

Economic note

28 June 2010

Australian political developments and the G20

- In a dramatic political development, Australia has a new Prime Minister, with Ms Julia Gillard taking over from Kevin Rudd. Ms Gillard, Australia's first female Prime Minister ('PM'), is expected to run a much more consultative and traditional style of government.
- The major areas of policy development are expected to be on the Resource Super Profit Tax ('RSPT'), tax reform more broadly, health, climate change, population policy and asylum seekers.
- The new PM has expressed a willingness to negotiate with the mining sector to come to a more balanced agreement on the RSPT. This has been largely welcomed by mining companies.
- Any changes to the structure of the RSPT will, however, have implications for the budget forecasts. A lower revenue stream could have implications for the bond market, but the new PM has confirmed the goal of returning the budget to surplus by 2012/13.
- The weekend G20 meeting in Toronto has sent positive signals on fiscal consolidation, exchange rate mechanisms and bank regulation – but the immediate market implications look to be minimal.

A new Australian Prime Minister

In a dramatic week for Australian politics, Prime Minister Kevin Rudd announced that he would stand down as leader of the Australian Labor Party (ALP) last Thursday and would not contest a vote for the leadership.

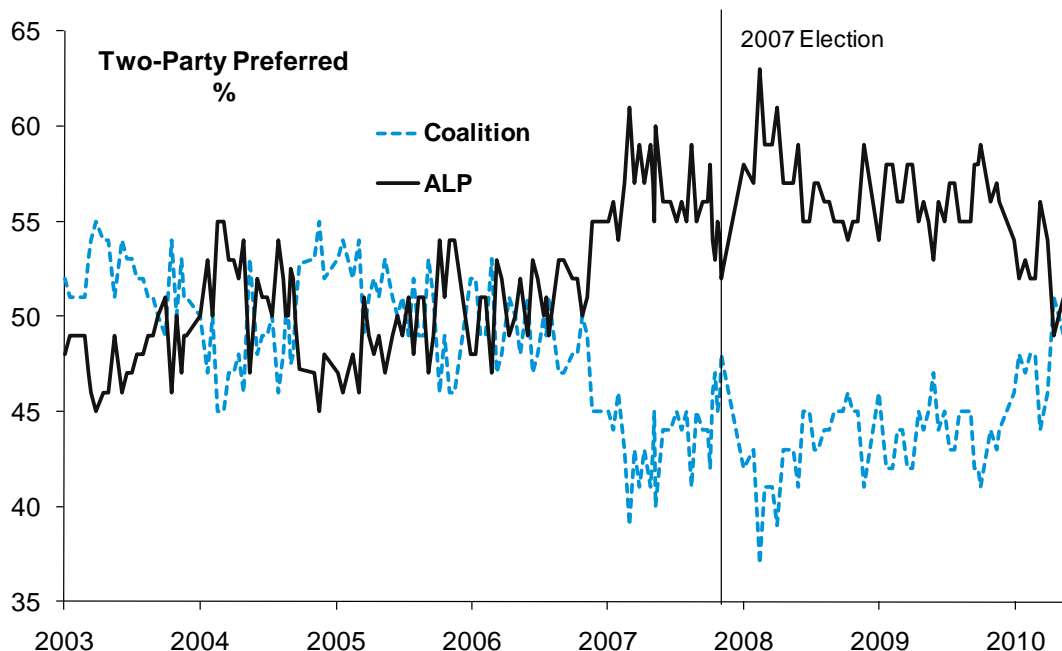
As a result, Ms Julia Gillard was elected unopposed as the new leader of the ALP and was sworn in as Prime Minister. Julia Gillard is Australia's first female PM and Australia's 27th leader.

Treasurer Wayne Swan was elected unopposed as the new Deputy leader and Deputy PM. He retains the Treasury portfolio and represented Australia at the G20 meeting in Toronto over the weekend (see below for further details on the G20 meeting). In a further development, Finance Minister Lindsay Tanner announced that he would not re-contest the upcoming election and would retire from politics.

The demise of Kevin Rudd as PM was an unprecedented development, given that his popularity was high until very recently (see chart over page) and given the strength of his win at the 2007 election. A sitting PM has never been replaced by his party in the first term of office.

However, frustrations had been growing over the former PM's leadership style, with a small inner circle of colleagues forming policy rather than the traditional style of broad consultation within the party. The change in leadership of the ALP will, therefore, be seen as a stabilising force within the party.

The new PM has today announced minimal changes to the Ministry. Simon Crean has taken over the PM's previous portfolio of Education, Employment and Workplace, while Foreign Affairs Minister Stephen Smith has had Simon Crean's previous portfolio of Trade added to his responsibilities. Former PM Rudd does not have a portfolio at this stage, but with the new PM stating that she would be "very delighted" to have Mr Rudd as a senior minister if the government was re-elected.



Source: Newspoll. Data to 27 June 2010.

Policy implications

PM Gillard is likely to move quickly to try and re-establish the Government's position on a number of policy areas – especially the RSPT, tax reform more broadly, health reform, climate change, population policy and asylum seekers.

PM Gillard announced last week that she will withdraw the Government's advertising campaign on the RSPT and has asked the mining industry to do so in return. BHP Billiton has committed to do so. The new PM also stated that the Government's "door" will now be open to negotiations on the RSPT and has asked the mining sector to open their "minds" to this negotiation.

The PM has stated that she will be seeking “consensus” and to end the “uncertainty” and has asked Treasurer Swan and Resources Minister Martin Ferguson to lead the negotiations.

On the RSPT, the consensus is that changes to the originally designed tax are now likely. One possible change will be remaking the RSPT to closely resemble the current ‘offshore’ PRRT (petroleum resources rent tax). This would remove the controversial downside insurance capital expenditure write-off element of the RSPT and also increase the uplift rate from the government bond yield to the government bond yield plus a margin for risk, say 5%. This is likely to be seen as a positive for the resources sector.

This would mean changes to the Government’s Budget forecasts, with the revenue collected from the RSPT likely to change depending on the type of tax introduced.

This has raised concerns that it could delay the Budget’s return to surplus in 2012/13, if no changes are made on the expenditure side, such as the promised Health spending or cuts to the corporate tax rate.

The RSPT in its current form is expected to generate revenue of A\$12bn after its proposed implementation of 1 July 2012. The budget implications of changes to the RSPT may have a (marginally) negative impact on bond markets, although the new PM has re-committed to returning the budget to surplus in the current timetable.

Any budget changes that flow from a new deal on the RSPT will have to be included in the Pre-Election Economic and Fiscal Outlook (PEFO), which must be published within ten days of calling an election.

Other areas of policy changes are likely in climate change, where PM Gillard has expressed the desire to generate a community consensus on the issue and the disappointment of not having a price of carbon in Australia.

Another area of policy where the new PM has distanced herself from the previous PM is in the area of population growth, with much less ambitious targets for Australia’s population now likely.

Economic implications

The most direct impact on the Australian economy from the change of leadership will likely be from the possible changes to the RSPT. While it is unknown at this stage what form the new tax will take, mining companies have shown confidence that the solution could be better than previously expected.

What is critical for the Australian economy is to ensure we maintain a very competitive mining industry that is able to compete with other countries and continue to attract funding to undertake the large pipeline of mining and infrastructure work to take place in coming years. Current forecasts include A\$105bn of mining capital expenditure to take place in the next financial year and this will be one of the key drivers of economic growth over the coming year.

The new PM’s views on population growth will also likely impact on the Australian economy over the medium-term. Climate change policies will also be critical, as will any potential changes in health, broad taxation reform and infrastructure spending.

Election timing

Given the strong bounce in opinion polls over the weekend (see chart above), PM Gillard looks set to enjoy a 'honeymoon period' where she may be inclined to go to the polls relatively early - ie. in August.

While an election can actually be delayed until April 2011, the previous election was held in November 2007, and so there is a strong expectation that an election will be held this side of Christmas.

Victoria goes to the polls on 27 November and there seems general agreement that the Commonwealth election will be prior to this date. Ruling out the last weekend of September (AFL grand final) and the first weekend of October (NRL grand final) puts an election as early as August, or around mid-September or mid-to-late October.

The G20

At the weekend meeting in Toronto, Canada, the leaders of the G20 announced a number of important milestones. The leaders of the advanced economies agreed to aim to reduce their budget deficits by half by 2013 and to stabilise their net government debt/GDP ratios by 2016.

The host of the G20, Canadian PM Stephen Harper stated that given the still "uneven and fragile" state of the global economy it was "imperative we follow through on existing stimulus plans", but that "at the same time, advanced countries must send a clear message that as our stimulus plans expire, we will focus on getting our fiscal houses in order."

While markets welcomed this commitment on government debt, actions will speak louder than words and financial markets seem to be more concerned at present with nearer term developments.

In addition, the major emerging market economies agreed to take measures to strengthen social security networks, increase infrastructure spending and promote exchange rate flexibility.

It is interesting to note that the recent move back to a more flexible exchange rate regime in China was not mentioned specifically in the communiqué, but looks to have received strong support – with the US President welcoming the move, but stating clearly that the US authorities would expect the RMB to continue to appreciate in the months ahead.

On banking regulation, the G20 moved to agree that banks need to raise "significantly" more capital, but that countries should be allowed to phase in new rules out to the end of 2012.

Indeed, it could be argued that what the global economy needs now is more private sector liquidity and lending to profitable private sector companies and consumers – not a near-term increase in the cost of credit to the banking system.

In addition, the G20 called for a "single set of high quality" accounting standards and executive pay rules. The G20 also looked to improve the over-sight of hedge funds, credit rating agencies and OTC derivatives trading.

The G20 is expected to take another look at banking and financial regulation at the next meeting, to be held in Seoul in November, with the Basel Committee on Banking and Supervision to provide a roadmap for reform.

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