

NEW ZEALAND ECONOMICS KEYLESS

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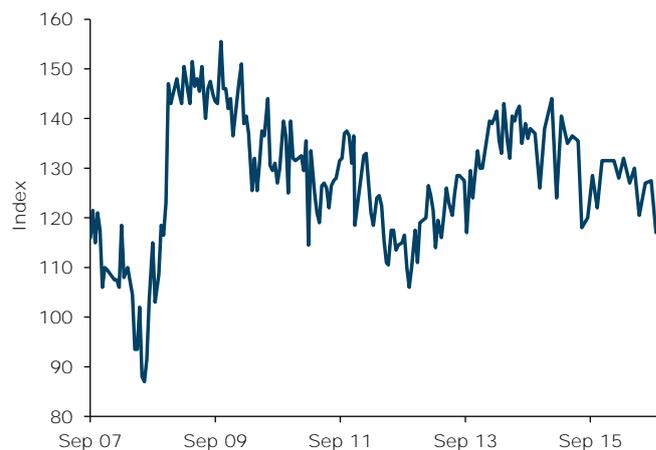
SUMMARY

- **In this note, we ask; does the resignation of John Key as Prime Minister materially change New Zealand's economic story?** This question is particularly pertinent in a world where politics and the potential for the resentment vote (and change in economic direction) are becoming greater considerations across the investment community.
- **The answer is no.** New Zealand coped with the departure of All Black captain Richie McCaw, and this is no different!

ASSESSMENT

- **We typically shy away from commenting on politics, but the reality is that we live in a world where government (and fiscal) policy is becoming a more important investment thematic, and politics – as well as economics – shapes policy.** Government policy direction is always a key investment thematic but has been usurped by central banks, monetary policy, and the magic of the interest rate wand for the past decade. Going forward, central banking is set to hold less sway. Government policy will be more relevant given the prevalence of the resentment vote around the globe, forcing the contract between society and politicians to be renegotiated, which in turn will shift the direction for policy.
- **New Zealand has had an enviable record of political stability** going back multiple governments. The transition to MMP **didn't cause too many ripples.** It has simply not been in New Zealand's DNA to change tack. Sense and sensibility have been apparent over the long haul across different Governments. The prior Government delivered the Super Fund, KiwiSaver, the China Free Trade Agreement and reinvested in infrastructure. In opposition they put some hard issues (superannuation and capital gains tax) on the table. **So we've seen credibility** and competency from all sides. We can always pick economic holes in various aspects of policy but the spirit has been pretty good in general.
- **More recently, political stability and a good policy track record has helped set New Zealand apart from others around the globe.** It's been an intrinsic part of the economic story, though impossible to measure. The likes of the NZD has been a beneficiary; the NZD/AUD is trading at 0.96 despite the yield differential saying it should be sub 0.90. The NZD on a TWI basis is above 78. That's far beyond levels implied by growth, yield or commodity prices.
- **The immediate question being asked is, does the resignation of the incumbent PM mean a reassessment is required?**
- **There are some arguments supporting this proposition:**
 - **'Brand Key'** has been a big part of the Government's game plan, and the loss of it will raise questions about strategy heading into the 2017 election.
 - PM Key has brought an element of **unity and CEO credentials** to the table; that cannot be understated.
 - PM Key has **raised New Zealand's profile** overseas immensely.
 - PM Key has **considerable political nous.**

- **Under an MMP electoral system, it wouldn't take much of a swing** away from National (perhaps only a few percentage points) to challenge its ability to form a Government come the 2017 election.
- **Even if the incumbent Government slips only slightly it will strengthen the position of NZ First** (Winston Peters) as Kingmaker, based on current polling.
- **The emergence of contenders** for the PM's role (though subsequently withdrawing) despite the PM endorsing one candidate – Bill English – signals some desire for change within the current Government.
- **However, there are strong counter-arguments.**
 - **A key feature of the past few years has been positive sentiment towards New Zealand's economic direction.** It has been a notable difference with international peers and allowed the policy platform to continue. The Roy Morgan Government Confidence Index (which measures whether people feel the country is heading in the right or wrong direction) rose to 141 in November, the highest since January 2015.

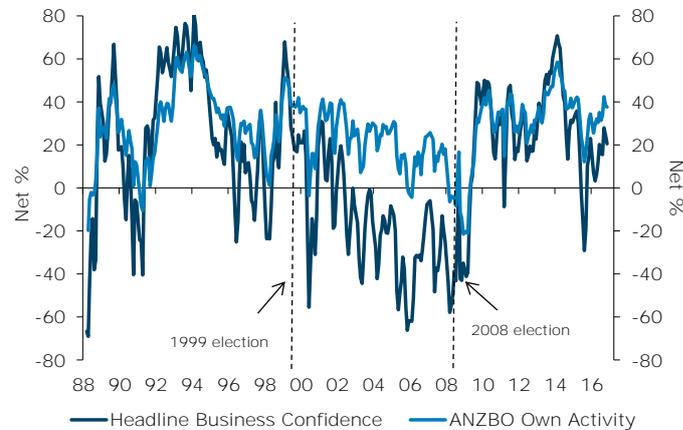
FIGURE 1. NZ GOVERNMENT CONFIDENCE INDEX

Source: ANZ, Roy Morgan

- **The Government has shifted more and more to the middle of the political spectrum.** Benefit rates were lifted last year to close the wage-benefit gap. The Government's investment approach to social spending is making inroads. Such forces do not remove the potential for political kickback, and New Zealand does have a housing affordability lightning rod to be mindful of, but they do temper this pressure. Like many countries, New Zealand is facing kick-back on a number of fronts (migration, housing affordability and income inequality). But unlike a host of nations, New Zealand has at least brought them to the forefront of policy and discussion (which is not to be confused with the provision of solutions).
- **We doubt the direction of policy will change significantly.** Any near-term directional change – if it occurs at all – would likely be minor; you don't shift the direction of an economic super-tanker overnight via tweaks in microeconomic policy settings.
- **The policy tilt looks set to be less about tax cuts and more about reducing debt and lifting priority spending** (i.e. education,

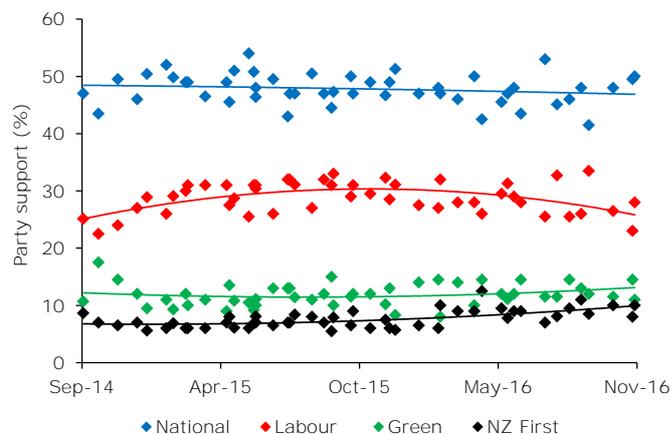
housing and infrastructure) than under the status quo. The announcement in yesterday's HYEPU of a significant increase in the capital allowance (from \$900m to \$3bn in Budget 2017 and to \$2bn in future budgets) to provide for investment (mainly infrastructure) is one such example. Tax cuts are considered a lower priority. The Budget Policy Statement made it clear: "When it is affordable, and when economic conditions permit, the Government would like to lower income taxes, with a focus on helping lower and middle income earners obtain a greater return from their own hard work. However, responding to the earthquakes and reducing debt are currently of higher priority." This, in effect, would shift the incumbent Government even more centralist. We also suspect there will be greater willingness to address the economic elephants, a key one being the sustainability of National Superannuation.

- **Any debate about policy direction (tax cuts, pay off debt versus more spending) masks a key point – that there are choices on the table!** The fiscal accounts are in such good shape that debate surrounding the appropriate policy mix can take place. If the books were not in such good shape such options would not be on the table.
- **With the fiscal accounts looking good, the Government (and incoming PM) have plenty of options with regards to policy initiatives.** Yesterday's HYEPU projected underlying surpluses rising to \$8.5 billion by 2021 and net debt falling below 20% of GDP. This is quite different to the challenges Europe faces, or recent leadership changes in Australia, for example, which have occurred at times when the fiscal position is strained, meaning tough fiscal decisions need to be made.
- **New Zealand has had an MMP electoral system since 1996 and it's worked.** Over that time there have been ructions and challenges, but nothing major. The system is working; deals eventually get done as horse-trading takes place. This is not like other countries where spills and political thrills / changes are frequent.
- **There is an argument – and we have sympathy for it – that the speed of change could have been quicker over the past eight years;** more political capital could have been burned addressing unpopular but necessary reforms around key issues. There are some economic elephants in the room (the age of eligibility for National Super for one) that can't continually be kicked down the road.
- **We've seen businesses get nervous with regards to politics before, via weakness in general business confidence** (such as the period post the 1999 election). However, more important measures such as **firms' own activity expectations** and employment and investment intentions (which are more closely correlated to growth), **do not show the same political fallout.** With domestic activity growth strong and finding labour the most significant problem facing firms, the wider credentials of the economy need to be respected; a change of PM is not going to alter that picture.

FIGURE 2: ANZ BUSINESS CONFIDENCE AND FIRMS' OWN ACTIVITY EXPECTATIONS

Source: ANZ

- **The incumbent Government is still popular** (it is polling around 45-50%), which is all the more remarkable considering it is in its third term. In an MMP environment, the incumbent needs to be running that strongly to secure a victory, so this in itself might prove challenging. **But it's a solid starting position nonetheless.**

FIGURE 3: PARTY POLLING SINCE 2014 ELECTION

Source: ANZ, Roy Morgan, One News Colmar Brunton, Herald-Digipoll, Newshub Reid Research

- The All Blacks lost Richie McCaw last season, but lo and behold, they remained top of world rugby rankings – setting a new world record for consecutive wins in the process. There is a lesson in that; there is no **'I' in team**. The broader group / framework / environment matters much more. And the All Blacks are arguably a better team now anyway.
- **The bottom line: there is going to be an element of political uncertainty in New Zealand over the coming months.** Whenever there's change – whether it's in a political party, publicly listed company or a school – there's always uncertainty for a while. People stand back and watch and see if the new leadership starts delivering on what it promises. **But we doubt a wisp of uncertainty and/or tilt in policy direction will have a material impact on the economy.**

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