions targets. Analysis of these policies is beyond the scope of this advice. Our other work (such as our upcoming annual report monitoring emissions next due in July 2026, and previous advice on emissions reduction plans) addresses broader prospects for reducing emissions through the NZ ETS and other mechanisms.

14. Has the conflict in the Middle East affected this advice?

- The current conflict in the Middle East began after our recommendations were finalised. The conflict has implications for fossil fuel supply and prices.
- Our advice already factored in significant uncertainty in the outlook for fossil fuel prices and for Aotearoa New Zealand's emissions. Based on the limited information available now about the impacts of the conflict, we consider our analysis appropriate.
- The situation is evolving, and it is too early to tell whether the conflict will have a sustained impact on emissions in Aotearoa New Zealand. It will be important to monitor the implications over time and make considered decisions based on evidence, rather than react before impacts are understood.
- The annual updates to NZ ETS settings allow the Government to respond to uncertainty and changing circumstances. The next update scheduled for 2027 would be an appropriate time to assess implications of the conflict.

15. What else needs to happen with the NZ ETS?

- Investors need credible, well-signalled policies on the NZ ETS, and on climate change generally, to give them confidence that their investments in emissions reduction will generate returns.
- We have previously advised that meeting emissions targets is likely to require a strengthened NZ ETS as well as targeted policies in other sectors such as transport, energy and agriculture.
- The point when the NZ ETS in its current form will no longer be able to incentivise further net emissions reductions is drawing closer. Our updated analysis for this NZ ETS settings advice indicates that this could happen as early as the mid-2030s.