

New Zealand Election Review 2017

25 September 2017



New Zealand's 2017 election: Implications for financial markets.

- Sunday's election has left NZ First in a monarch-maker position between National and Labour/Greens.
- However, the details of the result suggest that a National / NZ First deal is more likely.
- The housing market is likely to experience a short bounce now that capital gains tax is off the table for at least another three years.
- We may look to reduce our net immigration forecasts.
- Financial markets were broadly unmoved by the election result, although any coalition announcement could produce a further market reaction.

As expected, New Zealand's general election delivered no clear outcome – neither the centre-right bloc (National and ACT) nor the centre-left bloc (Labour and Green) has the numbers to form a government. This leaves the centrist and nationalist New Zealand First Party in a monarch-maker position. However, we think that the results make a National / New Zealand First Government the more likely outcome.

The party vote was similar to the most recent polls, which had shifted in favour of National, as the table below shows. However, there are still around 384,000 special votes to be counted (15% of the total). Historically, a greater proportion of special votes have been for Labour and the Greens, compared to the vote count on election day.

National's election day tally this year would translate to 58 seats in a Parliament of 120. Based on historical trends, political analysts have suggested that this could drop to 56 seats after special votes are counted, while Labour and the Greens could gain two seats between them. However, even a two-seat swing would not change the fundamental features of the result – NZ First would still hold the balance of power.

The big surprise of the night was that the Maori Party (a support partner of the incumbent National Government) lost its electorate seats, leaving it ineligible for any seats in Parliament.

Table 1: Recent polls compared to election day outcome

	Colmar Brunton 20 Sep (%)	Reid Research 21 Sep (%)	Curia polls average 21 Sep (%)	Actual election day result (%)	Seats
National	46.0	45.8	43.3	46.0	58
Labour	37.0	37.3	39.7	35.8	45
NZ First	4.9	7.1	6.6	7.5	9
Green	8.0	7.1	6.6	5.9	7
Maori	0.5	0.4	1.0	1.1	0
Act	0.3	0.6	0.4	0.5	1
Total seats					120

New Zealand has not seen an election outcome of this kind for many years. In every election since 1999, the largest party has had a range of smaller parties that it could realistically work with, giving it options for forming a government. This time is different. The large parties have no real options, so more of the negotiating power lies with a smaller party.

We should begin the discussion of coalition possibilities by stating that although a National / Green partnership is arithmetically possible, it is politically infeasible – indeed, the Greens’ leader has already all-but ruled it out.

That leaves two possible governing combinations – National / NZ First or Labour / Green / NZ First.

A Labour / Green / NZ First Government seems the less likely option. Each piece of legislation would require the ascent of all three parties – an extremely tricky proposition given the diametrically opposed policy priorities of NZ First and the Greens. Furthermore, this three-party combination would have only a slim majority in Parliament, leaving it more susceptible to rebellion by rogue Members of Parliament. And finally, the leader of NZ First has stated that he would talk first to the party with the most seats in Parliament.

We view a National / NZ First deal as the more likely outcome. It could take two possible forms. The first is a formal coalition government, where NZ First ministers have places in Cabinet. The second possibility is a National minority government, with NZ First agreeing to vote with the Government on confidence and supply in return for specific policy concessions. NZ First would not be represented inside Cabinet, but might hold senior ministerial posts outside Cabinet. This would leave NZ First free to vote against the Government on policy areas not covered by their confidence and supply agreement. It would also leave the National Party free to seek support from the Greens or Labour if New Zealand First was not willing to vote with National on a particular issue. Either way, New Zealand First would have a significant influence on policy.

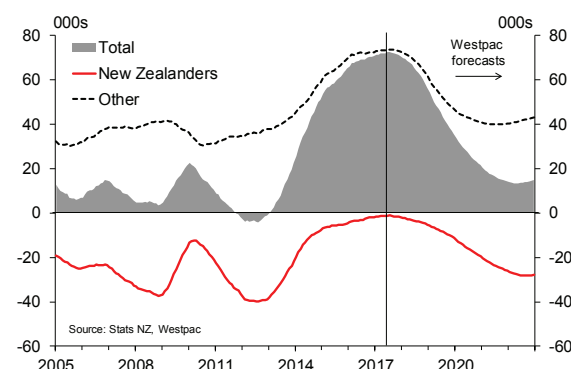
How would a possible National / NZ First Government affect economic forecasts?

At this point, assessing what the election means for economic forecasts is very tentative at best! Even if National and NZ First do form a Government as expected,

we cannot tell exactly which aspects of NZ First’s wide-ranging policy platform will have an influence on policy. What follows is a discussion of some areas of our economic forecast that might be affected if a National / NZ First partnership comes to power.

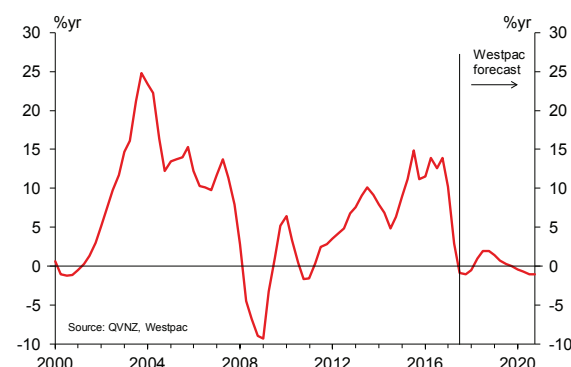
Immigration: A key NZ First policy platform is to tighten immigration restrictions – the NZ First leader has stated he would prefer net immigration of 10,000 per annum, compared to over 70,000 per annum presently. Net immigration has already started to fall, and we are already forecasting that it will drop to 20,000 by the end of 2020. If some policy change prompted us to forecast a steeper decline in net immigration, we would also consider reducing our GDP growth forecast.

Westpac net migration forecast, annual



House prices: We suspect that if a National / NZ First Government is formed, the housing market will react “positively” – that is, turnover will pick up and prices will be higher than otherwise. True, NZ First favours lower immigration and restrictions on foreigners’ ability to buy property. If implemented, such policies would tend to reduce house prices. But those policies pale in comparison to the potential impact on house prices that Labour’s proposed tax changes might have had. There may be a short-term “relief” bounce in the housing market now that capital gains tax is off the table for at least another three years.

Westpac house price growth forecast



What happens over the longer term in the housing market depends, as always, on economic factors like mortgage rates – our view is that prices will track sideways once

the relief bounce has run its course. The housing market might also be sensitive to opposition parties' policy announcements over coming years. New Zealand has not elected a fifth-term government since 1925, and neither of the previous partnerships between NZ First and a major party was returned for a second term in office. Property investors will therefore be sensitive to the possibility of a change of government in 2020, and the tax changes that that could herald.

Monetary policy: NZ First favours changing the Reserve Bank Act with an eye to generating a more exporter-friendly exchange rate. National favours the status quo of inflation targeting, and is unlikely to give any ground on that. However, NZ First's presence in government does make some sort of change at the Reserve Bank more likely – for example, a change from the present single-decision maker structure to a committee for monetary policy decisions.

Fiscal policy: NZ First's policies are expensive, and it has not signed up to any budget responsibility agreement. In the first instance we would expect that policy concessions to NZ First, such as its various regional development priorities, could be managed within the Government's existing budget. However, the direction of risk on fiscal policy is that this Government will hue towards smaller surpluses and more debt than otherwise.

Market reaction

There was little initial reaction in the NZD when markets opened this morning. A few hours later persistent selling emerged. It is possible that this was a delayed reaction to the election, but it could just as easily have been related to

other factors – for example, Germany's election result was announced at 6:00am New Zealand time.

NZD/JPY (somewhat isolated from the impact of the German election on the EUR and USD) closed on Friday at 82.16, and rose slightly to 82.33 after markets opened this morning. Several hours later, it was 0.4% lower. Similarly, NZD/AUD did not start a persistent decline until several hours after the open, falling from 0.9215 to 0.9140.

We expect the NZD will remain weighed down by uncertainty until a government is formed. If a National / NZ First government emerges, as discussed in the sections above, then the NZD would probably rise a little on the passing of uncertainty. Beyond that, the medium term implications appear NZD-neutral, so long as the market is satisfied about the durability of the Government.

NZ interest rates for longer maturities may rise slightly if projections for fiscal surpluses are lowered and for public debt are raised, and the spread between swap and NZGB yields could narrow.

Short term interest rates, which react to implications for the OCR, might rise initially, as the risk of a capital gains tax reducing house prices passes for now. Beyond that, the medium term implications for the OCR are uncertain. The combination of slightly higher long-maturity rates and relatively stable short-maturity rates should result in a steeper yield curve.

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