

Australia's less than certain election result



Key points

- The unclear Australian election result has added to investor uncertainty in Australia and doesn't augur well for stable visionary policymaking for the next term of government.
- Beyond a few financial market jitters and lost opportunities until the next election, the uncertain election outcome doesn't justify big falls in Australian investment markets, as it's unlikely to threaten Australia's favourable longer-term prospects.

Hung parliament

Historically, Australian elections have had little impact on financial markets¹. By contrast, the 2010 election may prove a little different, with the outcome being a hung parliament for the first time in 70 years and independents' set to decide the victor for which the outcome may not be known for days (or maybe even weeks). On top of this, the Greens have likely gained the balance of power in the Senate, raising fears of less business-friendly policies emanating from Canberra.

The last thing investors want – particularly at a time of 'unusual uncertainty' regarding the global economic outlook – is more uncertainty, and unfortunately the Federal election has delivered just that; not just in terms of which side of politics will be able to form government, but also in terms of how stable that government will be and which direction policymaking will take.

This is an unfortunate result for Australia. It seems like only yesterday Australia was riding high in global investors' perceptions following its Houdini-like escape from the global financial crisis on the back of similar experiences through the 'tech wreck' and the Asian crisis. But now, coming on the back of a debilitating debate over the resources tax, the election result risks further diminishing global investors' favourable perceptions of Australia as a model of stability and longer-term growth potential.

However, while uncertainty has increased, it's hard to see the election causing any lasting damage to Australia's favourable fundamentals.

Increased uncertainty and less decisive government

At this stage, it's too early to determine who will be the victor. Counting is still continuing in key close-run seats, and even if there is an outcome soon, there may well be recounts. This could take days (or weeks). And it's unclear which way the four or five independents will go. On the one hand, three of the Independents are conservative and come from seats where Labor support is very

low, so this might suggest the Liberal/National Coalition has the best chance of forming government. Against this, there appears to be majority support amongst the Independents for action on climate change, a national publicly-owned broadband network and the proposed mining tax, which might suggest that Labor has the advantage. Either way, both sides will no doubt engage in lots of horse trading to try and form a working government. Since most of the Independents are from regional Australia, one clear winner will likely be regional Australia in terms of infrastructure spending and population planning. Such an outcome may be a good thing given the population and housing pressures in the major capital cities (so long as it doesn't result in a return to agrarian socialism with farmers hiding behind a wall of protection).

Sources of uncertainty

There are several sources of uncertainty flowing from the election which will likely weigh on Australian financial markets.

- In the short term, the uncertainty over who will form government may weigh on markets. So, too, will fears that the Green's holding the balance of power in the Senate, combined with a possible Labor government, will result in less business-friendly policies going forward, e.g. a tougher mining tax or tougher action on climate change.
- Beyond this, there is a risk a minority government from either side of politics might be unstable (i.e. just one heart attack away from falling apart), less responsive to economic challenges and less inclined to undertake necessary longer-term structural reforms of the economy. Certainly visionary reforms as undertaken by the Hawke/Keating and Howard/Costello governments seem to be a thing of the past for now.
- We may also be in for a shorter political cycle as the new minority government may be tempted to call another election as soon as the opinion polls look favourable.
- A sense of political instability may also weigh on consumer and business confidence, acting as a dampener on economic and profit growth.

But don't expect a big negative fallout

While political uncertainty has likely increased, it's hard to see the election having a big and lasting negative impact.

- First, financial markets had to some degree priced in the risk of a hung parliament in Australia and this may partly explain the muted reaction so far in the local currency and share markets. Another factor possibly explaining the muted reaction of financial markets to date is that according to betting agencies the odds favour a Liberal/National Coalition government being formed, and this would be seen as positive for mining stocks given the Coalition's commitment to dump the mining tax.

1. See "The Australian election and investment markets", Oliver's Insights, July 2010.

- Second, while some fear a leftward shift in policymaking following the likely ascendancy of the Greens in the Senate, it's noteworthy that policy emanates from the lower house and there the Greens will have only one seat. Of course, if the Liberal/National Coalition forms government there is no chance of left-leaning policies getting up. What's more, the Greens won't get the balance of the power in the Senate until the new Senate forms on 1 July next year. By then, there is plenty of scope for the new government to try and get legislation passed by the old Senate. And of course by July next year Australia may well have had another election!
- Third, it should be noted that Australian governments – both Labor and Liberal/National – have spent much time over recent decades with a 'hung parliament' anyway in the sense that another party has controlled the Senate, necessitating negotiation over key policy issues.
- In addition, policy differences between the two major parties are minor. None promised significant productivity-enhancing policies during the election campaign anyway, but nor does any party have any mandate for a leftward shift in economic policies. While a Liberal/National Coalition government would resist less business-friendly policies, the Labor Party is also likely to avoid upsetting business given its debilitating battle with the miners and the knowledge it will only work against the economy in the longer term. There is also no threat to the independence of the Reserve Bank and both sides of politics are committed to returning the budget to surplus (although there is a risk of fraying at the edges on both of these if policymaking becomes more populist).
- Finally, the election has done nothing to alter Australia's relatively favourable long-term fundamentals based on our export exposure to high growth in Asia, high terms of trade, low public sector debt and a stable financial system. The main driver of the Australian share market and the Australian dollar in the shorter term will remain perceptions about the strength of the global recovery, and the lead coming from both the US and China.

So while the election has boosted short-term uncertainty and dimmed for now the prospect of radical visionary longer-term economic reform designed to boost Australia's flagging productivity record, it probably won't result in the downside many fear either.

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