

# Australia & New Zealand Weekly

Australia/New Zealand

## In this week's issue:

- ▶ RBA official to point the way
- ▶ Investment liberalisation key outcome of FTA
- ▶ US IP bounce but inflation negligible

Australia liberalises foreign investment  
The big FTA achievement (see page 2)

Glenn Stevens talks  
The delicate issue of asset prices (see page 4)

The week ahead: Australia & New Zealand  
RBA Deputy Governor Glenn Stevens speech (see page 5)

The week ahead: Global  
US industrial activity & sentiment, CPI; Japan GDP (see page 6)

Market roundup  
Stevens speech awaited after big currency bounce (see page 7)

Weekly calendar (see page 8)

Monthly calendar (see page 10)

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# Australia liberalises foreign investment

## The big FTA achievement

Because US and Australian manufacturing tariffs are already very low and because the US concessions in agriculture are limited, we doubt the free trade agreement between Australia and the US announced last week will have much more than a marginal impact on Australian trade with the US, let alone on economic growth. It is a useful agreement but both its opponents and supporters have wildly exaggerated its significance. It should over time be somewhat easier for Australian firms to compete in the US services markets and new access to the US government procurement market will be helpful, but nothing in the agreement on goods and services will validate Prime Minister John Howard's claim that it will set Australia up for the next half century. There is, however, one area where the agreement will make a difference, and that is in the liberalisation of Australia's foreign investment regime.

It is true that Australia has continued to reserve urban land, air transport, telecommunications, defence and media from the new rules, and that it will maintain existing foreign ownership restrictions for Telstra, Qantas, CSL and airports. It is also true that even under the agreement the Australian Treasurer retains the right to reject on national interest grounds proposed take-overs of Australian firms by US firms, although the threshold at which a bid needs to be notified to the Foreign Investment Review Board (FIRB) has been increased from \$50m to \$800m. And finally it is true that of 4747 foreign investment applications made to FIRB last financial year, only 79 or 2% were rejected, a rate which suggests the FIRB constraint was not binding. All that said, the changes are much more sweeping than has been generally understood.

Once the agreement comes into force, there will be no requirement to notify to the Foreign Investment Review Board of any US investment in Australia which does not involve the take-over of any existing company. Currently any such investment of over \$10 million needs to be notified, which means it is potentially subject to the Treasurer's power to determine if it is in the national interest. It does not mean the usually environmental or other policies would not apply, but it does mean the proposed US investment would be treated exactly like a proposed Australian investment.

While the Treasurer retains the right to reject takeover proposals from US interests for Australian companies, the increase in the notification threshold from \$50 million to \$800 million makes a big difference. Most major Australian companies have a market capitalisation considerably greater than \$800 million. But there are 1400 listed companies on the ASX, and once the top 100 are excluded the average market capitalisation of the remainder is \$70 million. This is above the existing threshold, but nowhere near the new threshold. US companies will now be able to make offers for the great majority of Australian listed companies without needing to notify the FIRB.

It has been rightly said the FIRB approves nearly every application made to it. But of those approved last year, three quarters were approved only with conditions. For take-overs of industrial companies these conditions may include requirements for a local board, a local CEO, or for commitments to R&D or manufacturing facilities. Under the new rules there will be no conditions for bids under \$800m, and no notification will be required. And while a take-

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## Australia liberalises foreign investment

over above that threshold requires approval, the acquisition of a blocking s take against other predators may not. Under Australian law an interest can acquire 19% of a listed company before being required to make an offer for the remainder. Under the proposed FTA rules, a US company would presumably acquire 19% of a \$3.2 billion company without being required to notify FIRB. Since FIRB notification automatically involves the disclosure to the targeted company of the predator's intention, the new rules will be considerably more convenient for predators.

When the new rules are operating they will be extremely discriminatory, since they apply only to US firms. When an Australian target is defending against a foreign predator it is quite common to make the case to FIRB that the offer is against the national interest. The target knows the case will be rejected, but it also knows it will achieve a delay which allows it to construct a more effective defence. Under the new rules the US firm will not face this impediment. But if the Australian firm seeks a white knight which happens to be British or New Zealand or German or Japanese, the white knight will be compelled to go through the FIRB processes. It seems to us this is not a sustainable position. It is all the more delicate because Australia already has understandings with New Zealand and with Japan that those countries will enjoy the most favourable investment rules into Australia which apply to any other country. It is highly likely therefore that within a few years the newly liberal rules will apply to all intending investors, and the role of FIRB will be whittled down to very large transactions, and those sectors which continue to be reserved. There is even a possibility that the Treasurer's discretionary authority to refuse take-overs on national interest grounds will be exposed to some public review, which is not the case today.

# Glenn Stevens talks

## The delicate issue of asset prices

Discussing “recent issues for the conduct of monetary policy” tomorrow RBA Deputy Governor Glenn Stevens may well traverse some of the material in last week’s *Statement on Monetary Policy*. We expect him to be reasonably confident that global growth will be markedly stronger this year than last. He may also say that while there are some signs that housing is finally slowing, there is plenty of work in the pipeline and household spending overall remains very firm. The currency is certainly stronger and particularly against the US dollar, but we expect Mr Stevens to point out that Australia exports are trending up despite the currency – not least because the drought is now over, and world growth is stronger. The formal RBA target is after all inflation. Mr Stevens will thus have to elaborate the Bank’s argument that while inflation will fall over the remainder of this year, it will increase back to the 2.5% mid point of the target in 2005 and continue to trend upward. Just how hard Mr Stevens goes on that argument will betray just how committed are he and RBA Governor Ian Macfarlane to further rate rises in the near future. We think the Bank will make two more before the end of June. Mr Stevens will not want to leave the market under the misapprehension that the tightening episode is over.

The Bank’s judgements about the outlook for inflation and growth are of course not the only recent issues for the conduct of monetary policy. Another is the role of expected asset price changes in monetary policy. This was certainly a big issue late last year, with the Bank drawing attention to the rapid rate of growth of house prices and the “unsustainability” of the accompanying growth in credit. The rate of increase in house prices and of credit growth were surely more compelling issues in the Bank’s decision to begin a tightening episode in November 2003 than the very distant prospect that retail price inflation might otherwise be picking up to the mid point of the target band sometime in 2005. Last week’s *Statement* focused on the trajectory of non tradables inflation as a more compelling, simpler and accustomed reason for tightening – one which requires no change in the Bank’s mandate, no change in the Bank’s public discourse, and only a passing affront to logic and plausibility. But if Mr Stevens wants a model of a really good speech on the subject, one which either he or Mr Macfarlane should have offered three months ago, he can do no better than read Reserve Bank of New Zealand Governor Alan Bollard’s January 30 talk on *Asset Prices and Monetary Policy*. In it Dr Bollard set out the issues with simple clarity, and unambiguously states his own position. If he did think there was an unsustainable bubble in New Zealand housing prices, he said, then despite the fact that his mandate requires him to focus on retail price inflation he believes he would be entitled to take the risk of tightening monetary policy more than would be required if the sole objective was to keep consumer price inflation within the target range. Mr Macfarlane and Mr Stevens are doing it, but are reluctant to say it.

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# The week ahead: Australia & New Zealand

## RBA Deputy Governor Glenn Stevens speech

This week is very quiet on the Australian and New Zealand data front, with no major New Zealand releases and only secondary Australian data. But the main event is a speech Tuesday lunchtime from RBA Deputy Governor Glenn Stevens.

RBA Deputy Governor Glenn Stevens speaks Tuesday (12:45 AEDT) on “Recent Issues for the Conduct of Monetary Policy” at an Australian Business Economists function in Sydney. Following so closely after last week’s quarterly *Statement on Monetary Policy* from the RBA, his speech will no doubt have a tone similar to the *Statement*, and leave the way open for further tightening. Like the *Statement*, Stevens will affirm that the Australian and global outlook remains firm, that policy remains accommodative, and that whilst the near-term inflation outlook is benign, inflation will most likely be on “a gradually rising trajectory” in 2005. Markets will watch his speech for any subtleties that may hint how close the Bank is to another tightening. Our HSBC view is that they will next tighten in April, but the risk for an earlier move in March cannot be dismissed, particularly with consumer confidence seemingly unfazed by the two 25bp rate hikes so far, with sentiment higher than it was prior to the first hike in November.

Australian data commences Tuesday with the latest NAB monthly business survey for January. In the December survey, the business conditions index edged lower to +18 from +22, but was still at an historically strong level consistent with annual growth in non-farm GDP and/or domestic demand of 5% or more. The business confidence index stabilized after recent declines, rising 2 points to +12.

Other Australian data includes the latest Melbourne Institute leading index of activity for December (prev showed annualised growth of 2.6%) on Wednesday, and the February RBA Bulletin on Thursday.

As noted earlier, there are no major New Zealand data releases scheduled for this week.

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# The week ahead: Global

## US industrial activity & sentiment, CPI; Japan GDP

This week's US data releases focus on industrial activity and sentiment, with the February Empire manufacturing index, January industrial production and the February Philly Fed manufacturing index. January US price data is also due with producer and consumer prices. Japan releases include Q4 GDP, while UK releases of note include retail prices, February MPC minutes and January retail trade. The Eurozone sees December industrial production.

US markets are closed Monday for the Presidents' Day holiday. Tuesday then sees the February Empire manufacturing index where we expect a slight decline to 36.0 from a record high of 39.2 previously. Tuesday also sees January industrial production. With manufacturing hours worked up 0.6% m/m and the ISM production index at a cycle high of 71.1, we look for a solid rise of +1.0% m/m after December's disappointing +0.1% result. This would lift capacity utilisation to 76.4% from 75.8% previously. However, we expect the mismatch between the very strong survey evidence and disappointing trend in the official data to persist. Wednesday sees January housing starts, where we expect a pullback to 1950k from the 20-year high of 2088k previously. Thursday sees weekly jobless claims (fcst 355k vs 363k prev), January producer prices and the February Philly Fed index. We expect headline producer prices to rise 0.3% m/m (same as previously) led by fuel price increases, but this would see the annual rate fall to 2.9% y/y from 4.0%. The core rate is expected to remain soft though, and we forecast +0.1% m/m (vs -0.1% prev) taking the annual rate to +0.7% y/y from +1.0%. Like the Empire index, we expect the February Philly Fed index to pullback from a 10-year high in January of 38.8 to 35.0 in February. Finally, Friday sees the January CPI. Rising energy prices should see the headline CPI rise 0.3% m/m (vs +0.2% prev) keeping the annual rate unchanged at 1.9% y/y. The core CPI rate should remain benign at +0.1% m/m (same as previously) which would keep the annual rate unchanged at 1.1% y/y, whilst the 3m-annualised rate would drop to just +0.5% ann.

In Fed speeches this week, Chicago Fed President Moskow speaks on the economic outlook Thursday (17:30 GMT, Q&A to follow) and St Louis Fed President Poole speaks on "The State of the US Economy" on Friday (13:45 GMT).

Japan releases this week include Q4 GDP (Wednesday) where we expect a strong quarterly outcome of +1.4% q/q. Growth will be led by exports, private capital investment and private consumption, while public capital formation is expected to keep falling. A 1.4% q/q result would lift annual growth to +2.4% y/y from +1.9% previously.

UK data this week includes January retail prices (Tuesday), the February MPC meeting minutes (Wednesday) and January retail trade (Thursday). With retail prices, we expect the HICP inflation rate to remain unchanged at 1.3% y/y, the 68<sup>th</sup> consecutive month below the 2% target. With the MPC minutes, the catch phrase will remain "interest rates will rise only gradually". For retail trade, despite the rise in the BRC and CBI retail surveys in January, we expect a fall in retail trade of -0.5% m/m after gains in November and December. But this would still allow through-year growth to rise to +5.3% y/y from +4.0% previously.

Please refer to the attached *Weekly Calendar* for all our forecasts.

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# Market roundup

## Australian and New Zealand financial markets

Indicator	Local weekly close*			HSBC end-quarter forecasts		
	6 Feb. 04	13 Feb. 04	Change <sup>#</sup>	Q1 2004	Q2 2004	Q3 2004
AUD-USD spot	0.7634	0.7908	+3.6%	0.79	0.81	0.80
AUD-JPY spot	80.94	83.35	+3.0%	81.4	81.0	77.9
NZD-USD spot	0.6849	0.7008	+2.3%	0.69	0.70	0.69
NZD-AUD spot	0.8972	0.8862	-1.2%	0.87	0.86	0.87
Australian 90 day bank bills	5.58%	5.55%	-3 bp	5.55	5.95	5.90
Australian 10 yr govt bonds	5.71%	5.54%	-18 bp	6.00	6.20	6.25
New Zealand 90 day bank bills	5.61%	5.58%	-3 bp	5.75	5.95	5.90
New Zealand 10 yr govt bonds	6.00%	5.89%	-11 bp	6.20	6.35	6.40

Source: Bloomberg, RBA, HSBC \* 4pm AEDT, 6pm NZT r = revised # change calculated using unrounded data

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## Stevens speech awaited after big currency bounce

After a listless month the Australian and New Zealand dollars roared off last week, driven by news of an Australia US free trade agreement, the prospect of higher interest rates at home and the global market's view that Federal Reserve Board chairman Alan Greenspan would be very patient indeed in raising US rates. By the end of last week the Australian dollar had risen nearly three cents against its close against the US dollar the previous Friday, and the New Zealand dollar well over one cent. Against euro the gains were much more modest, underlining the global weakness of the US dollar in the aftermath of Dr Greenspan's well modulated congressional testimony last week. At the long end Australian and New Zealand rates continued to be tethered by low US bond rates, and the relatively flat yield curve remained.

This won't be a big week for data but the market will be closely watching a scheduled speech by Reserve Bank of Australia Deputy Governor Glenn Stevens Tuesday. We thought last week's RBA *Statement on Monetary Policy* left the door wide open for a couple more rate rises by mid year. The RBA doesn't like the stellar Australian dollar, but recognises most of the move is against the USD and there isn't much it can or should do to stop it. We expect Mr Steven's Tuesday speech to offer a fairly confident view of the global and local growth outlook, and express some concern over rising price pressures as the economy nears full employment – both views alerting markets to the risks of a higher cash rate. The US market is closed for vacation Monday. US January industrial production could bounce 1% Tuesday but we think both the Empire and Philly indices later in the week will be weaker than last time and the core January CPI up a mere 0.1% Friday – outcomes unlikely to stir the settled market conviction that the US dollar is headed down while US interest rates remain very low.

# Weekly economic calendar

Week commencing Monday 16 February 2004

Country/		Period	Market forecasts			Actual
Region	Event or economic release		HSBC	Consensus	Range	Previous
<b>During the week</b>						
JPN	Trade surplus, customs-cleared, n.s.a.	Jan	-¥52.4bn	-	-	+¥1122bn
GER	Producer prices	Jan M/M	+0.2%	+0.2%	-	Flat
		Jan Y/Y	+0.6%	+0.6%	-	+1.8%
GER	CPI, preliminary	Feb M/M	+0.2%	-	-	Flat
		Feb Y/Y	+0.8%	-	-	+1.2%
<b>Monday, 16 February 2004</b>						
US	Presidents' Day holiday					
<b>Tuesday, 17 February 2004</b>						
AU	NAB business survey	Jan	-	-	-	-
AU	RBA Deputy Governor Stevens speech: "Recent Issues for the Conduct of Monetary Policy" (12:45 AEDT)					
UK	RICs housing market survey: net balance	Jan	+45	-	-	+41
UK	Retail prices: RPI	Jan M/M	-0.1%	-0.2%	-	+0.4%
		Jan Y/Y	2.7%	2.8%	-	2.8%
	Retail prices: RPIX	Jan Y/Y	2.5%	2.4%	-	2.6%
	Retail prices: HICP	Jan Y/Y	1.3%	1.4%	-	1.3%
GER	ZEW business survey: expectations	Feb	70.0	72.0	-	72.9
US	Empire manufacturing index	Feb	36.0	37.0	-	39.2
US	Industrial production	Jan M/M	+1.0%	+0.7%	-	+0.1%
	Capacity utilisation	Jan	76.4%	76.3%	-	75.8%
<b>Wednesday, 18 February 2004</b>						
AU	MI leading index of activity	Dec ann	-	-	-	+2.6%
JPN	GDP	Q4 Q/Q	+1.4%	+1.1%	-	+0.3%
		Q4 Y/Y	+2.4%	+2.1%	-	+1.9%
UK	MPC minutes	Feb	-	-	-	-
EMU	Industrial production	Dec M/M	+0.3%	+0.5%	-	+0.1%
		Dec Y/Y	+2.5%	+2.6%	-	+0.9%
US	Housing starts	Jan	1950k	2000k	-	2088k
<b>Thursday, 19 February 2004</b>						
AU	RBA Bulletin	Feb	-	-	-	-
GER	GDP, 2 <sup>nd</sup> estimate	Q4 Q/Q	+0.2%	+0.2%	-	+0.2% p
UK	Retail sales	Jan M/M	-0.5%	+0.3%	-	+0.9%
		Jan Y/Y	+5.3%	+6.0%	-	+4.0%
UK	Public finances: PSNCR	Jan	-£10.5bn	-£11.2bn	-	+£13.1bn
EMU	ECB meeting (non-policy meeting)					
US	Jobless claims	W/e 14 Feb	355k	-	-	363k
US	PPI: headline	Jan M/M	+0.3%	+0.3%	-	+0.3%
		Jan Y/Y	+2.9%	+2.9%	-	+4.0%
	PPI: core	Jan M/M	+0.1%	+0.1%	-	-0.1%
		Jan Y/Y	+0.7%	+0.7%	-	+1.0%
US	Philly Fed index	Feb	35.0	35.0	-	38.8

## Weekly economic calendar

## Week commencing Monday 16 February 2004 (continued)

Country/		Period	Market forecasts			Actual
Region	Event or economic release		HSBC	Consensus	Range	Previous
<b>Friday, 20 February 2004</b>						
JPN	Tertiary industry activity	Dec M/M	-0.4%	-	-	-2.3%
		Dec Y/Y	+2.5%	-	-	+0.6%
US	CPI: headline	Jan M/M	+0.3%	+0.3%	-	+0.2%
		Jan Y/Y	+1.9%	+1.9%	-	+1.9%
	CPI: core	Jan M/M	+0.1%	+0.1%	-	+0.1%
		Jan Y/Y	+1.1%	+1.1%	-	+1.1%

Source: HSBC, Dow Jones, Reuters, Bloomberg Notes: p = preliminary; r = revised; n.f. = not forecast; n.s.a. = not seasonally adjusted; ann. = annualised; bn = billion; m = million

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# Monthly economic calendar

February/March 2004				
Monday 16 February	Tuesday 17 February	Wednesday 18 February	Thursday 19 February	Friday 20 February
	AU NAB business survey (Jan) AU RBA Deputy Governor Stevens speech	AU MI leading index (Dec)	AU RBA Bulletin (Feb)	
<i>US Presidents' Day holiday</i>	US Empire mfg index (Feb) US Industrial production (Jan)	US Housing starts (Jan)	US PPI (Jan) US Philly Fed index (Feb) US Leading index (Jan) US Jobless claims	US CPI (Jan)
Monday 23 February	Tuesday 24 February	Wednesday 25 February	Thursday 26 February	Friday 27 February
		AU Wage cost index (Q4) AU Building work done (Q4)	AU Private new capital expenditure (Q4)  NZ PPI (Q4)	AU Private credit growth (Jan)  NZ Building permits (Jan) NZ Trade balance (Jan, p)
	US Conference Board consumer confidence (Feb)	US Existing home sales (Jan)	US New home sales (Jan) US Durable goods orders (Jan) US Jobless claims	US GDP (Q4, 2 <sup>nd</sup> estimate) US Uni. of Michigan consumer sentiment (Feb, f) US Chicago PMI (Feb)
Monday 1 March	Tuesday 2 March	Wednesday 3 March	Thursday 4 March	Friday 5 March
AU Trade balance (Jan) AU Business indicators (Q4) AU AiG PMI (Feb)	<b>AU RBA Board meeting</b> AU Balance of payments (Q4) AU Retail trade (Jan)	AU GDP (Q4) AU AiG PSI (Feb)	AU Building approvals (Jan)  <b>BoE MPC meeting</b> <b>ECB policy meeting</b>	
US Personal income & spending (Jan) US Construction spending (Jan) US Mfg ISM (Feb)		US Non-mfg ISM (Feb) US Beige Book	US Productivity (Q4, f) US Factory orders (Jan) US Jobless claims	US Employment report (Feb) US Consumer credit (Jan)
Monday 8 March	Tuesday 9 March	Wednesday 10 March	Thursday 11 March	Friday 12 March
AU ANZ job ads (Feb)	NZ Trade balance (Jan, f)	NZ Retail sales (Jan)	NZ MPS & OCR review	NZ Terms of trade (Q4)
		US Trade balance (Jan) US Wholesale inventories (Jan)	US Retail sales (Feb) US Jobless claims	US PPI (Feb) US Business inventories (Jan) US Current account (Q4) US Michigan consumer confidence (Mar, p)

Source: HSBC