

ECONOMICS: AUSTRALASIAN PERSPECTIVES—AUGUST 13, 2010

AUD May Feel the Heat if Voters Return a Hung Parliament

■ **Guy Bruten**

Australian Economist—Global Economic Research

Ordinarily, elections are a nonevent for markets in Australia. This time, however, a hung parliament looks possible for the first time in 60 years. Should such an outcome prevail, we expect the effect on markets will be felt first in the Australian dollar.

Campaigning in the run-up to Australia's general election, to be held on August 21, has suddenly become interesting—not so much for the policies being promoted or the intrigues behind the scenes, but for its closeness. If the opinion polls are to be believed, the possibility of a hung parliament in Australia is the strongest it has been since a federal election last produced such a result, in 1940.

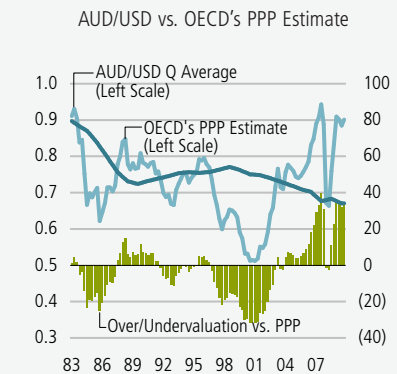
Ordinarily, elections are a nonevent for markets in Australia. Though not obvious from the day-to-day political banter in the media, there is broad consensus between the two major parties—the Australian Labor Party (ALP) and the Liberal Party—regarding the general thrust of macroeconomic policy. For example, both parties support an independent central bank with an inflation-targeting remit, and both believe in a fiscal framework that aims to balance the budget over the course of the economic cycle.

The incumbent ALP Government—led by Prime Minister Julia Gillard who toppled

her predecessor, Kevin Rudd, in June—is still favorite to win. The ALP's actual majority in the current parliament is eight seats; but once the impact of a redistribution of electoral boundaries is taken into account this increases to an effective lead of 13. A plausible outcome, however, is that a handful of independents in the lower house (House of Representatives) will have the power to determine who governs. There are already three independent members in the lower house—all with a conservative background—and the polls indicate that the Greens party could pick up one or two seats. Should such an event occur, we consider it unlikely that a resolution would be achieved quickly.

One reason for thinking this is that—unlike, say, the British political parties in the run-up to this year's UK general election—the major Australian parties have had little forewarning of the possibility of a hung parliament, and so have had little time to broker deals with each other regarding policy trade-offs and short cuts, or how they might work together in a coalition

Display 1
On a Long-Term Basis, AUD Is Stretched



Source: Datastream, OECD, AllianceBernstein estimates

government. This would be a unique outcome in the postwar Australian political landscape. We would expect it to take weeks rather than days to resolve how to manage a hung parliament effectively.

Add to this the likelihood that the Greens party will hold the balance of power in the upper house (Senate), and the potential for unstable government and policy paralysis is high. In an environment where a number of decisions are pending—including ironing out the details of the mining super-profits tax—such uncertainty will be most unwelcome.

Should such an outcome prevail, we believe the effect on the financial markets

will be felt first in the Australian dollar. As we saw during the uncertainty that followed the announcement of the mining tax, the currency can be vulnerable. While there are still a number of positives tending to support the currency—wide

interest-rate differentials, firm commodity prices (iron ore and coal), an improving trade balance—there is no doubt that the Australian dollar remains overvalued on most long-term valuation metrics. This is a key source of vulnerability (**Display 1,**

previous page). The OECD's purchasing power parity measure, for example, puts AUD/USD fair value at 0.68, implying the currency is around 34% overvalued on a bilateral basis. ■

The information contained here reflects the views of AllianceBernstein L.P. or its affiliates and sources it believes are reliable as of the date of this publication. AllianceBernstein L.P. makes no representations or warranties concerning the accuracy of any data. There is no guarantee that any projection, forecast or opinion in this material will be realized. Past performance does not guarantee future results. The views expressed here may change at any time after the date of this publication. This document is for informational purposes only and does not constitute investment advice. AllianceBernstein L.P. does not provide tax, legal or accounting advice. It does not take an investor's personal investment objectives or financial situation into account; investors should discuss their individual circumstances with appropriate professionals before making any decisions. This information should not be construed as sales or marketing material or an offer of solicitation for the purchase or sale of, any financial instrument, product or service sponsored by AllianceBernstein or its affiliates.

Note to Canadian Readers: AllianceBernstein provides its investment management services in Canada through its affiliates Sanford C. Bernstein & Co., LLC and AllianceBernstein Canada, Inc.

Note to UK Readers: UK readers should note that this document has been issued by AllianceBernstein Limited, which is authorised and regulated in the UK by the Financial Services Authority. The registered office of the firm is: Devonshire House, One Mayfair Place, London W1J 8AJ.

Note to Australian and New Zealand Readers: This document has been issued by AllianceBernstein Australia Limited (ABN 53 095 022 718 and AFSL 230698). Information in this document is intended for wholesale investors only, and is not to be construed as advice.

Note to Readers in Vietnam, the Philippines, Brunei, Thailand, Indonesia and India: This document is provided solely for the informational purposes of institutional investors and is not investment advice, nor is it intended to be an offer or solicitation, and does not pertain to the specific investment objectives, financial situation or particular needs of any person to whom it is sent. This document is not an advertisement and is not intended for public use or additional distribution. AllianceBernstein is not licensed to, and does not purport to, conduct any business or offer any services in any of the above countries.

Note to Readers in Malaysia: Nothing in this document should be construed as an invitation or offer to subscribe to or purchase any securities, nor is it an offering of fund management services, advice, analysis or a report concerning securities. AllianceBernstein is not licensed to, and does not purport to, conduct any business or offer any services in Malaysia. Without prejudice to the generality of the foregoing, AllianceBernstein does not hold a capital markets services license under the Capital Markets & Services Act 2007 of Malaysia, and does not, nor does it purport to, deal in securities, trade in futures contracts, manage funds, offer corporate finance or investment advice, or provide financial planning services in Malaysia.

Note to Singapore Readers: This document has been issued by AllianceBernstein (Singapore) Ltd. (Company Registration No. 199703364C). The Company is a holder of a Capital Markets Services Licence issued by the Monetary Authority of Singapore to conduct regulated activity in fund management.

Note to Taiwan Readers: This information is provided by AllianceBernstein funds Taiwan Master Agent, AllianceBernstein Taiwan Limited. SFB operating license No.: (97) FSC SICE no. 049. Address: 57F-1, 7 Xin Yi Road, Sec. 5, Taipei 110, Taiwan R.O.C. Telephone: 02-8758-3888. AllianceBernstein Taiwan Limited is a separate entity an independently operated business.

Note to Hong Kong Readers: The document has not been reviewed by the Hong Kong Securities and Futures Commission. The issuer of this document is AllianceBernstein Hong Kong Limited.