NZD Plummets on Political Change

- NZD falls on uncertainty
- Potentially putting upward pressure on future rates
- Fiscal policy to ease
- More debt to be issued
- Growth on a firm footing

NZD hit by political uncertainty . . .
The New Zealand dollar has tumbled. This largely reflects a combination of heightened uncertainty surrounding the policy mix of the incoming government coupled with fears that New Zealand First leader Winston Peters will push for a change in monetary policy settings such that a weaker NZD becomes a focus of policy.

We had cautioned ahead of the election that this was a likely reaction to a change in Government. However, we also cautioned that there was a real risk that any such reaction would get overdone. We may well be reaching that point with the NZD stretching further below our fair value model estimate of USD 0.73.

But fixed interest markets unfazed . . .
Interestingly, fixed interest markets have actually rallied modestly. This means there is currently something of a disconnect between the interest rate and foreign exchange markets. At current levels, the TWI is 5% below that assumed by the RBNZ when it produced its August MPS. All things being equal, this would argue for a 0.5 percentage point increase in its year-ahead CPI inflation forecast and an interest rate track around 50 basis points higher. Clearly, all things are not equal but it goes without saying that the longer the NZD stays at these levels, the greater will be the upward pressure on interest rates. It seems then that the initial market reaction is to price in a lower growth outlook. Something we are not, at this stage, subscribing to.

So, we know that we now have a Labour-NZ First government, with the Greens supporting that government in confidence and supply. But there remain a huge number of questions as to what the policy mix of that government will be. We know that Labour will be the dominant party and what the broad thrust of its policy is. What we don’t know is the full extent of the concessions it has had to make to operate alongside New Zealand First. We will get more information on this across the course of the day and substantial detail has been promised for early next week.

Labour policy drives the agenda . . .
As we wrote in our pre-election briefing, compared to the outgoing regime, Labour will:

- run looser fiscal policy;
- necessitating a larger debt programme (Labour says it will issue $7bn more debt over the next four years than was in National’s mandate);
- be more redistributive in its approach to taxes and spending;
- government building of “affordable” housing will start almost immediately;
- implement a higher minimum wage;
- transition to free tertiary education and higher student allowances;
- generate modestly more inflation;
- expand the Policy Targets Agreement to include employment as a target;
- ensure that monetary policy decisions will be made by a committee dominated by Reserve Bankers but including independent members;
- publish the minutes of that committee;
- keep the age of superannuation at 65; and
endeavour to resume payments into the New Zealand Super fund.

Much of the above is supported by NZ First which will also look to:
- reduce net immigration;
- impose tighter rules on foreign ownership, especially the foreign purchase of existing homes and it will be interesting to see how the foreign ownership rules impact New Zealand’s free trade objectives – particularly, in the first instance, TPP;
- moderate some of Labour’s policies which were seen as anti-business especially the proposed water tax for the agriculture sector.

In acknowledgement of the Greens support
- environmental policy changes will be supported;
- the Greens will be given three ministerial positions outside cabinet; and
- welfare payments will increase.

Upward pressure on interest rates . . .
On balance, the new policy mix will put some upward pressure on interest rates. The combination of increased demand for debt and more inflationary policy should have an impact at both the short and the long end of the curve – eventually. But we are talking at the margin, here, not an aggressive move.

In the longer run it’s hard to know what all this means for the New Zealand Dollar but initially it will be, and has been, seen as a negative which, in turn, puts further upward pressure on rates. Uncertainty is the major factor here. Realistically, though, international developments will dominate.

Fears of currency manipulation overdone . . .
In the run up to the election, New Zealand First stated that it wanted to control the NZD using a Singaporean type model. We believe this is one policy that will not see the light of day so NZD investors should be less spooked than they appear to be.

There will be much discussion over ministerial positions but we do know that:
- Jacinda Ardern will be the Prime Minister;
- Winston Peters will have senior portfolios - he has been offered Deputy PM but hasn’t yet decided whether to take it;
- Labour will keep the finance portfolio; and
- New Zealand First will have four ministers in cabinet

For businesses . . .
In the first instance, policy uncertainty will weigh on businesses as will policy change. Moreover, because we have no track record of seeing how such a grouping will behave in office and how stable it is questions will be asked about policy sustainability. Only time and observation will ultimately resolve this – one way or t’other.

For financial markets . . .
From financial markets and economic forecasters’ perspectives the immediate questions that we would like answered are what will monetary policy look like (and we are sure any incoming Governor would like to know this too) and what will happen to the tax package that National had announced, which is now central to most forecasts.

For National . . .
For National, it’s now a spell in opposition. Bill English has not confirmed what he will do but his performance in this campaign would likely mean that the job as leader is his if he wants it. The view is that he won’t but we will just have to wait and see. National will be large and strong in opposition and will, undoubtedly, spend considerable time attempting to drive wedges between the component parts of the new Government.

For the economy . . .
Whatever the outcome of the above machinations, we restate our view that the New Zealand economy is on a fundamentally firm footing. We can say with some certainty that:
- the global economy will be supportive;
- fiscal policy will be stimulatory;
- monetary conditions will be stimulatory; and
- the terms of trade will help boost New Zealanders incomes.

We are not forecasting drought, aggressive monetary tightening or a global shock.

This being the case we maintain our view that the economy will continue to press on for the foreseeable future. Sure, short-term uncertainty may impact activity but it should be transitory in nature.

stephen_toplis@bnz.co.nz
Contact Details

BNZ Research

Stephen Toplis  
Head of Research  
+(64 4) 474 6905

Craig Ebert  
Senior Economist  
+(64 4) 474 6799

Doug Steel  
Senior Economist  
+(64 4) 474 6923

Jason Wong  
Senior Markets Strategist  
+(64 4) 924 7662

Main Offices

Wellington  
42-52 Willis Street  
Private Bag 38906  
Wellington Mail Centre  
Lower Hutt 5045  
New Zealand  
Phone: +(64 4) 473 3791  
F: 0800 283 269

Auckland  
80 Queen Street  
Private Bag 92208  
Auckland 1142  
New Zealand  
Phone: +(64 9) 976 5762  
Toll Free: 0800 081 167

Christchurch  
111 Cashel Street  
Christchurch 8011  
New Zealand  
Phone: +(64 3) 353 2219  
Toll Free: 0800 854 854

National Australia Bank

Peter Jolly  
Global Head of Research  
+(61 2) 9237 1406

Alan Oster  
Group Chief Economist  
+(61 3) 8634 2927

Ray Attrill  
Head of FX Strategy  
+(61 2) 9237 1848

Skye Masters  
Head of Interest Rate Strategy  
+(61 2) 9295 1196

Wellington  
Foreign Exchange  
+800 642 222  
Fixed Income/Derivatives  
+800 283 269

Sydney  
Foreign Exchange  
+(61 2) 9295 1100  
Fixed Income/Derivatives  
+(61 2) 9295 1166

London  
Foreign Exchange  
+(44 20) 7796 3091  
Fixed Income/Derivatives  
+(44 20) 7796 4761

ANALYST DISCLAIMER: The person or persons named as the author(s) of this report hereby certify that the views expressed in the research report accurately reflect their personal views about the subject securities and issuers and other subject matters discussed. No part of their compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in the research report. Research analysts responsible for this report receive compensation based upon, among other factors, the overall profitability of the Markets Division of National Australia Bank Limited, a member of the National Australia Bank Group (“NAB”). The views of the author(s) do not necessarily reflect the views of NAB and are subject to change without notice. NAB may receive fees for banking services provided to an issuer of securities mentioned in this report. NAB, its affiliates and their respective officers, and employees, including persons involved in the preparation or issuance of this report (subject to the policies of NAB), may also from time to time maintain a long or short position in, or purchase or sell a position in, hold or act as advisors, brokers or commercial bankers in relation to the securities (or related securities and financial instruments), of companies mentioned in this report. NAB or its affiliates may engage in these transactions in a manner that is inconsistent with or contrary to any recommendations made in this report.

NEW ZEALAND DISCLAIMER: This publication has been provided for general information only. Although every effort has been made to ensure this publication is accurate the contents should not be relied upon or used as a basis for entering into any products described in this publication. Bank of New Zealand strongly recommends readers seek independent legal/financial advice prior to acting in relation to any of the matters discussed in this publication. Neither Bank of New Zealand nor any person involved in this publication accepts any liability for any loss or damage whatsoever may directly or indirectly result from any advice, opinion, information, representation or omission, whether negligent or otherwise, contained in this publication.

US DISCLAIMER: If this document is distributed in the United States, such distribution is by nabSecurities, LLC. This document is not intended as an offer or solicitation for the purchase or sale of any securities, financial instrument or product or to provide financial services. It is not the intention of nabSecurities to create legal relations on the basis of information provided herein.

National Australia Bank Limited is not a registered bank in New Zealand.