

CONTENTS

ISSUE 1 2016

4

From the
Managing Editor

6

Secular stagnation: A review of the key arguments

IVAILO ARSOV and ASHVINI RAVIMOHAN

This article provides an overview of the secular stagnation hypothesis, the debate that has surrounded it and some of the key alternative explanations for the relatively low growth in advanced economies over recent years.

17

Momentum crashes: The Australian evidence

CLIVE GAUNT

Previous studies report that significant alpha can be generated in various international equity markets by employing a momentum strategy – i.e. buying past winners and short selling past losers. However, the strategy sometimes crashes, generating large negative returns over one or more consecutive months. Using Australian data, this study generally confirms recent US findings that these crashes tend to occur following steep market declines and are characterised by large positive returns by the past Loser portfolio rather than large negative returns by the past Winner portfolio. This paper also identifies significant risk changes to a momentum strategy in bear markets but, unlike the US study, it does not find the strategy to exhibit option-like behaviour at the time of a momentum crash.

27

Mispricing of Australian IPOs

RON BIRD and HAMZA AJMAL

Much economic analysis has been undertaken on the well-known anomaly of the incidence of high returns on the first day that an initial public offering (IPO) is listed. This study focuses on the Australian market, which is one of the largest markets in the Asia-Pacific region and has several relevant institutional and regulatory features different from the US market.

SPECIAL SECTION: DIVIDEND IMPUTATION

35

Dividend imputation and the Australian financial system

KEVIN DAVIS

There is ongoing debate about the precise effects of the dividend imputation system on the Australian financial sector, company and investor behaviour, and real sector consequences. In discussions about the costs, benefits and the future of imputation, a critical but largely ignored issue is the need to identify the appropriate counterfactual. Any alternative will involve some differences between Australian and overseas tax systems and differential treatment between investors, which will involve various types of distortions. Based on the available evidence, this paper argues that the benefits of imputation outweigh its costs. Moreover, the disruption to financial markets caused by substantive change such as abolishing imputation would be substantial.

41

The impact of dividend imputation on share prices, the cost of capital and corporate behaviour

ANDREW AINSWORTH,
GRAHAM PARTINGTON and
GEOFFREY J WARREN

Debate continues about how dividend imputation affects equity markets. Central issues are whether franking credits are 'priced' by the market, and how imputation influences the behaviours of market participants. We argue that the presence of imputation affects investor and corporate behaviour, and that it would be dangerous to assume imputation has no effect on prices because they are entirely determined in global markets. Focusing on the impact on corporate behaviour, especially with regard to dividend payout and capital structure policies, we conclude that imputation matters and it has probably been beneficial.

50

Dividend imputation and the corporate cost of capital

STEPHEN GRAY

The contentious debate about how to best estimate the value of imputation credits has been heightened in the regulatory setting. While an accurate estimate of the cost of capital is important for every firm, it is particularly important for regulated infrastructure firms where a regulator sets the allowed revenue each year in accordance with its estimate of the cost of capital. This paper explains how the regulatory allowance depends on the estimated value of imputation credits and summarises the debate that has occurred, over many years, in this setting.

58

Dividend imputation: The international experience

ANDREW AINSWORTH

An overlooked aspect of the debate surrounding Australia's dividend imputation system is the international experience with dividend imputation. Between 1999 and 2008, nine countries removed their dividend imputation systems. This raises a number of questions. What was the motivation for removing imputation? How were dividends taxed after imputation was removed? What happened to corporate tax rates? What are the lessons for Australia? This paper seeks to provide answers to these questions.