

A guide to the 2017 election for financial markets

18 September 2017

- This bulletin previews New Zealand's General Election, scheduled for Saturday 23 September.
- It is likely to be of most interest to overseas financial market participants, who may have less familiarity with the New Zealand electoral system.
- We review the possible outcomes of the election and summarise key opposition party policies.
- The bulletin is the opinion of the Westpac Economics Team and does not necessarily reflect the views of Westpac New Zealand Ltd.

Background on New Zealand's political landscape

Under New Zealand's proportional representation system, voters get two votes. An electorate vote determines the local parliamentary representative, while the party vote determines the share of seats in Parliament for each party. Since proportional representation was introduced in 1996, no single party has won a majority of the seats. Instead, the major parties have had to either enter into a coalition or form a minority government with support agreements from smaller parties.

The most significant parties are:

National: A centre-right party, favouring fiscal discipline, tax reductions, and a targeted approach to social spending. National has led the government since November 2008.

Labour: A centre-left party, favouring increased social spending and a greater role of government in the economy, especially in the housing market. Labour was previously in power from 1999 to 2008.

New Zealand First: Advocates tighter controls on immigration and foreign ownership, and spending on regional economic development. NZ First (NZF) is left of centre on economic policy, but is conservative on social policy. It has supported both National and Labour governments in the past.

Green: Further left on the economic spectrum, focused on environmental and social justice issues. Labour and the Greens are natural coalition partners.

Maori: Focussed on Maori issues. Supported the current National government, but has said it is open to talking to either major party.

ACT: A small party naturally aligned to National.

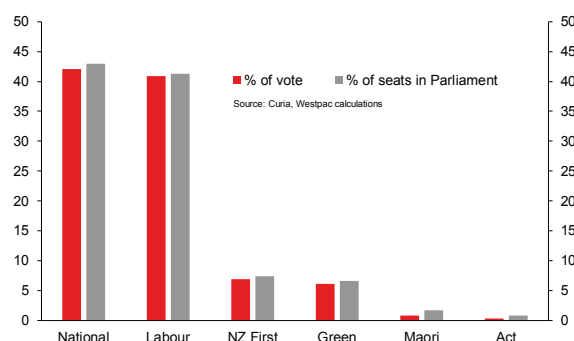
An important technicality is that in order to qualify for representation in Parliament, parties must win either 5% of the party vote or win at least one electorate seat – Maori and ACT are currently in Parliament by virtue of winning electorate seats, while NZ First and the Greens qualified on their party vote.

What do the polls say?

For much of this year, public polling suggested that National would gain the largest share of votes by a substantial margin, though it would still require the support of NZ First and/or other minor parties in order to reach a majority.

However, the balance has changed dramatically since early August, when a change of leadership for the Labour Party revitalised its prospects. The election now looks very close. Which party is ahead now varies by polling company. Colmar Brunton polls suggest that the Labour Party is four percentage points ahead of National, Reid Research polls have National ten percentage points ahead of Labour, and Roy Morgan has the two parties within half a percentage point of each other.

Figure 1: Curia average of polls (as at 17 September)



Among the smaller parties, the Greens popularity roughly halved after one of their co-leaders resigned. In some polls the Greens have been below the 5% minimum threshold for entering Parliament, while others suggest the Greens are clear of the threshold. NZ First also dropped in the polls when Labour surged, but has remained well clear of the 5%

hurdle. Polls suggest that ACT will win one electorate seat, and Maori will win two (although the latter is uncertain).

The best way to cope with the variability of the polls is to average them. We focus our attention on the Curia weighted average of recent public polls, shown in figure 1. Polls that are more recent or have larger sample sizes are accorded greater weight. The two major groupings – National/ACT and Labour/Green – are currently neck and neck, but neither is close to being able to govern alone. That leaves no clear path towards forming the next government: the outcome is going to depend on the results on election day, and the coalition negotiations that follow. As we see it, the three most plausible configurations are:

National + NZ First: NZ First has stated that it would prefer to work with the largest party in Parliament. On the current average of polls that would be National by a whisker. Furthermore, on both of the two past occasions when NZ First supported a major party in Government, it sided with the incumbent government – in this case National. However, on current polling this combination would have only 61 seats in a 122 seat parliament. In order to govern it would require either a shift in the polls, or the ACT party would have to be brought on board in some capacity.

Labour + NZ First: This strikes us as the most plausible combination involving NZF and the Left. NZF and Labour could work together (and have in the past). By contrast, it seems less likely that NZF could work with the Greens or the Maori party, given their policy priorities conflict. Indeed, in 2005 New Zealand First partnered with Labour only on the condition that the Greens were excluded from the coalition. On current polling, Labour + NZ First would not have enough seats to govern, but it would take only a small change in the polls to give this combination a majority. There are two other ways that this combination could form a government: (1) If the Green Party slips below the 5% threshold and is excluded from Parliament altogether, the Greens' seats would be redistributed. Based on current polling New Zealand First would have the choice of governing with either Labour or National; (2) Labour and New Zealand First could form a government without a clear majority in Parliament, but with the Greens' formal agreement to abstain on confidence and supply votes.

Labour + Green + Maori: The Maori Party is currently a support partner of the National Government. However, it is possible that Maori could join Labour and the Greens in a left-of-centre coalition. Based on current polling, the three parties together would command 60 seats in a 122 seat parliament, so a small shift in the polls would be required to allow this combination.

Key policies – Labour and the Greens

This section summarises selected policies of the Labour Party and the Green Party, restricting our attention to the areas that are most relevant for financial markets. The aim is to give a sense of how a change of Government might affect economic forecasts.

Fiscal Balance

Labour and the Greens have signed up to Budget Responsibility Rules that require sustainable surpluses and net core crown debt to fall to 20% of GDP within five years of taking office. Net debt is currently around 22% of GDP.

Labour plans to spend more than the current Government, primarily on education and health. This would be only partly funded by cancelling tax cuts that were legislated to take effect on April 1 and introducing new taxes. The balance would be debt funded, implying that Labour's fiscal plan is more stimulatory – by June 2021, Labour plans to run with around \$7bn more net core crown debt than is currently budgeted (equivalent to 2.2% of GDP). More expansionary fiscal policy would tend to see us lifting our GDP forecasts, although the cancellation of next year's tax cuts would have a negative effect on our GDP forecast for that year.

Monetary Policy

Labour plans to introduce a committee for making monetary policy decisions, with a mix of internal and external members and published minutes, similar to the Bank of England model. Labour also plans to give the RBNZ a dual mandate to target full employment as well as price stability. The employment target would not be numerical. We doubt these changes would make much difference to the conduct of monetary policy.

As far as we are aware, Labour has not proposed any change to the Reserve Bank's macroprudential powers.

Shortly after the election, the new Minister of Finance will approve the appointment of a new Reserve Bank Governor, and will agree a Policy Targets Agreement with him/her. The last Labour Government broadened the Reserve Bank's focus beyond inflation and increased the inflation target, but the current Labour Party has announced no plan in this regard.

The housing market

Currently, property investors who resell a property within two years are required to pay income tax on any capital gain. Labour plans to extend this two-year "bright line" to five years. Labour also plans to remove property investors' ability to write off losses on rental properties against their personal income. These measures might reduce house prices to some extent, but it is difficult to tell how large the impact would be.

Labour also plans to convene a tax working group that might recommend some variation on a capital gains tax, land tax or deemed rate of return tax on property excluding the family home. Depending on the type of tax chosen and the rate, such tax changes have the potential to put substantial downward pressure on house prices, which in turn would impact consumer spending. However, the working group's proposals would not be implemented until after the 2020 election. (This naturally generates a risk that they are not implemented at all.)

Labour plans to start an investment fund charged with building 100,000 affordable houses (and the associated infrastructure) over ten years. This would tend to lift construction activity and GDP, but would not necessarily have a large impact on overall house prices.

Immigration

Labour would reduce the number of student visas and work visas. It would also make it more difficult for people who entered New Zealand on student visas to stay on. Labour estimates that this would reduce net immigration by around 30,000 people per annum. Both the Reserve Bank and Westpac Economics are already forecasting a substantial reduction in net immigration over the coming few years, so these policies would only impact our wider economic forecasts if they reduced immigration by even more than we are currently forecasting.

Emissions Trading Scheme

Both Labour and the Greens have committed to making New Zealand net carbon neutral by 2050. Labour plans to achieve this via the Emissions Trading Scheme, while the Greens prefer a carbon tax. Importantly, both parties plan to bring agriculture within their climate change policies. This will tend to alter land use away from dairy and towards forestry. It will also reduce the burden of meeting New Zealand's climate change commitments that would otherwise be borne by non-agricultural industries.

Key policies – New Zealand First

If New Zealand First forms part of the next Government, it will be as the smaller party in a coalition. Some of NZF's key policies that are relevant to financial markets are:

- Reduce immigration – NZF seeks much more restrictive immigration policy than either of the major parties.

- Tighten restrictions on foreign investment and restrict ownership of houses and farmland to New Zealand citizens and residents.
- Repeal the Emissions Trading Scheme.
- Reform the Reserve Bank Act with an eye to making the exchange rate more exporter-friendly.
- Remove GST on basic foodstuffs, reduce business tax, and index income tax thresholds to inflation.

Realistically, NZ First would be unable to implement these policies wholesale. But it may be able to negotiate one or more of reduced immigration targets, tighter foreign investment restrictions, and/or a reduced RBNZ focus on inflation.

NZ First's policies are expensive, and it has not signed up to any budget responsibility agreement. We do not know whether a government that includes NZF would run more stimulatory fiscal policy than the dominant party alone, but it does seem possible. Finally, it is important to note that the NZ First leader has said that introducing a capital gains tax would be "off the table" in any coalition negotiation – meaning it is uncertain what a Labour + NZF coalition would do with taxes on property investors.

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