

RISKS TO WATCH

AUSTRALIA

Prime Minister Julia Gillard's minority government has ended the year on a high after securing a critical deal with crossbench independents to pass laws paving the way for construction of a promised \$35 billion broadband network. The 11th-hour agreement staved off mounting criticism that ruling Labor is unable to govern effectively, despite securing the backing of three independents and one Green MP to form a minority government following dead-heat August 21 elections. The key question now is whether political expediency and coalition politics force her to make changes to her climate change policy and plans for a 30 percent profits tax on big iron ore and coal miners and a \$37 billion broadband network.

GOVERNMENT STABILITY AND EFFECTIVENESS

The independents who backed the Gillard government have not promised blanket support for her policies. They will want concessions in return for support and keeping them happy may see the government distracted from policymaking. Key independent Senator Nick Xenophon has already flexed his muscle by forcing Gillard to release a confidential cost benefit summary for the broadband project in return for voting support.

Conservative leader Tony Abbott wants to topple the government within the three-year term. The election of a Labor MP as parliament speaker cut Gillard's majority from two to one: Labor cannot now have a single lawmaker absent for lower house votes unless the opposition gives permission. Still, the biggest battles are still some time away, with a fine-tuning of Labor's planned 30 percent mining tax and draft laws not expected until May 2011. Moves for a carbon emissions price are not expected until 2012. Overall, the political stability that many Australians have taken for granted for years is vulnerable.

What to watch:

- What concessions have the independents and Greens won in return for their support? Will they cause tensions that could split the ruling alliance apart?
- The minority government cannot control Australia's legislative agenda, with independents, Greens and conservative opposition forces already joining to introduce and pass minor laws and force a wide-ranging inquiry into the banking sector.

MINING TAX

Soon after taking office in June, Gillard forged a deal with global miners **BHP Billiton**, **Rio Tinto** and **Xstrata** to try to settle a row over the **resource tax plans** of her predecessor Kevin Rudd. She cut the headline rate to 30 percent from 40, and dropped the tax altogether for companies with profits of less than A\$50 million (\$45 million). But small miners remain angry.

The final shape of the tax is under negotiation between the government and miners. Labor is expected to present legislation to parliament by May next year. UBS estimates the effective tax rate for companies affected would increase to 44 percent from 38 percent.

What to watch:

- The government's deal with the miners is threatened by a dispute over state royalties, which miners say is a dealbreaker. Talks have wrapped up, with a report to reach Treasurer Wayne Swan this month. Resource Minister Martin Ferguson says there will be no change to the headline rate.



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Australian Prime Minister Julia Gillard smiles at the opening of a new shopping mall.
REUTERS/ Daniel Munoz

- Gillard will have to rely on the support of Greens in both houses of parliament. She has insisted this will not mean changes to the tax, but she may be forced to accede to some of their demands.
- The Greens want examination of financial details of the tax before backing it, and have said revenue should be saved in a sovereign wealth fund.
- Magnetite iron ore producers are taxed at the same rate as the rest of the iron ore sector, despite shouldering additional processing costs of around \$15 per tonne to create a saleable product. Calls by the burgeoning magnetite sector for exemptions have met a lukewarm response from the government so far. Similarly, producers of brown coal, which face additional costs of around \$25 per tonne to extract water from the mud-like coal, will be taxed at the same rate as black coal miners. Brown Coal producers include Great Energy Alliance Corp, **International Power Australia** and **TRUenergy Holdings**.

RISK DATA

Sovereign foreign currency:	
S&P	AAA (stable)
Moody's	Aaa (stable)
World Governance Indicators:	
Voice & Accountability	94.3
Political Stability	76.4
Govt Effectiveness	95.2
Regulatory Quality	98.1
Rule of Law	95.3
Control of Corruption	96.2
IHS Global Insight ratings	
Country risk	1.50
Sovereign	AA
Economist Intelligence Unit	
Sovereign risk	BBB
Political risk	AA
Country risk	BBB

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BANKING REGULATION

Treasurer Wayne Swan has moved to quell mounting anger over rising interest rates by saying he would announce reforms to bank regulation to promote more competition and cheaper rates. Swan will announce his plans in December. Independents, Greens and opposition parties voted on Oct. 28 to hold an inquiry into banking competition and fees in response to record profits recorded by major lenders, and mounting political anger over fees and rising mortgage rates. Australia's major lenders are [National Australia Bank](#), [Commonwealth Bank of Australia](#), [Westpac Banking Corp](#) and [Australia & New Zealand Banking Group](#). The four have more than 80 percent of the home-loan market. The nation's top lender NAB reported a 63 percent jump in full-year profit, while ANZ's full-year profit soared 33 percent.

Australian banks weathered the global financial crisis well, with the help of government guarantees, but have caused disquiet by gobbling up rivals and largely ignoring government calls to limit their rate rises to those of the central bank.

What to watch:

- Any move to circumscribe banks' activities would be at least a short-term negative for share prices.
- The inquiry will look at fees and charges, competition between banks and non-bank lenders, the ease of moving between banks for customers, hurdles to new banking services providers and assessment of claims by banks of the rising cost of capital. It will also look at whether existing regulations restrict or hinder competition within the banking sector. Australia's competition watchdog has joined calls for closer regulation of major banks.
- Increased restrictions on banking. The inquiry's recommendations when released cannot be ignored by the government, as support for the inquiry is underpinned by mounting public anger at banks for perceived unfair practices in a nation obsessed by home ownership.

AUSTRALIAN STOCK EXCHANGE TAKEOVER

Singapore Exchange (SGX) unveiled in October a \$7.9 billion takeover offer for Sydney-based ASX Ltd to create the fifth-largest listed exchange in the world. The deal would mark the first major consolidation of Asia-Pacific exchanges. Australian worries about foreign ownership prompted the government to promise exhaustive scrutiny of the deal. Opposition politicians are concerned the deal could hurt Australia's push to become a major regional financial center, as Singapore is its main competitor.

What to watch:

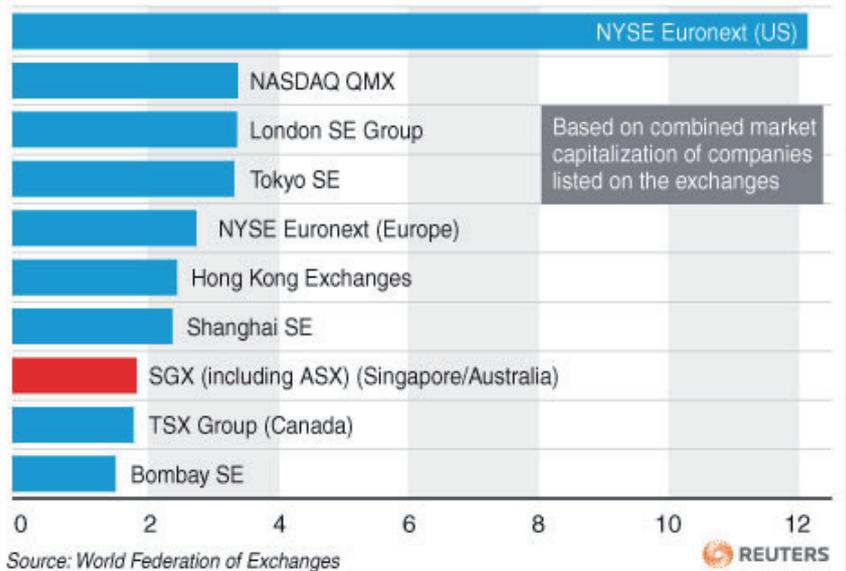
- Political backing for the takeover in Canberra is crucial as parliament needs to lift ASX's 15 percent cap on any single shareholder for the deal to go through, in what lawyers said would be the first takeover to go before parliament.
- The deal will also need approval from Australia's Foreign Investment Review Board. This could be tough as SGX is 23 percent owned by the Financial Sector Development Fund, which is controlled by Singapore's central bank.

BROADBAND

Labor's victory in the race to form the next government will allow it to forge ahead with its [\\$37 billion plan for high speed broadband](#) to be connected to 93 percent of homes. Labor's plan involves a \$10 billion deal with Australia's biggest phone company [Telstra Corp](#) to use its national network for the optic-fibre broadband service.

THE WORLD'S TOP 10 EXCHANGES

Market cap — \$ trln, as of Sept 2010



Gillard's crossbench deal has allowed her to deflect criticism from the opposition and large swathes of the public that the network is too expensive. She revealed that the cost to taxpayers for the NBN will drop by about A\$7 billion from the A\$43 billion first forecast to \$35.7 billion. It also helps cement control of the parliament.

What to watch:

- The government NBN plan hangs on Telstra's involvement, with a final, binding deal on Telstra's involvement in the NBN due by the end of December.
- The plan is expected to provide competitors like Singtel-owned Optus, Telecom NZ's AAPT, iiNet and TPG Telecom a greater opportunity to attack Telstra's market dominance.

CLIMATE POLICY

Climate change is a key political issue in Australia. Gillard has announced a delay in carbon pricing until 2012, angering the Greens. Big business and mining companies oppose carbon trading, saying it would increase their costs and force projects offshore, but the power sector wants a price on carbon to shore up the costs of future investment. Gillard's support for a trading scheme as essential to reduce carbon emissions has waned and she now seems more inclined to support an initial price on carbon before a full blown trading scheme.

What to watch:

- Will Gillard be forced to adopt a more aggressive climate change policy, and announce a stronger emissions reduction target, to keep the support of Greens and independents?
- The government could be influenced by strong outcomes from the Cancun climate summit in Mexico.

KEY DATES

- **February 1, 2011**
Reserve Bank of Australia monthly monetary policy meeting
- **February 4, 2011**
Monetary policy statement
- **February 15 2011**
Minutes of Reserve Bank of Australia monthly monetary policy meeting
- **May 2011**
Mining tax legislation expected to go before parliament

RISK DATA

JLT Group	
Strikes, riots & civil unrest	2
Terrorism	2
War & civil war	1
Economic risk	3
Currency risk	1
Sovereign risk	2
Expropriation	1
Contract repudiation risk	2
Legal & regulatory risk	2
Coface	
Country rating	A1
Business climate	A1
Transparency International	
Corruption Perceptions Index Score	8.7
Rank (of 180)	8
World Bank Doing Business	
Rank (of 183)	9
WEF Global Competitiveness	
Score	5.11
Rank (of 133)	16
Reporters Sans Frontières	
World Press Freedom Index Score	5.38
Rank (of 175)	18

