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## PLAY OF THE WEEK

### We're A Weird Mob

There was a whiff of cynicism as Aust PM *Julia Gillard* blew into town this week. You could reel out the clichés before she even got to shake hands with *John Key* at the airport. Blah blah historic occasion, blah blah mateship, blah blah ANZAC spirit, blah blah growing closeness. And then, suddenly, it was more. One thing, the most important, was the death of another Kiwi soldier in Afghanistan, only hours before Gillard got to her feet in our debating chamber. She alluded to this, pointed to the memorials around the debating chamber to past battles, and noted in most of them NZers and Australians served, and died, together.

It wasn't all solemn. There was the long awaited apple concession, of course, delivered with wry, rueful grace. *John Key* also noted the shared sacrifices and the shared informality across the Tasman. When overseas, he pointed out, NZers and Australians tend to seek each other out because we recognise something similar. The usual jokes about *Phar Lap* and *Crowded House* etc got a run. They're a bit tired and a bit clichéd – but this is kind of the point. They're the kind of jokes you have with family.

Down at policy level, there was more about the single economic market, particularly with the investment agreement. There is more to come on this. *Key* flagged the SEM, as it is known, as a major priority in his first week in office. The work has been going on for a decade now but this Govt has picked up the pace.

The usual issue of union gets a go – and Gillard alluded to it. If it comes, it will be a long way off. We are probably one of those families which gets on better if there's bit of distance involved.

*This week.....Julia Gillard's visit underlines the fact more work needs to be done on Aust-NZ economic relations as the two nations search for the total economic benefit of a single market...Gillard praises NZ as family...As she finally concedes defeat on NZ apple imports...We ask if the worst has passed for the economy..And the creaking welfare system is ripe for reform.*

## III Aust & NZ: Searching For Total Economic Benefits Of SEM

NZ and Aust signed up a new investment protocol this week as another building block towards creating a seamless business environment in a single economic market, an important, but not yet transformational move. *Julia Gillard* emerged from the negative shadow of *Kevin Rudd* to insist to her NZ audiences both countries must pursue economic reform together to ensure their mutual success. “We can achieve more together than we can ever do alone.” She emphasised Aust and NZ are island nations to whom nobody owes a living. “If we gain any advantage in the world it is because we fight for it.” **Beyond the mateship rhetoric appeared a firm commitment to the trans-Tasman relationship, firmer it seemed than from any Aust PM in the last 20 years.**

Gillard accepts in embracing NZ, Aust itself becomes stronger. Progress towards a single economic market in the past decade, however fervently espoused by politicians, has run aground on bureaucratic objections of fiscal cost. Without, for example, the cross-recognition of dividend imputation credits, the investment protocol is only a step towards freeing up the capital market between the two countries. Gillard, like her predecessors, is constrained by fiscal cost, as her battle in Canberra to implement a levy to pay for flood costs underlined, but her visit to Wellington may have helped shift the focus back to what is more important in reform, the total benefit which would be created for both countries. Gillard impressed NZ Ministers with the realism about the targets she will set, and her focus on what can be delivered.

### HOLY GRAIL?

- ▶ Julia Gillard insists NZ and Aust nuts vigorously pursue a single economic market.
- ▶ New trans Tasman investment protocol signed.
- ▶ Gillard says by embracing NZ Aust makes itself stronger.

## III Gillard: “Aust Has Many Alliances, NZ Alone Is Family”

As the first foreign leader to speak in Parliament's debating chamber, *Julia Gillard* declared NZ to be the “natural partner of what we believe in. Aust has many alliances: NZ alone is family.” She ended her speech with a striking passage. “This is the Asia-Pacific century and we are at the heart of it. This is our time, a time for optimism, a journey of hope.” She traced the history of CER “the gold standard, the envy of the world” of trade agreements, paying a graceful tribute to a “great New Zealander, *Hugh Templeton*” for his work in negotiating the trade pact, and describing how the sheltered economies were opened to lead to an unparalleled integration.

**Two-way trade has grown at a rate of 8% a year.** She spoke of her hopes for the Trans-Pacific Partnership, which she sees as the greatest economic opportunity since CER. She says it could be a stepping stone to an Asia-Pacific free trade area. Gillard's espousal of the free trade creed, coming from a politician who comes from the Left faction of the political Labor movement, was remarkable enough, but her identification of the true Aust-NZ nexus puts her far ahead of almost all of her predecessors.

## III Aust At Last, Accepts WTO Decision On Apples

Hard news, as well as rhetoric, came from the *Gillard* visit to Wellington. She says Aust will “abide by the umpire's decision,” in this case the ruling of the WTO, in accepting the importation of apples from NZ. This will end a dispute which has been running for almost a century. The Gillard announcement did not nominate a time for the trade to resume, though NZ apple

## Big Hitters" From Washington Arriving For US-NZ Forum

In sending one of its "big hitters" to the fourth US-NZ Partnership Forum in Christchurch, the Obama administration is signalling it wants to flesh out Hillary Clinton's "Wellington Declaration" which was presented last year as heralding a new era in the US-NZ relationship. Secretary of Homeland Security Janet Napolitano is coming to the forum, along with Assistant Secretary of State Kurt Campbell, and other distinguished US politicians and diplomats including Richard Armitage and Christopher Hill. As head of homeland security, Napolitano is responsible for US counter-terrorism, border security, natural disasters, and cyber security. For NZ the vital aspect of this clutch of responsibilities relates to exports to the US carried by container ships where the NZ Govt needs to ensure the smooth flow of the container trade, without undue or costly restrictions.

## Low Morale In MFAT, "Reconfiguring" To Be Sped Up

The Ministry of Foreign Affairs & Trade says its resources are stretched, given the ambitious agendas set by the Ministers of Foreign Affairs and Trade. A report tabled in Parliament by the Foreign Affairs, Defence and Trade Committee headed by Wairarapa MP John Hayes says it has restructured its senior leadership to focus on its strategic role, and begun a Ministry-led strategic planning process. The Committee notes one of the findings of the performance framework review of MFAT was the quality of advice and services provided to Ministers has been "variable." The Ministry, responding to a Committee query whether improvements had been made, said it had taken steps to ensure the advice and services it provides are "efficient and well-targeted, and advance the Govt's objectives." The Ministry acknowledged morale was low and a staff survey indicated the Ministry "needs to ensure its staff are meaningfully engaged in their work. The Ministry is working towards making its performance measures transparent, and addressing performance management issues." In seeking to increase its ability to respond to challenges, the Ministry is not closing any embassies but is "reconfiguring" its delivery of diplomatic services in Europe. A new service delivery model from the post in Poland is being trialled, with the post providing targeted services, while NZ's post in London provides core services. This trial will also be extended to NZ's posts in Spain and Sweden.

growers believe it might be before the end of this year. This decision removes a major irritant in the NZ-Aust relationship, and is seen in Wellington as a commitment by the Gillard Govt to stare down traditional opposition, not just among politicians but in the bureaucracy.

**Gillard also announced a resumption of the pattern of annual exchanges of visits by the two PMs**, which fell into abeyance under Kevin Rudd. In Beehive talks with Key, Gillard covered security issues as well as discussing how the single economic market could be advanced more swiftly. The two leaders agree Aust and NZ "have to complete" their mission in Afghanistan. They also reviewed progress on creating a regional solution for people-smuggling, with a centre in Timor-Leste. Gillard also pushed for more work on the "common border" to make travel easier between the two countries. Finance Minister Bill English says the investment protocol builds on existing agreements and aligns CER with other modern, high quality FTAs. While screening thresholds are lifted for most businesses, those for sensitive land and fishing quota are unchanged.

## The Economy: Has The Worst Passed?

The Govt has been warning the economy might have gone through a double-dip recession, with growth falling below zero in the last two quarters. The retail sector has been having a rough time, and housing turnover slumped in January. But the labour market has been improving, company profits (with some notable exceptions) are buoying the sharemarket, sentiment in the manufacturing sector is rising. Westpac CEO George Frazis says NZ is now at a stage where the risks of recovery coming through by the end of the year "are a lot lower." He believes **businesses must start to invest in growth to ensure they are ready to meet it when consumer demand returns.** ANZ Bank economists are convinced the NZ economy has regained momentum on a number of fronts "We believe we are at an inflection point. If so, we should see improving hard data in about 6 weeks' time." They add households have not had much to cheer about over the last few months, but there are signs the worst has passed. On the export front, the latest Fonterra online auction has seen dairy product prices reach new heights.

## Welfare System Ripe For Reform

Headlines like "Around the world on the dole" and "Job scheme pumpkin costs thousands" (even allowing for some hyperbole) leant substance to Prime Ministerial claims of inefficiency in the public sector. Equally significantly, they showed the welfare system is ripe for reform. Sweeping changes are being proposed by the Welfare Working Group led by Paula Rebstock entrusted with the task of finding solutions to what it described earlier as the "intolerable" social costs of long term welfare dependency. **The need for robust gateways into benefits, as well as sanctions on those who fail to look for paid work has been clearly established.** For the Govt, the priority may be the Rebstock proposals on how funding the ever-rising welfare budget can be capped or trimmed. The present system of funding through tax is simple, but plainly leaves much to be desired. This year's budget may come too early for any of the Rebstock reforms, but almost certainly they will form the basis for the fundamental changes on which National will campaign later in the year.

### IN THE LOBBY

**The Marine and Coastal Area (Takutai Moana) Bill is down for its second reading next week and ACT is convinced if the Govt allowed its MPs a free vote the legislation would be defeated.** As reported by *Trans-Tasman*, there was opposition outrage last week when the Maori Affairs Select Committee ignored thousands of adverse submissions and reported the Bill back without amendment two weeks ahead of deadline. ACT MPs John Boscawen and Hilary Calvert are leading opponents of the legislation to replace the Foreshore and Seabed Act, despite their party having a support agreement with National. Boscawen says National MPs have told him they oppose the Bill but don't have a choice about voting for it. The Govt has a very thin two vote majority on the Bill - 63 out of 122 - which comes from 58 National, four Maori Party and Peter Dunne. Those votes are locked in and the Govt wants the Bill through in a hurry before there's any more embarrassment.....**Attorney-General Chris Finlayson is in charge and Labour's David Parker targeted him at question time** on Tuesday, asking "what caused the change between 24 September 2010, when the Attorney-General promised there would be a full Select Committee process for the Bill, and last week when his Govt members caused the Bill to be reported back without amendments?" Finlayson said he wasn't responsible for the Committee and couldn't talk about its decisions. The second reading is a two-hour time limit debate but the Committee stage is open ended and it's going to be a long, hard ride for Finlayson.....**The row over Auckland Council's funding for its Maori Statutory Board is getting serious with its members taking legal action this week.** The Council backed down on its \$5.4m draft funding decision and cut it from \$2m to \$950,000 for this financial year and from \$3.4m to \$1.9m for next year - decisions which are being challenged through the Courts. Local Govt Minister Rodney Hide is being dragged in, saying on Tuesday the mess is evidence of his belief the Board's existence should never have been put into law. Hide says it's "inherently divisive and controversial." The comment provoked Maori Party leader Pita Sharples to call for Hide's resignation.



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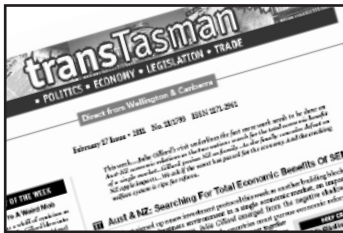
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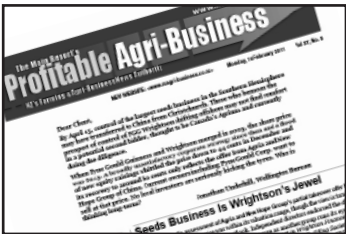
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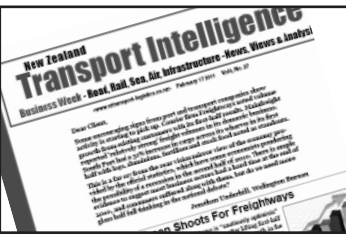
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## Frigate Upgrade Contracts Awarded

The Govt has awarded design and manufacturing contracts to *Siemens (NZ) Ltd*, *Noske-Kaiser NZ Ltd*, *Austn Marine Technologies Pty Ltd*, and *ThyssenKrupp Marine Systems Aust* for the second phase of a \$58m upgrade of systems aboard the frigates *HMNZS Te Kaha* and *Te Mana*. The upgrade attracted keen international interest. Defence Minister *Wayne Mapp* says this will improve the performance and extend the range of conditions in which the frigates are effective. The contracts cover the Integrated Platform Management System (IPMS) and the Heating Ventilation Air Conditioning (HVAC) system. The upgraded IPMS will provide improved control and monitoring systems and will enable the introduction of more automation while the one for the HVAC system will reduce the effects of temperature on the performance and availability of a number of key systems, as well as improving conditions for the crew. The work will be carried out in NZ, Aust, Canada and Germany.

## NZ Model For New Caledonia?

A top-level delegation from New Caledonia is to visit NZ next month as the Govts in Wellington and Paris work to bring the French territory closer to its neighbour. The visit had to be postponed in December after the sudden death of key political figure, *Jacques Lafleur*. An opponent of independence, he reached an accord in 1988 with the pro-independence leader *Jean-Marie Tjibaou* which ended five years of civil unrest. Under the 1998 Noumea Accord, an independence referendum can be called by the territory's congress after 2014. The French Govt is closely studying the various forms and systems of self-Govt NZ extended to Pacific neighbours including the Cook Is and Niue. The Noumea accord provided for the transfer of much of the business of Govt to the territory and it is envisaged the French republic would retain control of foreign policy, defence and justice. Both sides hope the visit will promote political and economic contacts.

## Economic Debate - Are High Food Prices Good For NZ?

The price of milk powder has risen again at *Fonterra's* online auction, boosting prospects of a plump payout for dairy farmers. Consumers have less cause to cheer because the retail prices of dairy foods are bound to rise further in our supermarkets too. *Statistics NZ* reports in the year to January, food prices rose 3.8%, including higher prices for milk, cheese, and eggs (up 8.9%). A TV3 report on Tuesday highlighted the adverse impact (and health implications) as the price of milk and other dairy products seriously strains household budgets.

**Price Concerns.** The surging cost of feeding families is a global issue. OECD Secretary-General *Angel Gurría* last month said surging food and commodity prices are undermining efforts to tackle global poverty and hunger and threaten economic growth. He welcomed a French Govt decision to include commodity price volatility and global food security among priority issues of its G20 presidency. The OECD is prescribing stronger disciplines against the use of trade restrictions on food exports and imports and it argues for deeper markets, with increased volume and more buyers and sellers. It regards concluding the WTO Doha negotiations as crucial. But don't hold your breath for world leaders to hasten to wrap up the negotiations, and it's worth asking if lower food prices are in this country's best interests.

**Benefits For NZ.** In a recent *BNZ Rural Wrap*, economist *Doug Steel* noted world economic growth continues to be centred in emerging markets (especially China), where an extra dollar earned tends to translate into a bigger increase in food demand compared with an extra dollar earned in the developed world. The reason: food makes up a bigger share of the household budget in poor countries. He also explained why we should welcome the resultant lift in international food prices. At times of rising food prices, the rest of the world must look at NZ and see strong growth prospects, and the benefits from the world buying our products at higher prices are shared across the economy. The NZ dollar tends to follow broad movements in international commodity prices. Among the benefits of this are lower prices for imported goods, leaving more money to be spent elsewhere. In the upshot, the effect of high international food prices is a net positive for the economy. **"To think otherwise, would be like thinking higher oil prices are a negative for Saudi Arabia. It would just not make sense."**

CAPITAL TALK..... *"Extremely relaxed, very informal, very friendly:"* is how one insider described the atmosphere at Premier House when **John Key** hosted **Julia Gillard** at dinner on Tuesday night. And you couldn't fault the food, which came from master chef **Steve Logan**. Gillard seemed to be enjoying her NZ experience, unlike some of her predecessors who didn't hesitate to show what a pain it was to have to travel to Wellington. And those critics who can't hack Gillard's broad accent would have found it hard to fault the extraordinarily warm speech she delivered in Parliament's debating chamber.....The heads of the NZ, Aust and UK Treasuries are meeting in Hawke's Bay. It is the first time the leaders of the 3 countries have held such a gathering. NZ Treasury Secretary **John Whitehead** is hosting Aust Treasury boss **Dr Ken Henry** and the UK's **Sir Nicholas Macpherson** to talk about the global growth outlook, state sector strategy, the European debt crisis, microeconomic reform and international integration. Finance Minister **Bill English** joined them for dinner on Wednesday, and **John Key** will lunch with them on Friday. Will they get a chance to sample some Hawke's Bay chardonnay? We hope so.....In vetoing Aust PM **Julia Gillard** speaking to the NZ Parliament, the Greens did so on the basis it would set a *"worrying and dangerous"* precedent. Ironically, the veto came from **Russel Norman**, himself Aust-born and reared. Maybe he thought he was saving MPs from listening to a speaker as boring as himself. The risk for the Greens in setting themselves up as the moral conscience of Parliament is they risk becoming instead Parliament's nitpickers.....National MP **John Carter** is to be

the next High Commissioner to the Cook Islands. Carter has built a reputation as one of the most assiduous electorate MPs in Parliament, and his majority in Northland makes it one of the safest seats. More recently Carter has been Minister of Civil Defence, serving outside Cabinet. It might be a useful experience if during his term in Rarotonga the Cooks are visited by one of their periodic devastating cyclones..... Social Development Minister **Paula Bennett** is off again, she left on Tuesday for a four-day welfare conference in Washington. Her departure this week coincided with TV3's exposure of apparently worthless Community Max programmes and she's being described as *"missing in action."*.....Brigadier **Tim Keating** has been appointed new Chief of Army, replacing Lieutenant General **Rhys Jones** who became Chief of Defence last month. Keating is currently Chief of Staff at Defence HQ and was previously Deputy Chief of Army.....Associate Judge **John Faire** has been appointed a temporary judge of the High Court from February 28 to June 3. He will sit in Auckland....Remarkable how many NZers changed their view of Aust PM **Julia Gillard** after they listened to her speaking in the NZ Parliament. Her carefully crafted speech was a model of its kind. Even more graceful was her short speech when she invested **Hugh Templeton**, the NZ architect of the CER trade pact, with an Honorary Order of Australia, at the Australian High Commission in Wellington....**Mita Ririnui** is the latest MP announcing his decision to pull up stumps and retire. Ririnui has been an MP since 1999. He says he decided to step down some time ago, but told the Labour caucus only this week.

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## GOVERNMENT BUSINESS

**Fruit supply.** The Ministry of Health seeks tenders for (a) the supply of fruit to students in NZ decile one and two primary and intermediate schools and (b) project management of the supply of fruit to these schools. The Ministry intends to purchase a service to provide one piece of top-quality fruit (or vegetable) per school day to around 100,000 students. The Children's Nutrition Survey (2007) indicated 23% of children do not consume even one portion of fruit daily. A free fruit in schools scheme was piloted in Auckland and Northland early in 2004. Deadline 5pm 8 March.

GETS reference 32315

**Smoke alarms.** The NZ Fire Service is inviting tenders to provide it with smoke alarms for a series of programmes to increase fire safety in homes, including the installation of smoke alarms. The programme is set to continue for the foreseeable future. NZFS installs between 1,500 -2,000 Long Life Photo-electric Smoke Alarms a month. Over the term of the current contract other Govt agencies have used the syndicated procurement clause to import smoke alarms directly for their own programmes. The tender does not cover standard smoke alarms, heat detectors or hearing-impaired smoke alarms. Deadline noon 4 March

GETS reference 32275

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<input type="checkbox"/>	<b>Housing Market</b> Market activity remains at weak levels, reflecting weak demand.
<input type="checkbox"/>	<b>Retail Sales</b> Subdued given continued headwinds to the household sector.
<input type="checkbox"/>	<b>Employment</b> Improvement patchy reflecting economic activity over H2 2010.
<input type="checkbox"/>	<b>Migration.</b> Net migration steady at low levels, permanent departures stabilising.
<input type="checkbox"/>	<b>Construction.</b> Activity still weak, rebuilding should boost recovery over 2011.
<input type="checkbox"/>	<b>OCR</b> RBNZ not expected to lift OCR till Sept given poor activity data.

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## COMPANIES IN THE NEWS

**Mainfreight Pursues Its Ambition To Be A Global Business.** Logistics giant *Mainfreight* has been one of the NZX's best performers through the downturn, and as part of its ambition of becoming a global business, it is making plans to expand into Europe and South America. It now earns 70% of its revenue from its overseas operations. For the 9 months to December, its net surplus before abnormal items surged 27% to \$34.6m. Total revenue rose 20% to \$1.01bn. MD *Don Braid* says the company performed "pretty well" in every market. Analysts say the result was slightly ahead of their expectations. Mainfreight should be an anchor for any portfolio.

**Freightways Cautious, But Sees Growth.** With its core express package and business mail division returning to double-digit earnings in the second quarter, *Freightways* reported a 7% lift in revenue to \$176m in the December half, and profit reached \$15.8m, up 8% on the previous corresponding half. Significantly, the company, with its balance sheet particularly strong, is looking for acquisition opportunities beyond Australasia. The information management division which is now in every state in Aust could also be a source for growth. MD *Dean Bracewell* says the company has successfully carried through a range of service, cost and growth strategies. *Bracewell* says: "There's a lot of noise out there the overall market isn't lifting to the extent we're seeing it in some of our businesses, so we've got to be a little bit cautious and realistic." Despite this, analysts are confident of good revenue and profit growth in 2012. This suggests there's upside in *Freightways*' shareprice, which rose to \$3.36 on its profit announcement. Interim dividend is increased to 7.25c from 7c.

**Steel & Tube's New Operating Model Delivers.** Lower Hutt-based *Steel & Tube Holdings* surprised the market when it announced a profit rise of 165% to \$8.4m, from revenue similar to a year earlier at a \$190.5m. The company has implemented a new operating model focused on the strengths of its product range, and geographic coverage. Facility rationalisation had seen 7 more business operations consolidated into existing facilities. Predicting a gradual improvement in activity for most sectors except commercial construction, the company sees second-half results as being similar to those of the first half. With dividend increased to a fully imputed 6c, the shares lifted 6% to \$2.45. But they still look underpriced.

**Fletcher's "Strong" Performance In Difficult Market.** NZ's biggest listed company *Fletcher Building* lifted net earnings after tax to \$166m, up from \$154m in the corresponding half the previous year. CEO *Jonathan Ling* described the results as "strong, given the mixed market conditions." The Canterbury earthquake and continued aftershocks have negatively impacted the NZ businesses, and while the the company expects a positive impact as repair and reconstruction efforts gain momentum this may not be significant in the second half. Most of the group's businesses across the Tasman got the benefit of the stronger Aust economy. Investors would take heart from the turnaround in the *Formica* business where operating earnings grew 130% to \$23m. The share price firmed and the company declared an interim dividend of 16c a share.

- ▶ **Foreign investors boosted their share of Govt debt on issue last month to just shy of \$28bn.** Non-residents now hold more than half the Govt securities on issue, at \$25.7bn worth of Govt bonds and \$2.2bn of Treasury bills. The Reserve Bank says this amounts to 57.8% of all Govt securities.
- ▶ **NZ retail sales tumbled more than expected in the Christmas season.** Total retail sales fell a seasonally adjusted 1.1% to \$5.4bn. Core retail sales fell 1.2% to \$4.2bn.
- ▶ **What To Watch:** NZ Credit Card Spending, (Mon 21 Feb), RBNZ inflation expectations, (Tues 22 Feb), AU Construction, (Wed 23 Feb), BNZ Credit Growth, (Fri 25 Feb).

## Trans-Tasman Financial Markets - Exchange Rates

New Zealand				Australia		
Historical	Latest	1 Month Ago	1 Year Ago	<b>ASB</b>		
USD	0.752	0.768	0.699	Latest	1 Month Ago	1 Year Ago
EUR	0.557	0.576	0.513	0.996	0.988	0.891
GBP	0.466	0.485	0.446	0.739	0.741	0.654
JPY	63.0	63.7	62.9	0.618	0.623	0.568
NZD/AUD	0.754	0.778	0.785	83.5	81.9	80.1
				1.326	1.286	1.274
Interest Rates						
90 days	3.20	3.19	2.72	4.91	4.95	4.41
10 years	5.61	5.46	5.85	5.70	5.52	5.55

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*This Week: The Coalition tries to put a lid on tensions surrounding deputy leader Julie Bishop...More problems for defence procurement with revelations of cost problems on the Eurocopter purchase...Julia Gillard gets a major policy coup with an agreement on health care...The Coalition takes a winning lead in the latest polls...And the Govt is to take aim at cross border red tape in order to boost productivity.*

**Quotable**

“The brewing trouble is also distracting Abbott and the Coalition from concentrating on keeping the government accountable and has given Julia Gillard some political respite and the opportunity to recover some confidence. The internal differences have given government ministers, particularly Kevin Rudd, ammunition for parliamentary question time and increased media pressure on Abbott.”

**The Australian’s Dennis Shanahan says the Gillard Govt is getting a free ride from the Liberals.**

“Gillard is acutely aware of the perceptions about her and knows she can only change opinion slowly with a steady and methodical approach to policy delivery. Labor is expecting no significant poll shift for at least a year until its work program is delivered. Gillard’s leadership also remains safe, if only for the fact that were she dumped, it would risk angering the independents and consigning Labor to opposition.”

**Sydney Morning Herald chief political correspondent Phillip Coorey says Julia Gillard is quietly building leadership credibility.**

“For Abbott, the poll’s message is bitter-sweet. He is presiding over the Coalition with a massive two-party preferred lead over the Government, but trails Gillard on every other measure - approval rating, preferred PM and on whose approach is preferred on the floods and climate change. The only state where he is the preferred Prime Minister is Queensland, where it is hard to see more seats falling the Coalition’s way.”

**The Age’s Michael Gordon says the Coalition may have an election winning lead in the polls, it does not yet have an election winning leader.**

**Politics**

**Liberal Tensions Rise Over Deputy Julie Bishop**

The knives are out for Liberal Deputy leader *Julie Bishop*, with at least three frontbenchers are prepared to stand for her job. But *Tony Abbott* moved to quell anger within Liberal ranks and reassured Bishop he strongly supports her. He has warned frontbenchers to stop destabilising her and agitating for her removal after more than three years as deputy leader. There’s continuing dissatisfaction with Bishop’s performance and frontbenchers within the Liberal Party are furious about reports of a split with Abbott over the Coalition’s proposal to cut \$448m in aid to Indonesian schools to fund Queensland flood recovery work. Senior Liberals are furious foreign affairs spokeswoman Bishop has gone out of her way to distance herself from the Indonesian school aid cut but did not vigorously oppose the plan when Coalition immigration spokesman *Scott Morrison* proposed it in a shadow cabinet meeting. The aid cut would help the Coalition meet the \$1.8bn in savings needed to avoid imposing a flood levy. The leaking of Bishop’s confrontation with Abbott was designed to ensure the deputy leader did not suffer “*collateral damage*” in the dispute over the proposed cuts and appear weak. Abbott believes destabilisation of Bishop’s position will destabilise him and hurt the opposition at a time when it should be taking advantage of its lead in the polls and the Govt’s weakness.

**Defence**

**Helicopter Project Faces Huge Operational Cost**

The Govt has been told maintenance and running costs for a fleet of new European military helicopters will be more than \$4.7bn over their life - more than the 46 choppers cost to buy. Defence analysts claim it’s a good deal while highlighting the huge ongoing costs associated with major defence purchases. Meanwhile the Senate has set up an inquiry into the running of the Govt’s military purchasing arm, the *Defence Materiel Organisation*. It has an annual budget of more than \$11bn. The inquiry will deliver its findings in November. Tension between industry and the DMO is high, The DMO is currently managing more than 200 major programs, 11 on the Govt’s Projects of Concern watchlist. Details of the helicopter purchase reveal operating costs for the troubled MRH-90 fleet will top \$4.7bn over 30 years. So far, 13 aircraft have been delivered to the ADF. The the \$3.8bn purchase is also running more than 12 months behind schedule for the navy and 18 months late for the army. The helicopters will replace army Black Hawks and navy Sea Kings.

**Health**

**Major Policy Victory For Gillard On Health**

*Julia Gillard* is to deliver \$16.4bn into the health system in return for absolute transparency about how State Govts spend federal money. Despite early resistance from states and territories, Gillard has sealed a deal she says will improve services, cut red tape and deliver “*unprecedented transparency*” on health. It is Gillard’s first major policy victory as PM. Last year, former PM *Kevin Rudd* proposed a \$15bn deal under which the Federal Govt would seize 30% of the states’ GST receipts and use the funds to assume responsibility for 60% of hospital funding. But with Liberal Govts in Western Australia and Victoria rejecting the deal, Gillard proposed a 50-50 partnership on all new hospital funding. Under the deal the states will retain their current GST receipts and contribute on a dollar-for-dollar basis into a central pool which will be independent. The key purpose of the pool will be to provide a means for transparency over how states perform against agreed “*efficient pricing*” on individual medical procedures, allowing waste or inefficiency to be identified.

**Emissions**

**Fears Carbon Price Will Double**

There are concerns in the business world the Govt’s starting price for carbon of \$20-\$30 a tonne from July 1 next year will double when an emissions trading scheme begins in 2015-16. Despite the early start to a carbon charge, the Govt accepts Aust will not meet its target of 5% reductions in greenhouse gas emissions by 2020. Meanwhile it’s claimed *Julia Gillard* will ignore Green Party demands to scale down compensation for the electricity and mining industries when she introduces the carbon charge from July 1 next year. The Labor decision is likely to place intense pressure on the Govt’s relationship with the Greens, despite its reliance on them to maintain power. The climate change strategy is set to force the Greens to make “*real*

## Forecasts



### Employment.

Growth remains strong, despite the impacts of natural disasters recently.



### Consumer Confidence.

Confidence up, but the flow-through to spending has been muted to date.



### Retail Sales.

Households cautious about spending despite higher consumer confidence.



### Building Approvals.

Approvals increase, underpinned by high demand for housing.



### OCR.

Cash rate unchanged, 2011 rate rises likely given medium-term outlook.



### Credit Growth.

Expected to remain weak over 2011 - businesses and households cautious.

[www.commonwealthbank.com.au](http://www.commonwealthbank.com.au)

As at 16 February, 2011

"We need to continue to work together to build on and sustain our competitive edge. That's why we are working hard to keep up the momentum of trans-Tasman economic integration. The latest initiative in this remarkably successful partnership is our recent conclusion of a comprehensive CER Investment Protocol. This will further reduce transaction costs for trans-Tasman investors. More investment in the end means jobs and prosperity for both our peoples."

**Julia Gillard and John Key extol the virtues of CER and the single economic market prior to their meeting in Wellington.**

## Stock Watch

### SONIC HEALTHCARE

This has been a strong performer in the healthcare sector over the past decade, but the past 12 months have seen a dip in performance, mainly due to regulatory changes. It has moved to expand its global presence in the past year, which should add to bottom-line performance.

**Price: \$A11.96** ☆☆☆

### VICTORIA PETROLEUM

This oil and gas explorer, is poised for a name change to Senex Energy, and has new management. 2011 is set to be a transformational year. It is basing its business on the Cooper Basin in SA, and is confident an increased drilling schedule will yield results.

**Price: \$A0.38** ☆☆☆

### RURALCO HOLDINGS

This is a rural services group which is continuing to expand its operations. Its main competitors are Elders and Landmark. It has expanded its hold beyond home state Tasmania, and now has more than 500 sites across the country. Net profits for 2010 jumped 40%.

**Price: \$A3.02** ☆☆☆

life" compromises on compensation for carbon-producing industries but also introduce a lower carbon price more than a year before the next election is due. While business is expecting an initial carbon tax of about \$20 to \$25 for every tonne of CO2 emissions, the final price has not been decided, but Cabinet is considering options up to \$30 a tonne.

## Emissions

### Insulation Scheme Fails To Deliver Emissions Promise

The Govt has toned down its claims of the environmental benefits from its troubled home ceiling insulation programme. In its latest emissions projections the *Department of Climate Change* estimates the programme will reduce emissions by 14.4m tonnes of CO2 equivalent from 2010 to 2020, less than half the abatement the Govt initially claimed it would deliver. A fact sheet issued by the dept says one of the main reasons for the revision is 1.2m homes were insulated rather than 1.9m originally expected.

## Polls

### Coalition Takes Winning Lead

The latest *Herald/Nielsen* poll shows the Coalition leading Labor on a two-party preferred basis by 54% to 46%, a swing of 4% since the August election. The poll shows on a primary basis, only a third of voters would select Labor as their first choice if an election were held now. The Coalition leads Labor on the primary vote by 46% to 32% while the Greens are at a relatively steady 12%. Since the election, this represents a two-point increase to the Coalition and a six-point fall for Labor. But it's not all bad for Labor, with the poll showing the proposed flood levy has majority support with 52% for the one-off tax increase and 44% against. Support for putting a price on carbon is also holding up. 46% support a carbon price and 44% oppose it, unchanged since the question was asked in October last year.

## Media

### Online Advertising Gathering Strength

The *Interactive Advertising Bureau (IAB) Australia Online Advertising Expenditure Report* says online advertising sales topped \$2.2bn in calendar 2010 and are on track to hit \$3bn by 2013. The report says online advertising sales were up 21% from the previous year. Search and directories advertising was about half the total expenditure, while classifieds made up 23%. General display advertising accounted for 27%. Online advertising sales for the three months to December 31, 2010, were worth \$627.75m, the largest ever quarterly result and up 22% from the year before. Video-based advertising grew 83% in the same period to \$9.7m. Online ranks third in terms of advertising dollars, behind television and print media.

## Business

### Govt To Target Cross Border Red Tape

The Govt is hoping to boost productivity by cutting the cost of doing businesses across state borders. State and federal leaders have agreed to develop more regulatory reforms focused on cutting red tape for businesses. The main thrust will be harmonising state laws. The aim is to remove inconsistent or unnecessary regulations across 27 areas, ranging from the licensing of plumbers to director liability laws. Thirteen of the reforms have been delivered, but another 10 are at risk. According to previous estimates from the *Department of Finance*, 10 of the 27 business reforms being targeted would create \$3.5bn in economy-wide benefits.

## Investment

### Global Hi-Tech Leader Shows The Way

TT Cochlear is one of Aust's most outstanding hi-tech companies, becoming the world's biggest ear implant maker. Last week it reported a 16% rise in first-half net profit to \$87.2m, beating analysts' forecasts of between \$82m and \$86m. Stripping out a one-off \$6.1m profit on the sale of Cochlear's new headquarters to *Macquarie University*, the result was largely in line with expectations. Revenue rose 8% to \$377m, driven by a 16% increase in Cochlear implant sales to \$309.6m on a constant-currency basis, and ebitda gained 14% to \$134.7m. The strong Aust dollar took the sparkle off the figures, wiping \$16.1m from the company's bottom line compared with the situation if exchange rates had remained the same as first-half 2010.

Cochlear CEO *Chris Roberts* is confident continued investment and an improving positive backdrop will drive growth. The company was "all about investing for the long term" in research and development, its manufacturing and supply chain capabilities and e-commerce. Shares in Cochlear initially closed lower on news of its

result, but when the market digested it fully, investors pushed the price up above \$80, with an advance of \$1.38 alone on Monday. Cochlear has clearly gained from the global recall by its rival *Advanced Bionics* of its *HiRes90k* implant last November. Unit sales of Cochlear implants increased 20% to 11,765, with its latest generation *Nucleus 5* implant making up more than two-thirds. Sales of the enhanced Cochlear *Baha 3* system grew 10% to \$45.6m in constant currency terms. Some analysts expect because of growth in sales and strength in the US and Asia-Pacific being positive, full-year net profit should top \$180m. The company has low debt of \$17.3m and strong cash flow, creating potential for buybacks or increased dividends.

Defending a lack of full-year guidance Roberts said he wanted people to move away from quantitative short-term forecasts to his qualitative longterm guidance. Increased sales in implants for adults drove developed markets, but emerging markets, dominated by sales in implants for children, represented a third of sales.

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