

From the Editor....



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Market Update

There has been a lot of coverage in the media over the government's decision regarding the resource super profit tax (RSPT).

The Wall Street Journal is without doubt the most influential global financial newspaper. Below is what the Wall Street Journal (WSJ) published on the proposed Australian RSPT.

The Rudd Mining Grab

Australia is the only developed country that didn't have a technical recession after the global financial crisis, mostly because its mining sector kept feeding China's economic boom. Now, the Labor Party government has decided all that wealth creation was a bad thing, and it's time to levy a 40% "super-profits" tax on these companies and redistribute the money.

The news was delivered Sunday in Canberra by Prime Minister Kevin Rudd and Treasurer Wayne Swan as the centerpiece of a proposed tax-reform package two years in the making. They argued that mining companies did so well that they sucked labor and capital out of other parts of the country, creating a "two-tier" economy. Mr. Swan says he wants companies to be "growing together," and would use the tax take to build infrastructure, help low-income workers with their pensions and "fund" a tiny, across-the-board corporate tax cut.

This economic thinking runs counter to

everything that made Australia rich over the last three decades: namely, the embrace of competition and capitalism, which rewards high risk with high returns. Setting up a mining company is not akin to opening a restaurant. Companies invest billions of dollars in exploration, build infrastructure to bring their products to a port, and then have to compete in a global marketplace and deal with volatile prices for their goods. As Rio Tinto recently discovered, the political risks of selling to countries like China are high, too.

Now the Rudd government wants to impose an arbitrary diktat on one of the country's most globally competitive industries in the name of "fairness." The government claims it settled on the 40% rate by following the lead of other trend-setters, like the U.S. state of Nevada. But why not 50%? or 60%?

The truth is that all windfall taxes, however they are dressed up and sold by politicians, are arbitrary and economically damaging. BHP Billiton estimates the "super-profits" tax would raise its total effective tax rate to about 57% from 43%, making Australia one of the most burdensome places to mine in the world. The increased tax burden would reduce profitability, discourage future investment and restrict companies' ability to return cash to shareholders through dividends.

That money, instead, will be redirected to the Rudd government, which estimates it will reap 3 billion Australian dollars (\$2.8 billion) alone in 2012, the first year the tax would go into effect.

The Minerals Council of Australia estimates mining companies already contributed about 16% of all corporate income tax revenue last year. BHP alone paid A\$6.3 billion in Australian company, state and other taxes over the same period.

What Messrs. Rudd and Swan didn't say Sunday is that this bonanza helped fund the Labor government's unprecedented spending spree, which sent the country from a A\$19.7 billion surplus into an A\$32.1 billion deficit in a single year. Lately Australians have been treated to a raft of revelations about how the Rudd government and the bureaucracy mis-managed billions of dollars of this spending.

Given that record, it's hard to have faith that Sunday's announcement is about "fairness" as much as it's about plugging fiscal holes that the government itself created. It doesn't hurt to whip up populist sentiment against big corporations in an election year, either.

If Mr. Rudd really wanted to reform the corporate tax system, he would simplify it and cut Australia's sky-high rates much more than the proposed trim to 28% from 30%. That would spur investment, create jobs and ultimately, a bigger tax base. What politician wouldn't like that?

We agree with all of the points the WSJ editorial makes. It is also obvious that many foreign investors agree also by the relentless selling that has occurred on our resources market with BHP Billiton and Rio Tinto bearing the brunt of the selling.

It is important to understand how bad this makes us look from a global perspective. The Federal Government basically said—it doesn't matter if foreign investors receive lowered returns on their Australian investments, which we would suggest is the single most stupid thing you can ever say to a foreign investor. It is a stupid strategy considering Australia, due to its low population and savings base, relies on foreign investment to fund growth.

This is a majorly negative event for Australia's perception and relative rating in a global context. As much as people like to talk up Australia's prospects, the fact of the matter remains that at just 2% of the world's global equity indices we are not a "must own" country. But how stupid are we to give global investors an excuse to "move on" from Australia. This RSPT is going to be used by foreign investors as an excuse to exit Australia altogether. Be very sure of one thing; if our currency also begins to sell off (which we think it will) it will accelerate foreign investor outflows/repatriation from Australian equities.

[European countries receive \\$1 trillion bailout package to try to help stabilize Europe's debt crisis.](#)

The celebration was touched off by an unprecedented \$1 trillion "loan package," not just for Greece, but for other struggling EU sovereign debtors. So the "solution," as it has been everywhere so far, is to issue more IOU's to those who cannot pay their current IOU's.

As for the particulars of the "bail out" mechanism, they are still quite sketchy and it may take time before we know precisely what has been proposed and what each European (and US) countries expectations are. All we know for certain is that huge "swap lines" between the various central banks in question have been activated; that the European Central Bank (ECB) has agreed to a form of "quantitative easing," and that the International Monetary Fund (IMF) has been pulled into the bail-out (thus bringing the US taxpayer into the bail-out indirectly given that the US funds just over 17% of the IMF's capital) directly.

The most important decision was that the ECB accept a mandate to buy European debt directly from the governments in question. The ECB has said time and time again that it would never monetize anyone's debt obligations, but that is precisely what it has agreed to do.

We note that it was only at the beginning of May, a mere eight or nine days ago at the time of writing that Mr. Trichet said emphatically that the ECB's authorities had "absolutely no intention" of buying government debt.

However, when the bank agreed to accept any and all Greek debt as collateral for future borrowing by the Greek government from the Bank the die was cast. This decision obviously tells us that the independence of the ECB has been utterly and completely compromised and that the political will of Brussels has trumped the economic will of Frankfurt.

Yes, the Bank has said that it will "sterilize" the long term effects of this monetisation policy and in so doing modify somewhat the long term inflationary impact of the decision. However, the plain and very simple truth is that the ECB's supposed "independence" has now been shown to be nothing more than a sham, and in the end the ECB and the euro currency will be punished for this decision to stand down from what had previously been considered sacred. But the end might well be some while into the future and the need for a bounce trumps all other concerns at the moment.

Over the course of this bear market, we've been in this situation many times before regarding bailouts. Think of the U.S. Treasury orchestrated SIV bailout in October 2007, the sale of Bear Stearns to JP Morgan in March 2008, or the government's official takeover of Freddie Mac and Fannie Mae in July 2008. They did not stop the carnage and Europe's latest rescue won't either. Before the bear market even started, it was in the previous bull market that companies "were too big to fail". The bear market would be different, because, the basic problem, which will be accentuated enormously by deflation, is this:

The world does not have enough revenue to service the debt built up over the past 7 decades. Now, we're talking entire countries, not just private companies.

So, we have even more reason to believe that these bailout packages won't work. The unfolding crisis, we believe, will be end up being too big to bail.

Commonwealth Bank (CBA)

CBA said that its cash earnings for the three months to March came in at around \$1.5bn, boosted by solid volume growth and disciplined cost control. It said it recorded impairment expenses of around \$500m for its fiscal third quarter. It said it saw a stabilisation of balances within its Institutional Banking & Markets arm as market conditions improved, while its Business & Private Banking division continued to "perform well in all segments".

CBA said it saw a dip in both funds under management and funds under administration at its wealth management arm during the quarter, impacted by outflows from short-term wholesale cash mandates. It said its operations in New Zealand maintained its "strong relative market positioning" in home lending and deposits but price competition for retail deposits have weighed on margins.

 Information in this Newsletter is drawn from various sources, including extensive and comprehensive research by Southern Cross, Bloomberg and the local press.

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