Harbour Navigator

A new NZ government: market implications

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After a long period in opposition, we now have a Labour-led government in coalition with New Zealand First, and with support from the Green Party. The most significant initial market reaction has been a fall in the NZ dollar by around 2 percent and NZ share market by 1 percent on the open, as markets priced-in the possibility of a deterioration in business confidence and nervous overseas investors. This Navigator will set out our initial take on the market implications. In a fast moving political situation, there are still many policy details yet to emerge.

By global standards, the National Party and Labour Party are relatively centrist and mainstream. Both have a record and reputation for monetary stability, fiscal responsibility, and respect for the rule of law and role of markets. This provided confidence to investors, no matter which party ended up leading the next New Zealand government.

Now that a Labour-NZ First coalition has been formed, the key questions facing markets is how much of the 'less-mainstream' NZ First policy agenda will be implemented, and where Labour and NZ First have found common ground. At this very early stage, the key policy themes of the new government seem to be:

- less net migration
- restrictions on foreign buying of houses and land
- increases in the minimum wage
- the RBNZ with a dual inflation and employment mandate
- an increase in fiscal spending relative to a National-led government.

Some of the more controversial policies during the campaign – Labour's water tax and NZ First's policy for the RBNZ to target the exchange rate – appear to have been dropped or diluted through the negotiations.

At a very high level, there are some relatively clear market implications from the Labour-NZ First coalition. The first is that on the margin, we are likely to see more fiscal spending, more government debt, higher inflation and higher long-term interest rates. Particular sectors of the equity market may also suffer, such as higher wage costs affecting the retail sector and weaker property prices potentially affecting the retirement village sector, despite the demographic changes that support long-term demand.

We will also be watching to see what impact migration policy has on the housing market, especially in Auckland where migrant demand is the most tangible. Sentiment is likely to deteriorate initially, but the magnitude of weakness is anyone's guess. A more protracted correction is a possibility. While investors will make a connection to the exposure banks have to the property market, the macro-prudential measures put in place by the Reserve Bank should make this sector much more resilient than might have been the case 10 years ago.

Other impacts are potentially more ambiguous or likely to differ in time.

For example, GDP growth may slow in coming quarters, due to an initial fall in business confidence brought about by policy uncertainty under the new government. However, further into 2018 and 2019, GDP growth may be supported by a larger amount of fiscal stimulus than under National.

Similarly, we expect the NZ dollar to remain under pressure initially, as investors place a greater risk premium on investing in New Zealand in a new and uncertain environment. Over a more medium to long-term horizon however, we may see that the NZ dollar, supported by Labour-NZ First policies, leads to higher inflation and wider interest rate differentials.

Heading into the NZ election, our actively managed portfolios have been positioned with a number of views on relative valuations in mind. In particular, views that:

- the risks to the NZ dollar are on the downside
- we favour globally-orientated stocks over domestically-orientated stocks
- short-term interest rates are anchored, with scope to fall further
- long-term interest rates are prone to rise higher with global yields
- inflation-indexed bonds provide cheap insurance against higher inflation.

In our opinion, the outcome of the NZ election negotiations reinforce these themes.

We are in a fast moving political situation but there are still many policy details yet to emerge; some will appear quickly - others will evolve slowly after formal reviews and further negotiations. Prior to the election, some had suggested a Labour/Greens/NZ First coalition would be a many-headed beast, incapable of clarity and cohesion. But, with the Greens essentially providing supply and confidence, and with coalition negotiations focussed on policy, Winston Peters has given the coalition the best possible chance of overcoming the challenges of a three-party government. Early messages will stress compromise and shared views.

Last night, one of Peters' strongest statements was in regard to the failure of neoliberal economics to deliver to the broader population. Under Helen Clarke's leadership, Michael Cullen was a strong advocate for economic orthodoxy and fiscal prudence. While Grant Robertson is also relatively mainstream and set to take the Finance portfolio, given the influence of Winston Peters we see some scope for policy to be more adventurous over time.

We believe that the New Zealand political situation should continue to be a key focus of investors in the months ahead.

Harbour Asset Management

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