RESEARCH

FEDERAL ELECTION 2019 MARKET INSIGHT

COALITION VICTORY PROVIDES CERTAINTY AND POLICY CONTINUITY

The surprise re-election of the Liberal/National Coalition removes the uncertainty for the property market that was associated with Labor's proposed changes to capital gains tax and negative gearing. The economic outlook remains unchanged but the RBA is expected to cut interest rates imminently to support growth.

Highlights

Voters reject policy change in favour of continuity.

The economic outlook remains unchanged but the RBA is expected to cut interest rates in the face of subdued consumer spending and low inflation.

The election result provides greater certainty for the property market as Labor's proposed capital gains tax and negative gearing changes will not be implemented.

Policy continuity

The Liberal/National Coalition has defied opinion polls and betting markets and been re-elected for a third term. While the results are still to be finalised, the Coalition looks likely to secure 78 seats in the 151 seat Parliament.

The election result means policy continuity and the removal of uncertainty associated with the Labor Party's proposed package of substantial policy changes.

Financial markets welcome result

Equities rallied following the election result. Policy continuity, and an end to the uncertainty arising from Labor's proposed policy changes, particularly to franking credits, capital gains tax concessions, and negative gearing reduce risk for investors.

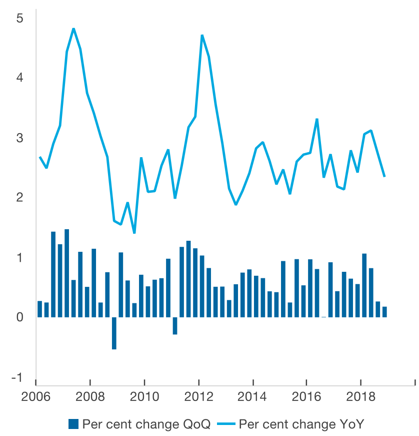
Bank shares have rallied particularly strongly, up around 10 per cent since the election. This follows a period of significant underperformance mainly due to the fallout from the Royal Commission into misconduct in the financial services sector.

Contemporaneously, sentiment in financial markets has also been boosted by the prospect of RBA policy easing and proposed policy changes announced by APRA to mortgage loan serviceability requirements. Currently mortgage lenders assess whether borrowers can afford their repayment obligations using a minimum interest rate of at least 7%, or 2% above the prevailing borrowing rate – whichever is the highest. In future, APRA plans to abolish the 7% interest rate floor and is proposing that lenders calculate the ability to service a loan using a 2.5% buffer above the prevailing mortgage interest rate.

Economic outlook unchanged, as RBA signals easing bias

The election result does not materially change the economic outlook. Growth remains solid but has moderated recently, with slow income growth and a soft

FIGURE 1
Real GDP
Per cent change



Source: Macrobond

FIGURE 2
S&P/ASX 200
Price index, September 2018 = 100

Source: Macrobond

BEN BURSTON
Partner, Head of Research & Consulting

Follow at @KnightFrankAu

CHRIS NAUGHTIN
Associate Director, Research

Follow at @KnightFrankAu

housing market weighing on household consumption and sentiment.

Although employment growth remains strong, the unemployment rate has drifted slightly higher as more people enter the labour market.

The RBA has signaled it will cut interest rates (mostly likely by 25 basis points to 1.25%) next month citing ongoing low inflation and the lack of further improvement in the labour market. Another 25 basis point cut to 1% is expected as early as August. Given the already high level of household debt and low level of interest rates, additional monetary policy easing is likely to less effective than in the past. While banks' funding costs have declined in line with short and long-term market interest rates, banks may be more reluctant to pass on interest rate cuts in full at such low levels.

RBA Governor Lowe recently highlighted the importance of additional support for growth from fiscal policy. The improved fiscal position of the Federal government, supported by higher commodity prices, provides scope for fiscal policy stimulus.

Easing bias to support pricing as capital growth slows

The shift to further easing by the RBA, and guidance by major global central banks that policy will remain very accommodative for the foreseeable future have seen in interest rates in short-term money markets and long-term bond yields decline. Yields on 10-year Australian government bonds have declined from 2.9% to 1.6% over the past 12 months, and the current yield reflects a historic low.

Lower interest rates and an accommodative outlook for monetary policy for the foreseeable future, in Australia and globally, will continue to underpin demand for commercial property assets and provide support to commercial property valuations at a time when capital growth is slowing from elevated levels.

Housing market to benefit from greater certainty

House prices are still falling but the pace of the decline has slowed. Data from Australian Property Monitors shows that house prices nationally declined by 7.9% over the year to March 2019, while prices in Sydney and Melbourne were 11.5% and 10.4% lower respectively. The prime market continues to hold up well compared to the wider mainstream market.

Auction clearance rates have recovered a little in recent months but market turnover remains subdued, while declining building approvals from elevated levels point to further falls in housing investment.

However, the election result ensures the continuation of the existing taxation regime for negative gearing and capital gains tax, and this will help restore confidence and certainty for investors in particular. With the housing market downturn appearing to lose momentum, policy continuity may encourage investors to re-enter the market more quickly than would have been the case if Labor had won the election and implemented its proposals.

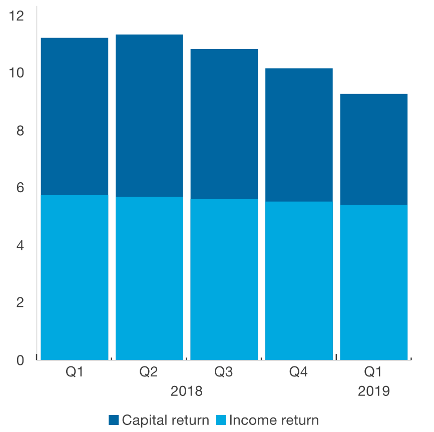
In addition, towards the end of the campaign, the government announced a first home buyer loan deposit scheme, which will be implemented from January 2020. Under the scheme, eligible first home buyers will be able borrow 95% of the value of the loan and not have to pay mortgage insurance (currently 80% LVR) as the scheme will guarantee the next 15% of the loan amount. Singles earning under $125,000 and couples under $200,000 will be eligible. There will also be a ceiling on the value of the dwelling the can be purchased under the scheme, which will be determined on a regional basis. Initially this will be limited to 10,000 guarantees.

On the other hand, the fledgling build-to-rent sector stood to benefit from Labor's proposal to halve the 30 per cent withholding tax rate on managed investment trusts for rental housing. The election result leaves a cloud hanging over investment in a sector in an early stage of development in Australia.

FIGURE 3
Market Interest Rates
Per cent

Source: Macrobond

FIGURE 4
Commercial Property Returns
Total return, year-on-year per cent change



Source: MSCI

RESEARCH & CONSULTING
Ben Burston
Head of Research & Consulting
+61 2 9036 6756
Ben.Burston@au.knightfrank.com