

AUSTRALIA



ECONOMIC UPDATE

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“Politics is not a game. It is an earnest business.”

– Winston Churchill

In hope of stable government

In our view, probably the best outcome from last night's leadership ballot was that the election is now more likely to be held earlier. While a Coalition victory would probably be better for the stock market, restoring stability within government is more important. In our view, a hung parliament has not served the nation well and the hope is that we see a clear winner when the election is eventually held.

Spill delivers a new leader ►

Forces have moved within government and Australia now has a new Prime Minister. Former Prime Minister Kevin Rudd won a party ballot 57-45, regaining the party leadership and his old job from Julia Gillard. Following the ballot seven ministers have resigned and a new cabinet will be announced in due course. As the result of the ballot was reasonably narrow, the new Labor leader's longevity in the top job could depend on how successful the party is at the upcoming election. Polling has shown that Labor has a much better chance of winning the election with Kevin Rudd as leader. Indeed, this was the key reason why he was able to win the ballot.

Election timing ►

The election must be held between 3 August and 30 November, and there is media speculation that it will be held around a month earlier than the date announced by the previous Prime Minister (14 September). In our view, bringing forward the election is good for the country. It has the hope to deliver a clear majority to the winner that gives them unequivocal power to pass legislation through the lower house. It's more difficult to speculate on the composition of the Senate, but the change of Labor leadership probably makes it more difficult for the Coalition to control this house of parliament. Furthermore, any new Senators that will be elected this year won't take their seat until 1 July 2014 and this means that even if the Coalition gains control of the Senate it will be difficult for them to pass legislation prior to that date.

Stock market implications ►

Our previous note ('Landslide Coalition win expected; assessing market implications') on the prospects for equity markets from the election showed that there would be more benefits for investors from a Coalition victory. In particular, QUB could benefit from a private sector development at Sydney's Moorebank intermodal freight terminal. However, there are also marginal benefits for BHP, RIO, FMG and QAN from the Coalition's plan to repeal the carbon tax if elected. Our retail analyst thinks that CCL could benefit from any subsidy that the government might pay the food manufacturing industry.

The spill ►

Last night the Labor leadership reached another tipping point, with a ballot held at 7.00pm. Challenger Kevin Rudd won the ballot 57 votes to 45, regaining the Labor leadership from Julia Gillard. He was reappointed Prime Minister by the Governor General this morning.

The fallout from the result of the ballot has been swift, with seven cabinet ministers resigning last night. It's possible there is more fallout given the reasonably tight ballot result. The following ministers have already resigned following the change in leadership:

- Wayne Swan (Treasurer)
- Craig Emerson (Trade)
- Peter Garrett (School Education)
- Stephen Conroy (Broadband and Telecommunications)
- Joe Ludwig (Agriculture)
- Greg Combet (Climate Change)
- Stephen Smith (Defence)

Julia Gillard has kept her pre-ballot promise by announcing that she will resign from politics and not contest the election.

At this stage, it seems likely that Bill Shorten (Employment and Workplace Relations Minister) will retain his cabinet position, and Resources Minister Gary Gray has also confirmed that he will retain his place in the cabinet. Anthony Albanese has been confirmed as the new Deputy Leader of the Labor Party and Deputy Prime Minister. Penny Wong has confirmed that she will be the new Senate leader, taking the place of Stephen Conroy. Chris Bowen is the new Treasurer.

The opposition has stated it would not move a no-confidence motion against the government, so it seems likely that the current parliament will see out its term.

Milestones from here ►

- Both houses of parliament will sit tomorrow after the Greens voted with Labor to extend the current sitting until Friday. There are reportedly at least 50 bills that are yet to pass the upper house. Parliament is not scheduled to sit again until 20 October. Consequently, it is very unlikely new policies would be presented to Parliament prior to the election.
- The former Prime Minister had not issued writs to the Governor General to dissolve Parliament, so the announced election date may change. Consequently, given the change in leadership, it's now unlikely that the election will be held on 14 September.
- There is some speculation that Prime Minister Rudd may want to build on any momentum he might currently have by calling the election earlier than planned by his predecessor.
- The earliest possible date is 3 August 2013 and the latest possible date is 30 November 2013, based on the sitting times of parliament. However, a further caveat is that it may only take place no less than 33 days after the writs are issued.
- Dates currently being mentioned in the media are 3 August and 24 August.

Let the campaign begin ►

The most recent Newspoll was released three days ago, and it showed Labor's primary vote had fallen to 29%, and 43% on a two party preferred basis. Recent polling shows that the party is better placed to win the election with Kevin Rudd as leader. Indeed, consistently poor opinion polling for Julia Gillard was the driving force behind the leadership spill.

In our view, there are several key political issues that the new Prime Minister will need to address in the lead up to the election:

- The government's policy on asylum seekers and border protection
- The carbon tax and climate change
- The Minerals Resource Rent Tax (MRRT)

These were some of the key issues that caused opinion polls to turn on Mr Rudd when he was last Prime Minister. However, the lack of tax revenue delivered to government by both the carbon tax and the MRRT mean that these taxes are possibly a smaller political issue than when Mr Rudd was last Prime Minister.

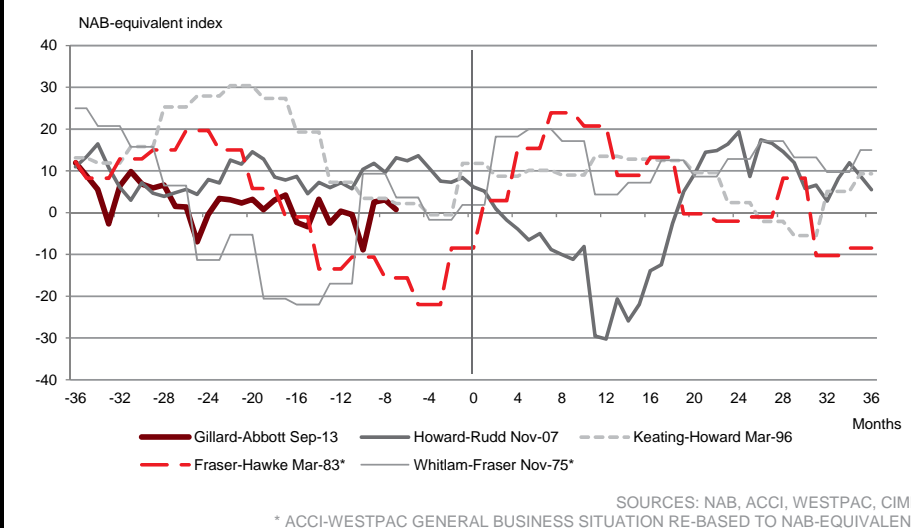
Market implications ►

If the polls are right and the upcoming election will be much closer now that Kevin Rudd has been reinstated as Prime Minister, then there are some market implications worth considering:

- Another hung parliament is a possibility, if the polls are accurate. However, this would be the worst possible outcome for the stock market and the economy because it would not improve general business confidence. Indeed, the government's lack of power to legislate has been one of the key reasons that it has been difficult to introduce new reforms.

During past changes in government there has been a tendency for business confidence to improve for around 12 months following the election. The outlier to this trend was the 2007 election, when Kevin Rudd lead Labor to victory over John Howard (Figure 1)

Figure 1: Business confidence before and after government-changing elections



- The budget position is tight, leaving little room for spending promises.
- An election will generally benefit the media sector, in particular SWM, FXJ and TEN.

In our view a Coalition victory would be generally more favourable for the stock market:

- It has been announced that the Coalition will repeal both the MRRT and the carbon tax. Even though these taxes have raised little revenue, their

removal would benefit companies exposed to these taxes. The removal of the MRRT would benefit BHP, RIO and FMG, while the removal of the carbon tax would benefit QAN.

- QUB would benefit if the Coalition was to win the election because the government currently has its own plans to develop an inter-modal terminal at Moorebank. QUB has an alternative concept that is more favourable for the company.
- The Coalition seems supportive of removing the 75% audience-reach rule, although this is probably not a high priority. We think PRT could benefit from any consolidation that would occur in the sector due to the removal of this rule. In our view, in the case of industry consolidation SXL may also merge with one of the major networks.
- The Coalition plans to fully restore the Australian Building and Construction Commission (ABCC) to police union activity in the sector. However, the extent of industrial relations reform would most likely be limited given the opposition leader's promise that Work Choices would not be re-introduced in his first term of government if he was elected. LEI, LLC and other builders could benefit from more liberal workplace relations.

The return of a Labor government could mean that some of the pressures on the manufacturing sector may ease.

- Our retail analyst, Daniel Broeren, thinks that under the new Prime Minister the government could introduce subsidies for the food manufacturing industry. The possibility of industry support could be a small positive for CCA.

As it seems more likely that the stock market would benefit from a change in government, we have listed some of the positives in figure 2 below.

Figure 2: Potential positives of a change in government

Sector	Policy impacts	Impacted stocks	CIMB view
Market	-	Miners, TLS, airlines, retail, QUB	The market impact of a change in government should be broadly positive, although the extent is likely to be moderated by: 1) its highly probable nature, making it well-priced; and 2) uncertainties about the deliverability of election promises given the soft budget position. Key beneficiaries would be miners (mining and carbon tax removal), airlines (most affected by carbon tax) and consumers (retaining carbon tax compensation).
Mining	Removal of MRRT	BHP, RIO, FMG	While the structure of the MRRT may have been flawed, we initially estimated the 22.5% impost on 'super-profits' above a 13% hurdle rate on the market value of capital would impact NPAT and NPVs of the major miners by 2-3%. More important than the direct earnings impact, the investment community has viewed sovereign risk as remaining elevated on this issue given the limited (embarrassing) scope of revenue collection, with the Greens minority partner calling for renegotiation and broadening of the tax. A change of government would negate not only the existing MRRT impact, but also the potential for any further increases.
Retail; Airlines; Industrials; Resources	Removal of carbon tax	Airlines, industrials	In our view, airlines were the most affected across the listed Australian space by the carbon tax introduction, with QAN advising an A\$55m impact at the 1H result (20% of pre-tax profits), which should reverse upon repeal. General industrials would also benefit from a repeal of the carbon tax through a reduction in their directly payable expenses, as well as through a fall in upstream energy costs (eg, electricity pass-through).
Telcos	Restructure of National Broadband Network (NBN)	TLS Contractors (-ve)	A Coalition government would likely maintain the overall NBN structure, but switch from fibre to the premises (FTTP) to a lower-capex fibre to the node (FTTN) technology. We estimate Telstra is about as well off in present value terms under this policy as with the current NBN plan. Telstra would receive migration payments earlier, although PSTN revenues would decline faster, particularly as regional markets open up faster to competition. Contractors would see the scope of NBN works decline under a Coalition govt.
Infrastructure	Transport infrastructure funding pledges	QUB, TCL	AOFM to examine an Infrastructure Partnership Bonds Scheme for private-sector investment. Coalition will contribute A\$5.6bn to Pacific Highway duplication between Newcastle and QLD, A\$1.5bn to M4 East (WestConnex Project), A\$1.5bn of East-West Link tunnel in Melbourne and A\$1bn for Gateway Motorway in Brisbane. QUB may directly benefit if the Coalition abandons the Federal Government's own plans for the development of an intermodal terminal at Moorebank, allowing QUB to proceed with their alternative concept.
Financials	30% tax on high-income earners' super contributions; 15% tax on retirement incomes above A\$100k	AMP, PPT	Labor has committed to increasing the tax on super contributions from 15% to 30% for those earning above A\$300,000 per annum, while also proposing a 15% tax on post-retirement incomes above A\$100,000 per annum. It is unclear whether either of these measures will gather the minority-support required to become law, but we believe the Coalition will not look to reverse the changes if legislated before the election.
Healthcare	Removal of means-testing of 30% health insurance rebate Improved pathology funding	RHC, PRY, SHL	The Coalition opposed means-testing of the 30% private health insurance rebate and has promised to wind the move back as budget conditions permit, which would be a positive for RHC if it eventuates. Pathology (PRY, SHL) may benefit from a Coalition govt, which historically has been more generous in funding negotiations.
Utilities	"Direct Action" Climate Plan	AGK, ORG	The Coalition has proposed an 'Emissions Reduction Fund' of A\$3bn for carbon emissions reduction tenders. This may be used to buy out inefficient generation in a similar manner to that proposed, but never executed, under the 'Energy Security Fund' of Labor's Carbon Pollution Reduction Scheme (CPRS).
Media	Election advertising Media reach rules	SWM, TEN SXL, PRT	We believe the election campaign will add 1% to TV advertising spend in this election year. The Coalition has appeared supportive of removing the 75% audience-reach rule, although we do not believe it would be a high priority (we see PRT as a potential beneficiary of consolidation in the sector, with SXL also likely to merge with one of the major networks).
Developers & Contractors	Restoration of Australian Building and Construction Commission (ABCC)	LEI, others	The Coalition plan promises to fully restore the Australian Building and Construction Commission (ABCC) to police union activity in the sector, although the extent of industrial relations reform should be limited given Abbott's pledge that the previous Work Choices regime (or similar) would not be re-introduced in his first term.
Small-Caps	Government handover	OKN (-ve)	Federal Elections have historically been negative for listed players given a reduction in Federal IT spend in periods both before and after elections due to uncertainty for government departments (more prolonged in the case of a change in government). Oakton (OKN) is the most exposed to this negative headwind given 20-25% of its sales are sourced from the federal government. This is followed by SMS Management & Tech (SMX), with 12% of sales from the federal government & defence department.

SOURCE: CIMB RESEARCH, COMPANY

Summary ►

Leadership instability resurfaced again within the federal government, although with Kevin Rudd being reappointed as Prime Minister the result of the upcoming election will probably be much closer than it would otherwise have been.

Media speculation suggests that the election will be held earlier than planned by the previous Prime Minister (14 September 2013). It must be held between 3 August and 30 November.

Given that some polling suggests the election could be tight with the new Labor leader, we think it's worth highlighting that another hung parliament would be the worst possible outcome and probably the biggest risk for markets.

The last 3 years have involved significant deal-making to get legislation passed and significant leadership instability. While there is nothing new in this because it's a general symptom of politics, it appears to have been extreme during this period.

In our view, the stock market would generally benefit more from a Coalition victory at the next election. However, provided the government is not hamstrung by its ability to pass legislation, the election outcome should have a relatively limited impact on the stock market.

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