

MEMORANDUM

TO: Iftekhar Omar
Australian Energy Regulator

FROM: John Handley
University of Melbourne

DATE: 25 May 2011

RE: Additional Estimates of the Historical Equity
Risk Premium for the Period 1883 to 2010

In an earlier report to the AER,¹ I set out estimates of historical excess returns (or equivalently estimates of the historical equity risk premium) relative to 10-year Commonwealth Government Securities (CGS) corresponding to various time periods between 1883 and 2010 and assuming various values for theta (value of distributed imputation credits).

As requested:

- the following table sets out similar statistics of the historical equity risk premium in Australia assuming distributed imputation credits are valued at 35 cents in the dollar. This table supplements and should be read in conjunction with my earlier report to the AER.
- the estimated premium for 2004, 2005, 2006, 2007, 2008, 2009 and 2010 was 23.0%, 15.9%, 19.6%, 16.4%, – 47.0%, 35.4% and 1.2% respectively.

¹ Handley, J.C., 2011, An Estimate of the Historical Equity Risk Premium for the Period 1883 to 2010, Report prepared for the Australian Energy Regulator, 25 January.

TABLE 1							
Historical Equity Risk Premium 1883 - 2010							
Assumed Value of Imputation Credits		0.35					
Relative to 10 year Bonds							
Period	Years	AM	SE	95% Confidence Interval		p-value	GM
				Low	High		
1883 - 2009	127	0.063	0.015	0.033	0.092	0.00	0.049
1937 - 2009	73	0.060	0.023	0.013	0.106	0.01	0.040
1958 - 2009	52	0.065	0.032	0.001	0.129	0.05	0.039
1980 - 2009	30	0.064	0.043	-0.023	0.151	0.14	0.037
1988 - 2009	22	0.058	0.041	-0.027	0.144	0.17	0.038
1883 - 2010	128	0.062	0.015	0.033	0.091	0.00	0.048
1937 - 2010	74	0.059	0.023	0.013	0.105	0.01	0.039
1958 - 2010	53	0.064	0.031	0.002	0.127	0.04	0.038
1980 - 2010	31	0.062	0.041	-0.022	0.147	0.14	0.036
1988 - 2010	23	0.056	0.039	-0.025	0.138	0.17	0.037
<i>Note: Refer to report for data sources and variable definitions</i>							
<i>Estimates in Bold are significant at the 5% level using a 2-tailed test.</i>							