Harbour Navigator

NZ election: Down to the No.8 wire

Harbour Navigator 31/8/17 contactus@harbourasset.co.nz +64 4 460 8300

The New Zealand election on 23 September may come down to the (No. 8) wire. By international standards, both National and Labour-led governments appear relatively centrist, without large policy differences. However, New Zealand equity market valuations are full, meaning that the market may become increasingly sensitive to changes in macro-economic settings, uncertainty and change. Some investors may want to be patient and see how the election evolves.

At the time of writing, in our opinion, there are no major policy differences which are likely to significantly influence particular equity market sectors.

A change to a Labour-led NZ Government may see a change in tax laws, which influence business and consumer confidence, and the willingness of businesses to make investment and employment decisions. Changes to labour policies, including the introduction of a living wage requirement, may impact on some companies with higher labour inputs (for example, quick service retail), but could have positive impacts in the rest of the economy.

The need for coalition party support to form a Government may see either a National or Labour-led Government tighten migration or environmental policies. If introduced, such policy changes may increase near term costs and reduce short term growth for some parts of the economy. A Labour-led coalition is unlikely to further privatise state owned assets.

While a Labour-led Government may tend to be more fiscally liberal than a National-led Government, relative to global alternatives, the New Zealand economy is still likely to be considered relatively low risk, regardless of which party is in power. For example, Labour's spending policies would still see net government debt to GDP below 30%, albeit a few years after National. Similarly, Labour and National are committed to the RBNZ having a flexible inflation targeting regime, though Labour supports some tweaks to bring RBNZ governance in line with overseas practice.[1]

Markets globally have become used to unexpected election outcomes, with investors initially reacting negatively to political change, only to reconsider and reinvest into assets in countries where major change has occurred (as has been the case recently in the US, UK and France) . It is unclear if

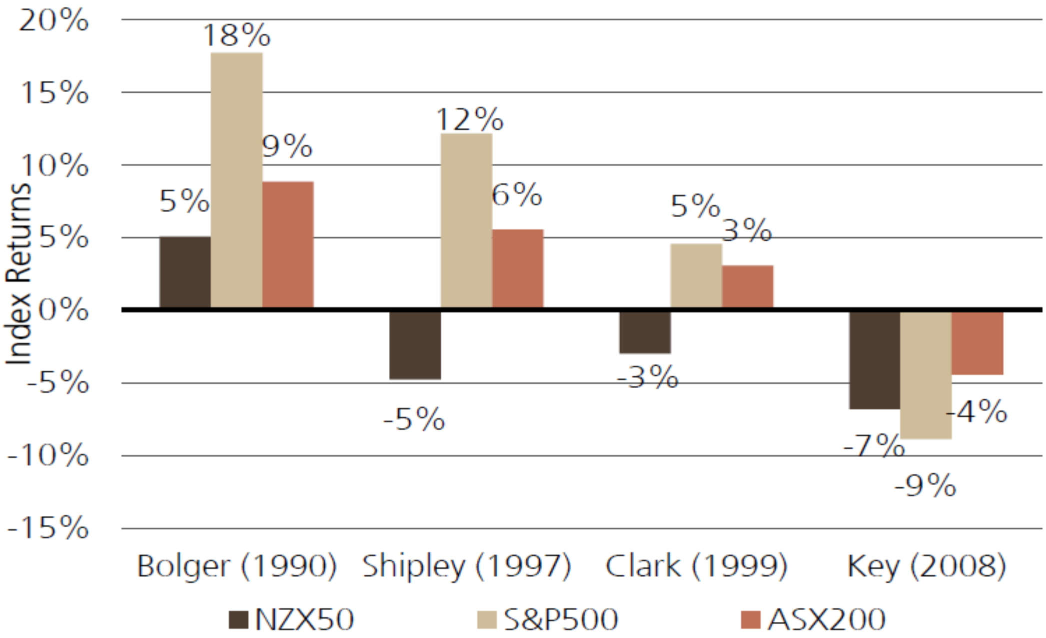
[1] Harbour Navigator: "Labour's mainstream monetary policy proposals", 11 April 2017

global investors into New Zealand assets are becoming wary of a potential change in New Zealand Government. However, it is possible that the potential for a change, in combination with slightly softer economic data (e.g. dairy prices, terms of trade) has contributed to a recent weakening in the NZ dollar against some of its major trading partners.

There is potential for a delayed global reaction to a change in New Zealand Government. Research by UBS, shown in figure 1 below, suggests that the New Zealand equity market has underperformed the US and Australian equity markets in the three months following a change in Prime Minister, over the last four change events (this research does not cover the most recent Key-to-English change). Important to note, though, is that economic events around these Prime Minister change events may have had an influence on the underperformance of the NZ market.

Given the full pricing of the New Zealand equity market, we would expect volatility and stock return dispersion to increase over the last third of 2017, whether due to the influence of the general election, or changes in global macro-economic policy settings. In a broader sense, Harbour believes that significant technological change is more likely to remain the most powerful influence on equity market returns.

Figure 1: Three month performance of the NZX40/50 after a change of Prime Minister



Source: UBS, Bloomberg. Published 23 December 2016

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