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Australia's new Government

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Key points

> The policies of the new Government if implemented are likely to lead to smaller government, less regulation and over time improved productivity and economic growth.

> Expect a mini-budget around November that may contain more aggressive budget savings.

> The historical experience combined with the more business friendly approach of the Coalition suggests a positive share market response over time.

> The key uncertainty relates to the new Senate.

It's over, at least for now

Pretty much as the opinion polls and betting agencies had foreshadowed, Australia now has a new Liberal/National Government. While it's dangerous to ascribe too much in terms of their economic impact to elections in Australia as either side of politics are not radically different from each other in their core beliefs – there was perhaps more riding on this election than usual given the difficult period of minority government over the past three years and the more uncertain environment the Australian economy has now found itself in. This note looks at what is expected in terms of changes to policies and implications for the budget, the economy and the share market.

Policy change

Based on their election platform, key policy changes under the Coalition Government will include the following:

- the abolition of the mining tax;
- the abolition of the carbon tax/Emissions Trading Scheme and its replacement with a direct action plan where companies will be paid to reduce emissions;
- a 1.5% cut in the company tax rate, although companies with income above $5m per annum will see this offset by a levy to pay for a paid parental leave scheme;
- a refocussing of government spending towards infrastructure and away from hand-outs like the "Schoolkid's Bonus";
- a delayed increase in the superannuation contribution;
- a reduction in the size of the public service;
- reduced spending on the National Broadband Network;
- various other savings such as reduced foreign aid, removal of carbon tax compensation payments, cancelling the low-income super contribution, ending the instant asset write-off;
- undertaking inquiries into the labour market, taxation, productivity & competition, the financial sector and infrastructure funding and an audit of government which will potentially pave the way for smaller government, reduced regulation & reinvigorated economic reform; and
- a greater focus on returning the budget to surplus.

Taken together and assuming the policies are implemented, this should lead to smaller government, less regulation and over time improved productivity and growth in the economy.

Impact on the budget

Prior to the election, policy costings released by the Coalition indicated a cost to the budget over four years of just over $33bn, which is more than offset by budget savings of around $42bn. This results in net savings to the budget of just over $6bn on a cash basis over four years. Allowing for debt interest savings the total saving may be a bit more than this.

While the Coalition has not committed to the latest budget projections contained in the Pre-Election Economic and Fiscal Outlook (PEFO) they give a rough guide to the impact of the Coalition's proposed savings to date. The table below shows the latest PEFO budget balance projections in the first row, with a return to surplus not occurring until 2016-17 under the previous Labor Government's policies. The Coalition's net savings (second row) help improve the budget balance over time but only marginally, by just 0.1 to 0.2% of GDP per annum and a surplus is still not achieved until 2016-17 (third row). In other words, on current policies the Coalition essentially has the same overall budget strategy as the previous Labor Government!

Budget deficit surplus projections

$bn (%GDP)	2013-14	2014-15	2015-16	2016-17	Total
PEFO Cash balance	-30.1 (-1.9%)	-24.0 (-1.5%)	-4.7 (-0.3%)	+4.2 (+0.2%)	
Net savings	+1.1	+2.4	+1.9	+0.6	+6.1
Revised balance	-29.0 (-1.8%)	-21.6 (-1.3%)	-2.8 (-0.2%)	+4.8 (+0.2%)	

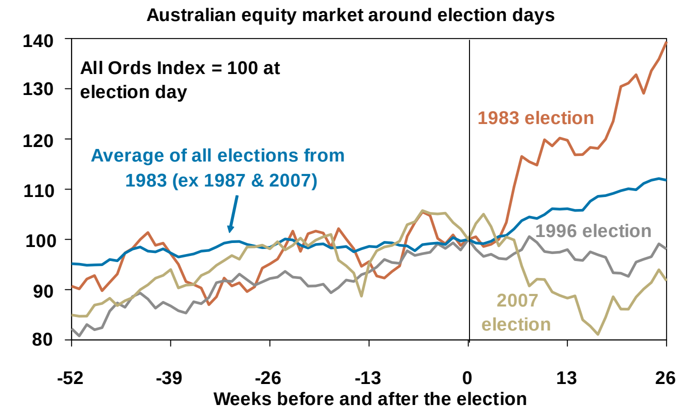
Source: Federal Treasury, Federal Coalition, AMP Capital

Now of course, under the new Government these projections are likely to change. In particular, the starting point for the budget projections may have deteriorated further and this may be accentuated by more conservative economic growth assumptions. As a result, there is a high risk the new Government will adopt more aggressive savings measures in order to meet its election commitments but at the same time ensure a return to surplus by 2016-17.

This is pretty much what the Howard Government did following its election in 1996. A mini-budget coinciding with the Mid Year Economic and Fiscal Outlook in November, and possibly after an audit of government spending has reported, may contain more aggressive budget savings.

Implications for financial markets

Putting aside the usual global influences it's likely that over time the response in financial markets to the change of government will be positive, particularly for the share market. There are several reasons for this. Firstly, over the last 30 years Australian shares have generally risen after Federal elections. This is evident in the next chart which shows Australian share prices from one year before till six months after Federal elections since 1983. This is shown as an average for all elections (but excludes the 1987 and 2007 elections given the 1987 global share crash and the start of the global financial crisis in 2007). What is clear is that after elections shares tend to rise more often than they fall.



Source: Thomson Financial and AMP Capital

The next table shows that after 8 out of 11 elections since 1983 the share market was up 3 months later with an average gain of 5.4%, which is above the 1.8% average 3 monthly gain from shares over the whole period.

Australian share market 3 months after elections

Election	Winner	Aust All Ord's share index 3 months later, %
Mar 1983	ALP	19.8
Dec 1984	ALP	5.4
Jul 1987	ALP	15.9
Mar 1990	ALP	-3.5
Mar 1993	ALP	3.2
Mar 1996	Coalition	-2.0
Oct 1998	Coalition	11.1
Nov 2001	Coalition	5.4
Oct 2004	Coalition	9.9
Nov 2007	ALP	-11.7
Aug 2010	ALP	5.7
Average		**5.4**

Source: Bloomberg, AMP Capital

Secondly, over the post World War Two period the average annual return from Australian shares (capital growth plus dividends) under Coalition Governments has been 13.2% pa as opposed to 9.9% pa under Labor Governments.

Average share market returns of post war governments

Period, All Ords Accumulation Index	Labor Governments, %pa	Liberal/National Governments, %pa
1945 - 1949	11.7	
1949 - 1972		12.8
1972 - 1975	-5.5	
1975 - 1983		13.5
1983 - 1996	17.3	
1996 - 2007		14.0
2007 - 2013	-0.4	
Weighted Average	**9.9**	**13.2**

Source: Thomson Financial, AMP Capital

Some might argue though that the Labor Governments led by Whitlam and Rudd/Gillard had the misfortune to be affected by the global stagflation of the 1970s and the GFC. The reformist Hawke/Keating period from 1983 to 1996 certainly defied conventional perceptions that conservative governments are always better for shares. However, it can be seen that Liberal/National governments have seen solid and reasonably stable average returns from shares and this may reflect a more business friendly policy approach.

Thirdly, we have now seen the end of a period of destabilising and uncertain minority government in Australia which has not been good for confidence.

Finally, Coalition policies with a focus on cutting taxes, refocussing government spending on productivity enhancing infrastructure, smaller government and less regulation promise to be business friendly, which should be positive for confidence and the economy. This is particularly so given that business confidence is running at sub-par levels.

Overall, this suggests a favourable reaction from investment markets.

What are the risks?

But, there are qualifications. First, the strong performance of Australian shares in August relative to global shares may have already partly factored in the change in Government.

Second, the favourable boost to confidence and longer term growth may be offset in the months ahead if the new Government chooses to go hard in terms of cutting spending.

Finally, and most importantly, the Senate may thwart the Government's program. Whilst the Coalition clearly won control of the House of Representatives, the Senate won't necessarily respect any claims that it has a "mandate". The current Senate that sits until June next year is controlled by Labor and the Greens and is very unlikely to pass legislation to abolish the carbon and mining taxes. Vote counting for the new Senate that will sit from July is yet to be finalised, but it looks like the Coalition will need the support of a variety of independents and minor parties with varying views to get its program through. With most of the minor parties to the right of the Coalition, the new Government has some chance of success. But hopefully this won't lead to a bunch of concessions and giveaways that are not in the national interest. Failure to reach agreement could mean a double dissolution election, although that is looking a bit less likely.

But on balance, the reaction from financial markets to the new Government is likely to be positive, with shares likely to be stronger than would otherwise have been the case, notwithstanding the usual gyrations driven by forces such as global developments. Share market sectors and companies likely to benefit include the miners (from the abolition of the mining & carbon taxes), heavy carbon emitters, engineering and contracting companies (from the infrastructure program), companies that provide salary packaging and car leases (as car FBT changes won't proceed) and small businesses.

The $A may also be a beneficiary, although given the need for a lower $A to help the economy adjust as the mining sector slows this would only bring forth more RBA rate cuts which would offset any positive impact on the currency.

A boost to consumer confidence may also boost the recovering housing market. This was perhaps evident on the weekend with auction clearances surging in both Sydney and Melbourne, albeit helped by lower listings owing to the poll.

Concluding comments

A whole range of factors influence financial markets with elections playing a relatively minor role. In the short term these include the threat of US military intervention in Syria, the US Federal Reserve's taper decision, US Congressional negotiations regarding the US Government's debt ceiling and worries about the emerging world and the mining slowdown locally. However, given the unstable policy environment of the last few years in Australia partly associated with minority government, the relatively subdued levels of business and consumer confidence and the business friendly policies of the Coalition there is likely to be a favourable reaction to the change of Government evident over time.

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