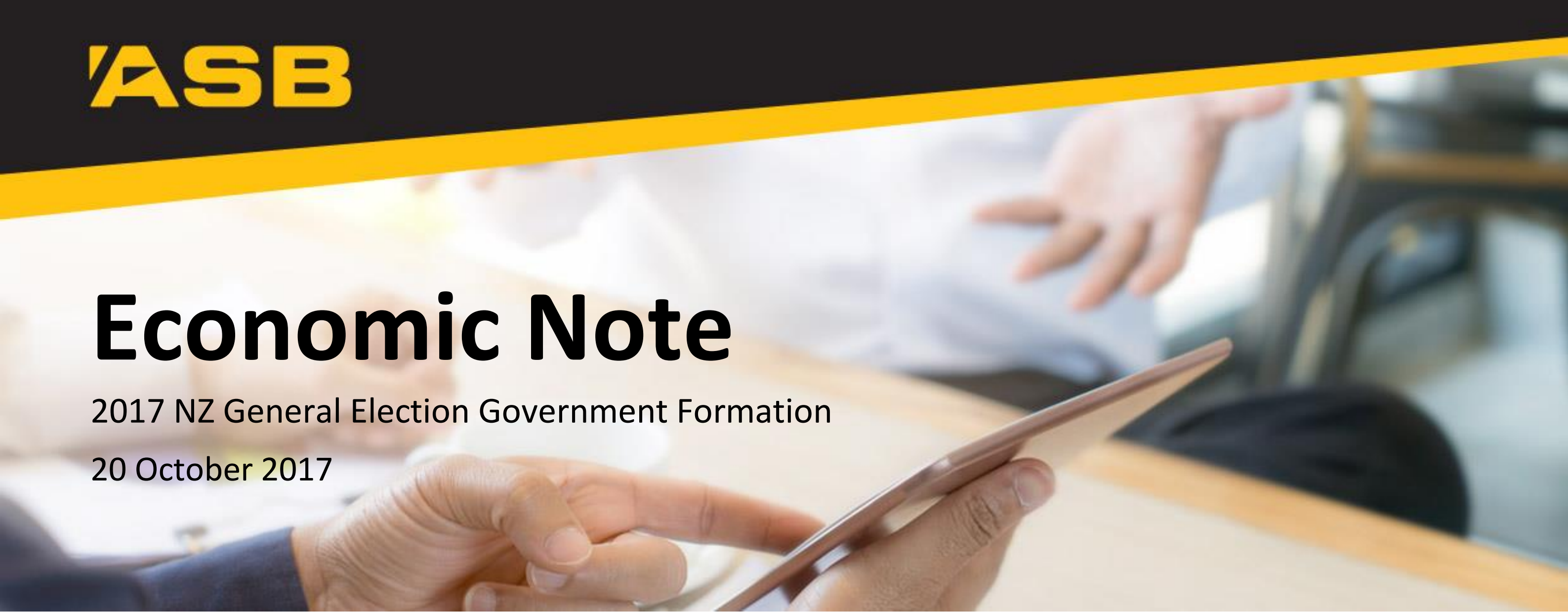

Economic Note

2017 NZ General Election Government Formation

20 October 2017

Winston has spoken: Let’s do this

Summary

The people (and NZ First) have spoken and NZ now has had its own watershed moment. The next Government will be a Labour-NZ First coalition with support from the Green Party. Winston has not gone with the biggest party but such are the realities of MMP, and it seems likely that closer initial policy alignment and more concessions on policy by Labour appear to have swayed NZ First’s decision.

Exact details on the key policy agreements and their economic implications are sketchy, and are likely to emerge in the next week or so. Our initial take is that the largest changes are likely to be in immigration, foreign ownership/investment and regional development.

The additional uncertainty provided by the modest change in government direction is likely to provide a short-term headwind to growth.

Make-up of the new Government

Last night Winston Peters announced that New Zealand First will enter into a coalition with Labour. The Greens are not part of the coalition, but will provide support on confidence and supply issues.

Jacinda Ardern is set to become New Zealand’s next Prime Minister, and while NZ First leader Winston Peters has been offered the Deputy Prime Minister role he has not yet decided whether to accept it. The final details of agreements were still being worked out and as a result details are sketchy. NZ First have been offered four Ministerial positions and one under-secretary post. The Greens will be outside of Cabinet, but will have three ministerial posts in areas of their specific interest and an under-secretary role.

Labour and NZ First will form a minority government, with the Green Party providing supply and confidence. The two coalition partners will have 55 out of the required 61 seats in Parliament. The Green Party has 8 seats, providing a 2-seat parliamentary buffer via the supply and confidence agreement.

Key areas of policy change

Details are sketchy, with agreements between Labour, NZ First and the Green Party expected to be signed off and released early next week. On the basis of the comments made by the political parties, the major changes are likely to be in the following areas:

- Immigration – the immigration taps will not be completely turned off, but a more targeted approach to NZ migration policy will be introduced, with Labour aiming to reduce by 20,000-30,000, from 72,000 currently.

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- Foreign investment – Labour and NZ first have agreed to restrict sales of residential land and farmland to NZ citizens, permanent residents who live in NZ, and companies that are majority NZ owned. A register of foreign ownership of land will be set up.
- Housing – greater role of the government in actual housing provision, with the aim of building 10,000 affordable houses per year under Kiwibuild. This will be challenging given capacity constraints.
- Regional development – more support to the regions. Focus on building up the infrastructure and more support to enterprises in the region.
- Fiscal policy – more government spending with a focus on health, education and social services. Next year's income tax cuts look to be a goner. Tax reform is on the agenda. The water tax is likely to be watered down.
- Monetary policy – whilst NZ First would have wanted more, changes to how the RBNZ operates are expected to be modest in practice. Expect some tweaks to the PTA to include employment objectives.

The table on the following page provides a more detailed look at what some of the changes to government policy may be, although we caution that this is our guesstimate of what the new framework might look like and the actual policies put in place could be quite different. Our initial take is that the new proposed policies and the greater uncertainty posed by the change in government administration, if enacted, may contribute to a modestly weaker shorter-term outlook for aggregate demand, until the economy adjusts to the new environment. This may weigh on the NZD and keep the onus on continued monetary support to the economy via low OCR settings from the RBNZ. Pressures on NZ interest rates (and potentially the NZD) beyond this adjustment period are likely to be marginally on the upside.

Initial Impressions

As with any new governing arrangement the devil will be in the detail, and we intend to publish a more in-depth note once further details emerge. Mr Peters is keen to stamp his mark and provide a legacy, in which foreign investment and immigration are checked and in which the regions and export activity thrives. He is unlikely to have gotten all that we wished for and time will tell whether his vision will come to fruition.

The next few months will be key and it will be interesting to see how long the Honeymoon period of the new government and the 2nd youngest NZ PM in history will last for. A slim parliamentary majority and a large National Party opposition suggest that the new administration will need to exercise considerable discipline to retain control and advance its ambitious policy agenda. It will be a tricky balancing act.

Initial Financial market impact

The market has reacted to the announcement, with the NZD broadly weaker, NZ swap rates lower across the curve but 10-year Government bond yields higher. The NZD fell 1.5 cents against the USD yesterday. The TWI posted similar falls. At the time of writing, **the NZD is trading at USD 0.7030.** NZ 10-year Government bond yields were marginally firmer. However, NZ swap rates fell across the curve as the market opened this morning.

The NZ sharemarket posted a small gain yesterday. However, given the announcement came after market close, we'd anticipate a reversal today, and a continuation of the trends seen in other markets.

The table below sketches out some *potential* changes to policy settings

Policy	Changes	Impact
Immigration	Cuts to net immigration (by 20,000 – 30,000 persons per annum), with reduced targets for non-resident arrivals, notably low skilled arrivals. More targeted approach towards attracting skilled immigrants, longer residency qualification period.	These changes will likely take some time to bed in. Lower net migration (which our forecasts currently allow for) will lower aggregate demand but also tighten the labour market. The details of the policy and hence the composition of net migration are important in terms of economic impact.
Foreign ownership	Restrict overseas purchases of existing residential housing, land and other 'strategic assets' to NZ citizens and Permanent Residents. Modify the Overseas Investment Act and beef up the mandate for the Overseas Investment Office.	Negative impact on domestic investment, could weigh on medium-term performance at the margin.
Trade	Aim to tighten restrictions on foreign ownership of NZ property and strategic assets in TPP-11 and FTA's under negotiation. Increased funding for MFAT/NZTE, with the focus on boosting primary value-add and manufacturing exports.	Remains committed to pursuing free-trade agreements albeit with the caveat of restrictions on foreign ownership (see above).
Housing provision	More state involvement in housing construction and the provision of more affordable residential land, via building 10,000 affordable houses per year over the next decade via Kiwibuild. More state involvement in provision of housing finance.	This will be difficult to achieve given capacity constraints in the construction sector.
Regional development	More support to primary industries, manufacturing and increased investment in tourism infrastructure in regions. Measures to encourage more regionally-dispersed immigration. Signal the eventual relocation of Ports of Auckland.	More funding for regions/Wellington.
Tax/Government spending	Overturn 2018 income tax cuts. More public funding and tax support for R&D. Review the current tax system, including GST exemptions. Increase government spending on health, education, law and order, and economic development. More expansionary fiscal settings and higher government debt profile relative to Budget 2017 projections (although net debt still reducing).	Initially soften demand at the margin, but more expansionary fiscal policy in latter-years. Stepping up of NZGB issuance, but DMO will take a strategic approach to minimise impact on NZ yields.
Superannuation	Keep retirement age at 65, but further tightening up of residency requirements for receiving NZ Superannuation. Restart taxpayer contributions to the NZ Superannuation Fund.	Modest in the short-term, but longer-term impacts look potentially more significant given demographic trends.
Industrial relations	More support to vocational education, on the job training, apprenticeships and paid internships. Rise in minimum wage and abolish 'starting out wage', with greater protections for workers. Some watering down of Labour proposals for industry-wide agreements.	Initial boost to labour incomes and consumer spending. Reduced labour market flexibility may weigh on medium-term performance.
Monetary policy	Rework the RBNZ Policy Targets Agreement (PTA) to include employment objectives. Move to formal monetary policy committee from sole decision-maker.	Modest, given current arrangements in place and practical difficulties in meeting differing economic objectives simultaneously.
Transport	Higher spend and likely reprioritisation towards rail/public transport investment. Potential reintroduction of regional fuel taxes to help cash-strapped council's.	Small positive boost to demand and inflation, but will help alleviate transport bottlenecks.
Education	Abolish charter/partnership schools and scrap National Standards.	Limited economic impact.
Banking	More enhanced role for Kiwibank. Look at introducing depositor protection for mostly NZ-owned banks.	Mild.
Water royalties	More targeted scheme, with exemptions for primary sector.	Small positive inflation impact, mild negative demand impact.
Net Impact	**Short-term headwinds to GDP growth due to increased uncertainty due to change in government. Medium-term growth will be supported by higher fiscal spending. Although slowing net migration will be a headwind to growth, and reduced foreign investment could also impact growth.** **Upward pressure on medium-term inflation.**	**Initially NZD negative and neutral for NZ rates, but upward bias for NZ interest rates thereafter.**

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