Institutional Banking
& Markets

Economic & Financial Market Outlook

“Cheer up Australia”
Local economy posts 23 years without recession

FinPro Conference,
Creswick, Victoria

John Peters
Senior Economist
Director, Economics
+(612) 9117 0112

27 February 2014

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Australian Economic & Financial Market Outlook

Outlook for Australian economy in 2014 & 2015

Direction of Risks

- ***Global Growth*** ↑ **Global economic growth of 3 - 3½% in 2013 & 2014.**
- ***Domestic Growth*** ↑ **Economy to grow by 2¾-3%pa in 2013 & 2014.**
- ***Monetary Policy*** ↑ **RBA has cut rates to 2½%. We think this will be cyclical low. We see a 0.25%RBA rate hike in QIV '14**

  Market now sees less than 10% chance of another 0.25% cut to 2¼% over next year.
- ***Underlying CPI*** ↑ ***CPI at 2.7% in QIV 2013*. Upside risks in 2014 as tradables inflation (ie import prices) lifts due to falling AUD. *QIV Core CPI was 2.6%pa.***
- ***Unemployment*** ↑ **Could drift up to 6¼% in HII; then lower in medium term. January unemployment at 6.0%.**
- ***AUD Outlook*** ↓ **Trade mainly in US$0.84-90 zone in 2014 & 2015.**

Our View

- **Return towards trend global growth in 2014 but downside risks remain**
  - growth drivers switch to advanced economies as emerging economies slow;
  - markets overly reliant on QE and overly sensitive to its withdrawal;
  - US returning to trend and will survive the end of QE, fiscal resolution would help;
  - European workout remains a long-run problem and will weigh on growth and markets;
  - China slowdown is structural but cycle means commodity price adjustment largely done;
  - some EMDE economies exposed in post QE world but risks are lower in Asia.
- **Australian growth to remain sub-trend as growth transition proceeds**
  - economy is navigating through four booms, three transitions and a bubble;
  - a successful baton pass to new sources of growth as mining capex winds down needs to be achieved.
- **Economic policy and markets**
  - below trend growth, low inflation and rising unemployment allow an RBA easing bias;
  - but preference is for any further stimulus to come via a lower AUD;
  - QE taper to dominate market pricing;
  - bond yields to rise, the curve to flatten, spreads to track sideways;
  - AUD to edge lower during 2014.

RBA Policy on Hold

Direction of Risks

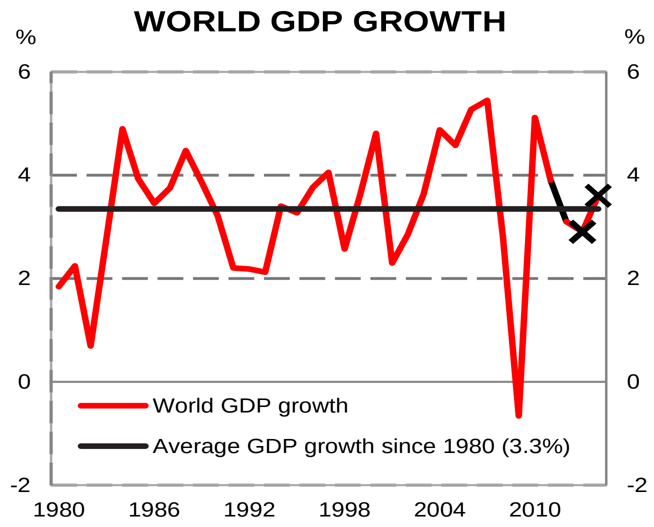
DIRECTION OF RISK OVER NEXT 6 MONTH s

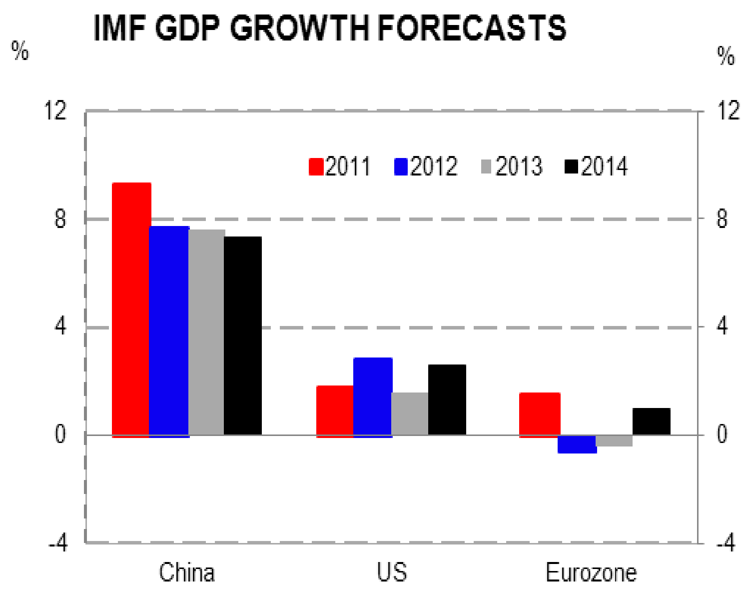
Monetary policy:	→
Short end:	→
Long end:	↑
AUD:	↓

THE KEY FORECASTS

	Current	6-month	12-month
Cash rate	**2½**	**2½**	**2½**
90-day bills	**2.62**	**2.7**	**3.0**
3-yr bonds	2.81	**3.70**	**4.1**
10-yr bonds	**4.18**	**4.5**	**4.7**
AUS-US sprd	**137**	**90**	**100**
EUR/USD	**1.3738**	**1.31**	**1.30**
JPY/USD	**102.23**	**111.0**	**119.0**
AUD/USD	**0.8969**	**0.87**	**0.84**

KEY CHARTS





CBA Australian Economic Forecasts

	2011/12 (a)	2012/13 (a)	2013/14 (f)	2014/15 (f)	2015/16 (f)	2011 (a)	2012 (a)	2013 (f)	2014 (f)	2015 (f)
Economic Activity										
Private final demand	**6.0**	**2.8**	**1.3**	**1.8**	**1.5**	**5.7**	**4.6**	**1.8**	**1.6**	**1.6**
Of which: H/hold spending	2.5	2.0	2.2	3.1	3.1	3.1	2.5	1.8	2.6	3.2
Dwelling investment	-2.2	-0.4	2.7	7.2	3.2	1.1	-3.3	1.3	6.5	4.6
Business investment	23.4	6.3	-2.6	-4.1	-4.5	19.7	15.0	1.1	-3.5	-4.7
Public final demand	**2.2**	**-1.3**	**1.6**	**0.9**	**2.0**	**0.0**	**3.0**	**-2.2**	**1.6**	**1.9**
Domestic final demand	**5.1**	**1.9**	**1.4**	**1.6**	**1.6**	**4.3**	**4.2**	**0.9**	**1.6**	**1.6**
Inventories (contrib to GDP)	0.1	-0.3	-0.2	0.4	0.0	0.4	0.0	-0.6	0.4	0.1
GNE	**5.2**	**1.6**	**1.2**	**1.9**	**1.6**	**4.7**	**4.2**	**0.3**	**2.0**	**1.8**
Exports	4.7	6.0	6.0	7.0	7.9	-0.4	5.8	6.8	6.2	7.4
Imports	11.4	0.3	-0.9	2.7	1.6	10.9	6.2	-2.5	2.3	1.7
Net exports (contrib to GDP)	*-1.3*	*1.2*	*1.5*	*1.0*	*1.5*	*-2.2*	*-0.1*	*2.0*	*0.9*	*1.4*
GDP	**3.6**	**2.7**	**2.6**	**2.9**	**3.1**	**2.6**	**3.6**	**2.4**	**2.8**	**3.0**
Prices & Wages										
CPI	**2.3**	**2.3**	**2.8**	**2.7**	**2.9**	**3.3**	**1.8**	**2.4**	**2.9**	**2.9**
Underlying CPI	2.4	2.4	2.7	3.0	2.8	2.6	2.3	2.5	2.9	2.9
Wage Price Index	**3.6**	**3.3**	**2.7**	**3.4**	**3.8**	**3.7**	**3.6**	**2.9**	**3.0**	**3.7**
Nominal GDP	5.6	2.5	4.8	5.4	5.3	6.9	3.4	3.5	5.4	5.3
Real h/hold disposable income	3.4	0.6	2.9	2.5	2.6	4.9	2.0	1.4	2.9	2.3
Labour Market										
Employment	1.2	1.3	0.6	1.7	1.9	1.8	1.1	1.1	1.0	1.9
Unemployment rate	5.2	5.4	5.9	6.0	5.9	5.1	5.2	5.7	6.0	6.0
External Accounts										
Current Account: $bn	**-47.8**	**-55.2**	**-44.9**	**-42.3**	**-33.0**	**-40.3**	**-61.8**	**-46.6**	**-42.2**	**-39.7**
% of GDP	*-3.2*	*-3.6*	*-2.8*	*-2.5*	*-1.9*	*-2.8*	*-4.1*	*-3.0*	*-2.6*	*-2.3*

CBA Interest Rate & FX Forecasts

	Markets	Current	Mar'14	Jun'14	Sep'14	Dec'14	Mar '15	Jun'15
Australia	Official cash	2½	2½	2½	2½	2¾	3	3
	90-day bills	2.62	2.6	2.7	2.8	3.0	3.2	3.5
	3-year bonds	2.81	3.3	3.6	3.9	4.1	4.2	4.2
	10-year bonds	4.18	4.4	4.5	4.6	4.7	4.7	4.6
	3-year swap	3.16	3.6	3.9	4.1	4.4	4.5	4.5
	10-year swap	4.50	4.8	4.9	5.0	5.2	5.2	5.2
USA	Fed funds	0-¼	0-¼	0-¼	0-¼	0-¼	0-¼	0.5
	2-year bonds	0.31	0.4	0.6	1.0	1.4	1.7	2.0
	10-year bonds	2.72	3.1	3.3	3.4	3.4	3.5	3.5
Spreads	AUS-US 10 yr	146	130	120	120	130	120	110
	AUS 3-10 yr	137	110	90	70	60	50	40
FX	AUD	0.8969	0.89	0.87	0.85	0.84	0.83	0.80
	TWI	69.2	70.1	68.2	67.5	66.9	66.0	63.3

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CBA Interest Rate & FX Forecasts

	Markets	Current	Mar'14	Jun'14	Sep'14	Dec'14
FX Majors	AUD-USD	0.8967	0.89	0.87	0.85	0.84
	EUR-USD	1.3738	1.33	1.31	1.30	1.30
	USD-JPY	102.23	108.0	110.0	112.0	114.0
	GBP-USD	1.6643	1.64	1.63	1.61	1.58
	USD-CAD	1.1115	1.12	1.14	1.16	1.18
	NZD-USD	0.8283	0.84	0.82	0.79	0.77
	USD-CHF	0.8872	0.93	0.95	0.96	0.97
AUD Crosses	AUD-NZD	1.0827	1.0595	1.0610	1.0759	1.0909
	AUD-EUR	0.6528	0.6692	0.6641	0.6538	0.6462
	AUD-JPY	91.69	95.23	96.57	97.75	99.96
	AUD-GBP	0.5388	0.5427	0.5337	0.5280	0.5316
	AUD-CAD	0.9968	0.9968	0.9918	0.9860	0.9912
	AUD-CHF	0.7958	0.8277	0.8265	0.8160	0.8148
	AUD-CNY	5.4647	5.3222	5.1939	5.0150	4.9140
	AUD-SGD	1.1267	1.1392	1.1049	1.0710	1.0584
AUD TWI		69.2	70.1	68.2	67.5	66.9

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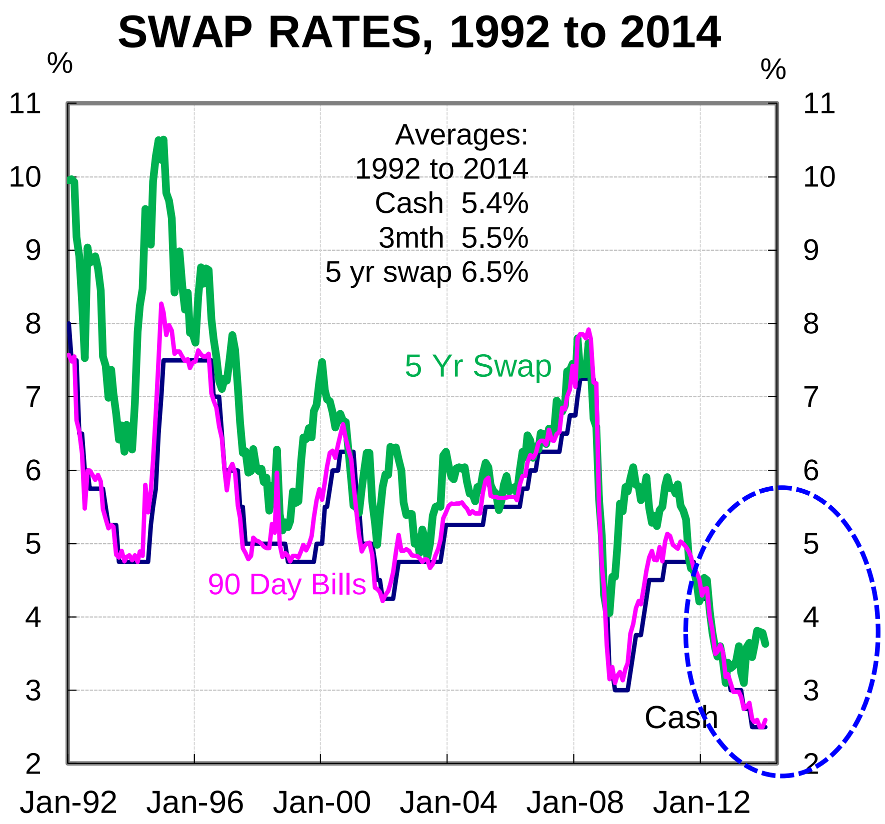
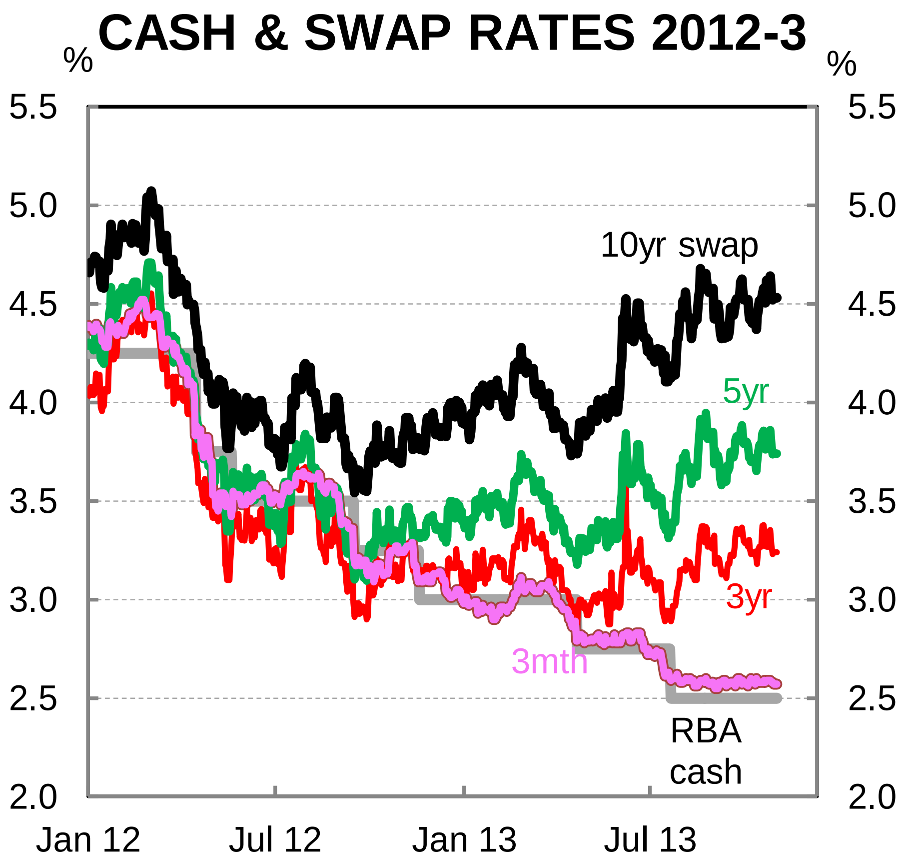
Swap Rates – Higher





- **Swap rates expected to rise through 2014, with some dips. Long end rising by more.**
- **3 year fixed rates expected to rise to 4.3% in late 2014.**
- **Risks remain in EU & US……….with occasional "bursts of pessimism" likely.**

Interest Rate Forecasts - Steeper Curve

Interest rates	Cash Rate	90 Day Bank Bill	3 Year Swap	5 Year Swap	10 Year Swap	10 Year Bond
Sep13	2.50	2.60	3.06	3.60	4.33	3.81
Dec-13	2.50	2.64	3.18	3.77	4.59	4.24
Mar 14(f)	2.50	2.60	3.65	4.25	4.85	4.40
Jun 14(f)	2.50	2.70	3.95	4.50	4.90	4.50
Sep 14(f)	2.50	2.80	4.15	4.75	5.00	4.60
Dec 14(f)	2.75	3.00	4.35	4.85	5.20	4.70
Mar 15(f)	3.00	3.10	4.50	5.00	5.20	4.70
Jun 15(f)	3.00	3.10	4.50	4.90	5.20	4.60
Sep 15(f)	3.00	3.15	4.40	4.70	5.15	4.50
Dec 15(f)	3.00	3.15	4.30	4.60	5.10	4.50

Australian Economic & Financial Market Outlook

Australia's stellar performance since 2008 in wake of GFC

- **Australia emerged from the GFC (Global Financial Crisis) with:**
  - **Low unemployment**
  - **Solid economic growth**
  - **A stable and profitable financial system; and**
  - **Low levels of government debt**
- **Australia's performance is unique among the advanced economies.**
- **For instance, 36 million jobs were shed globally after the GFC *WHILE* Australia has created over 950,000 new jobs. Australia's unemployment stood at 6.0% in January 2014.**

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The Task Ahead

Navigating through 4 booms, 3 transitions and a bubble

A number of things need to go right if good economic outcomes are to be maintained:

- A successful navigation through the three stages of the resources boom:
  - the aftermath of the income boom;
  - the end of the capex boom; and
  - the start of the export boom.

- Exploiting the “fourth boom”:
  - the emergence of the Asian middle income consumer.

- The growth transition needs to succeed:
  - focus on residential construction and non-mining capex;
  - sentiment, labour market trends, fiscal policy and the AUD need to help.

- An inflation transition is also required:
  - domestic inflation needs to slow as imported inflation lifts.

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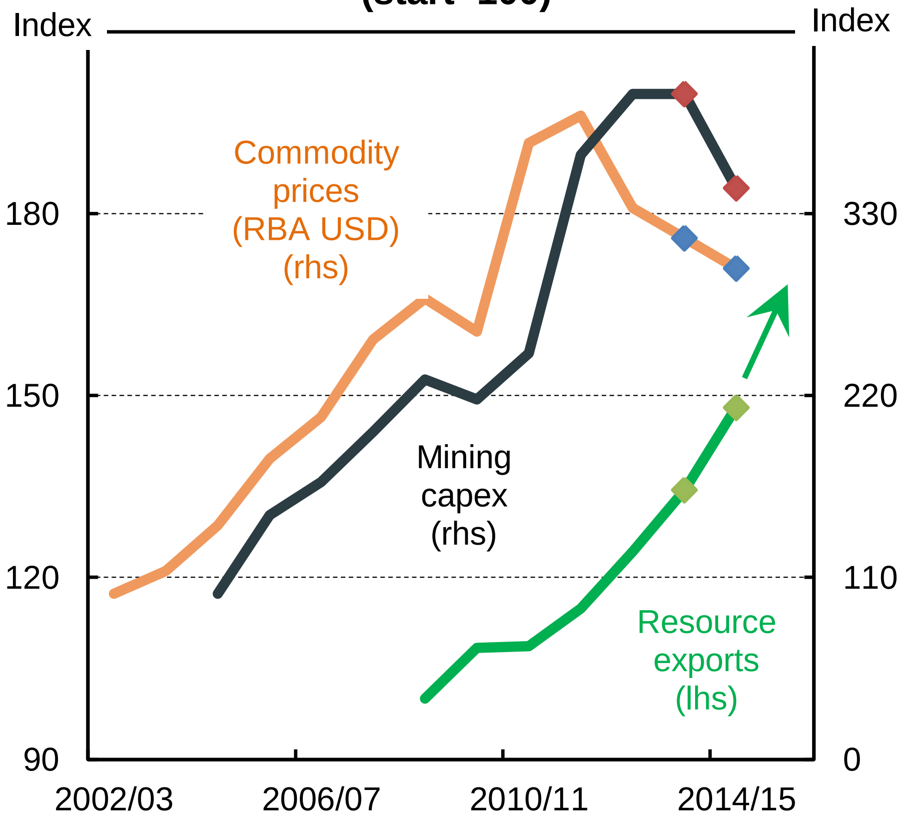
The Three Booms

Overlapping booms ...

THREE BOOMS
(start=100)



- **The resources boom is the defining feature of the Australian economic landscape over the past ten years:**
  - the *income* phase associated with the step up in commodity prices is over;
  - the mining *investment* phase triggered by high prices is ending; but
  - the *production and export* phase is just beginning.
- **For the export boom to work, our main export markets need to be strong enough to absorb the extra supply and pay a decent price.**

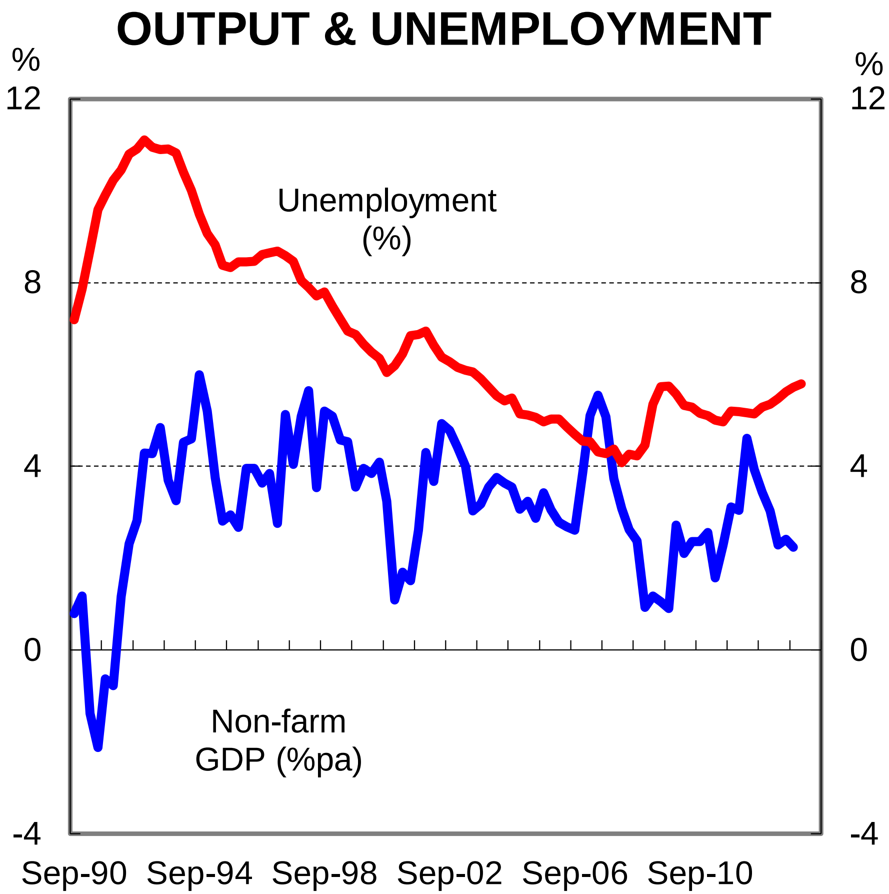
CBA Global Growth Forecasts

	2012 (a)	2013 (p)	2014 (f)	2015 (f)
World	3.2	2.8	3.5	3.6
United States	2.8	1.8	3.1	3.1
Japan	1.4	1.6	1.2	1.0
Eurozone	-0.6	-0.4	1.0	1.4
United Kingdom	0.1	1.8	2.6	2.3
Canada	1.7	1.8	2.3	2.5
China	7.7	7.8	7.5	7.6
India	5.0	4.2	4.6	4.9

- **CBA global growth forecasts envisage a trend growth in 2014 and 2015 as the advanced economies strengthen.**
- **China and US expected to do a bit better than the consensus. Japan a bit worse.**

Australia In Perspective

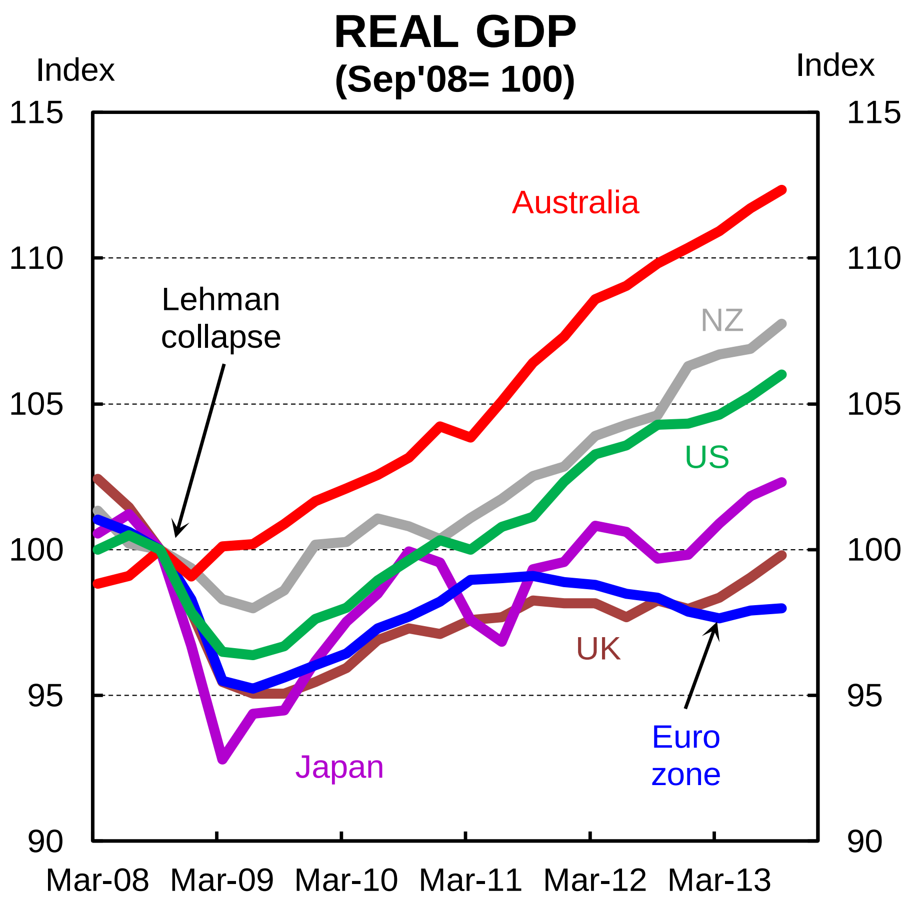
Reality: sub trend growth ...

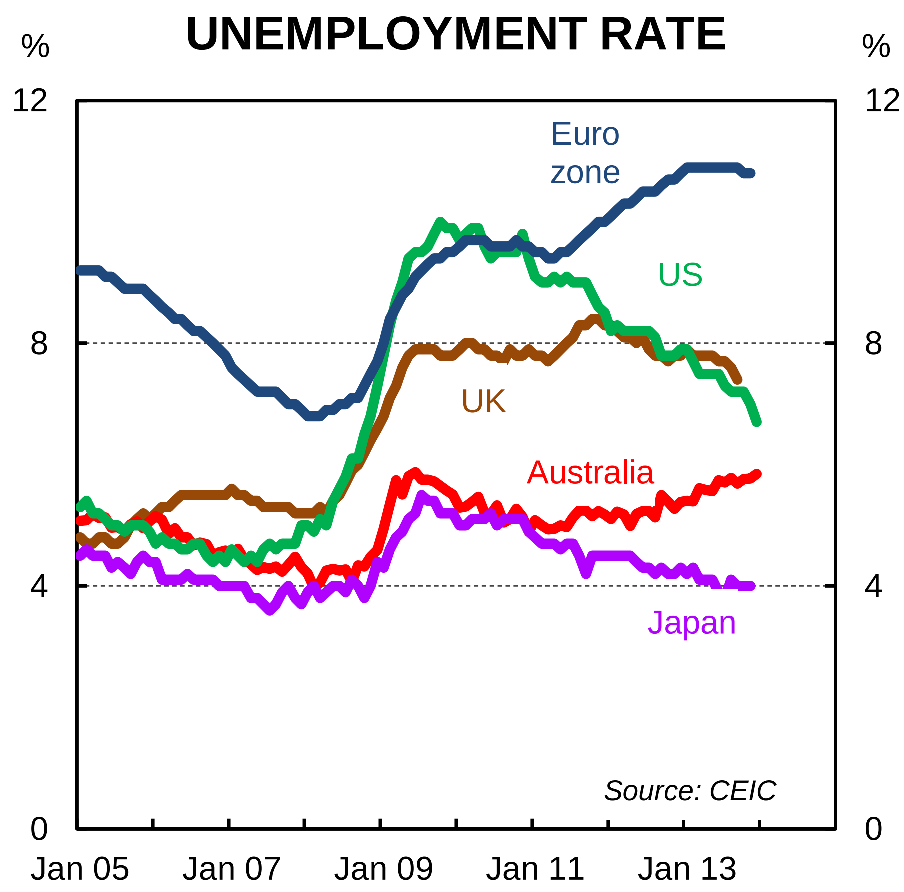


- **The Australian economy is running at a below trend pace (sub 3%).**
- **Implications:**
  - below trend growth means rising unemployment;
  - below trend growth means inflation remains low.

Australia In Perspective

... and end of the outperformance story??

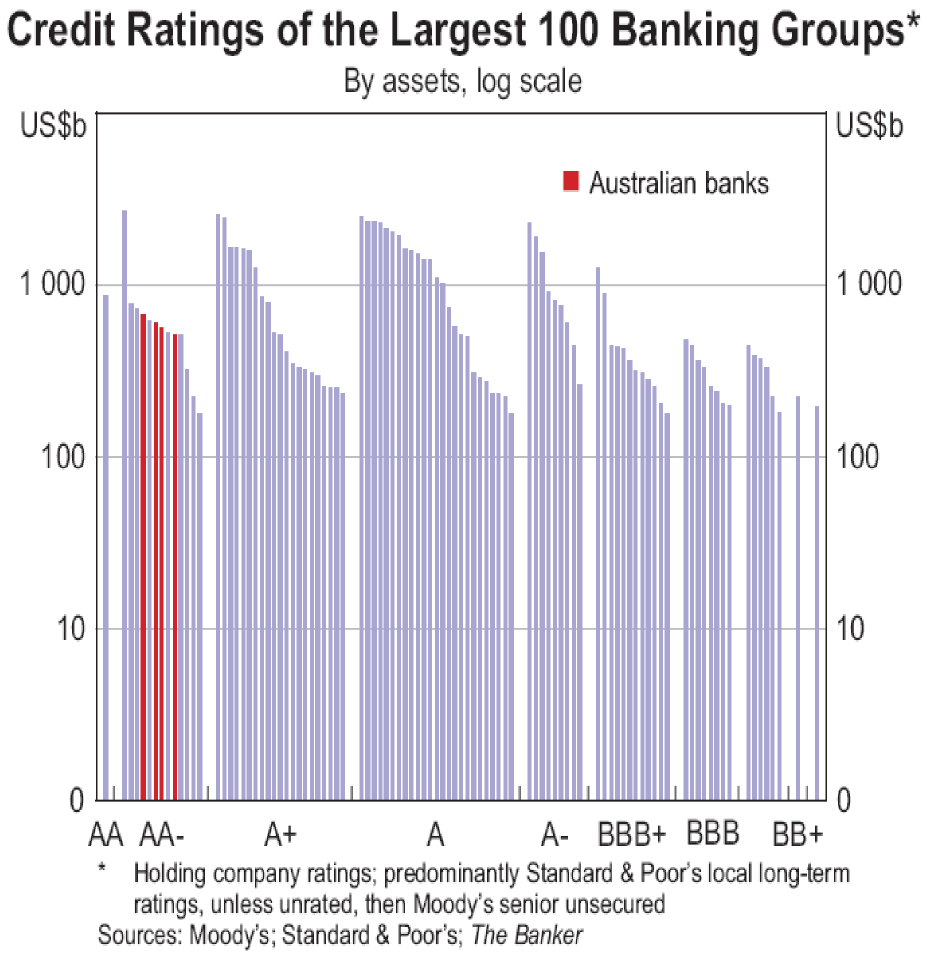


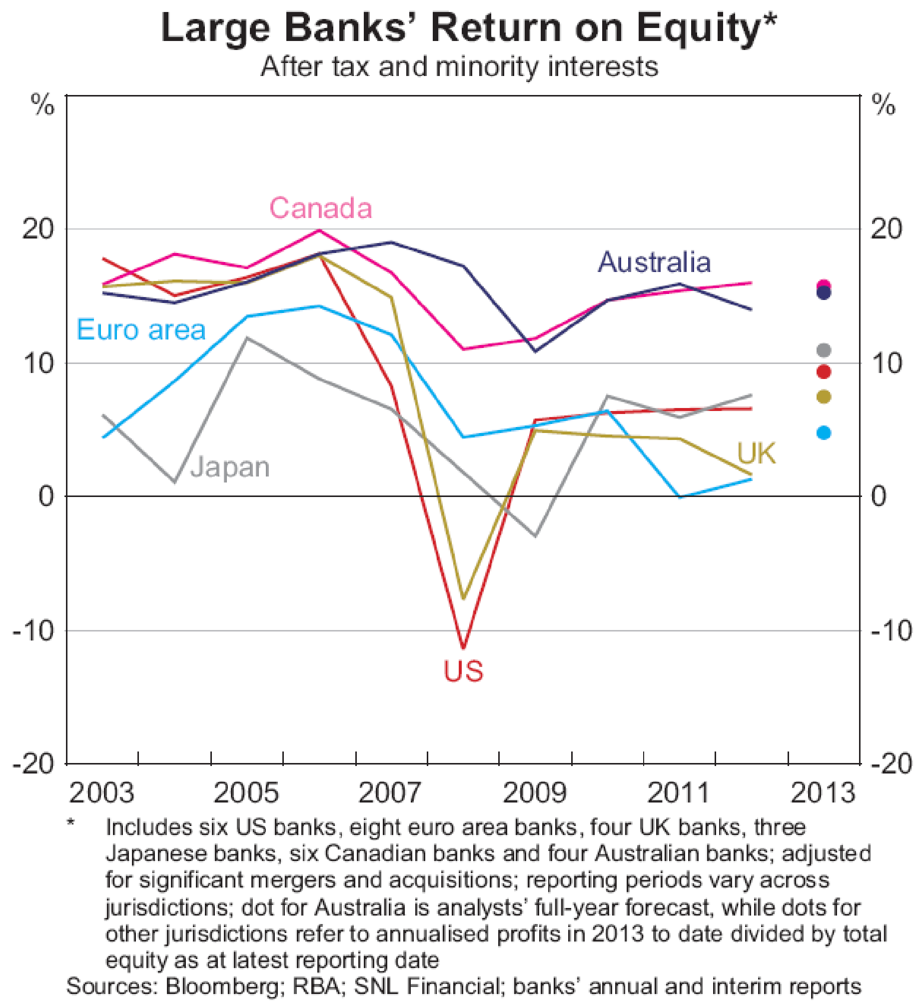


- **Sub-trend Australian growth as other advanced economies pick up means the economic outperformance story of the last few years is ending.**

Australia In Perspective

Reality: well positioned financial system



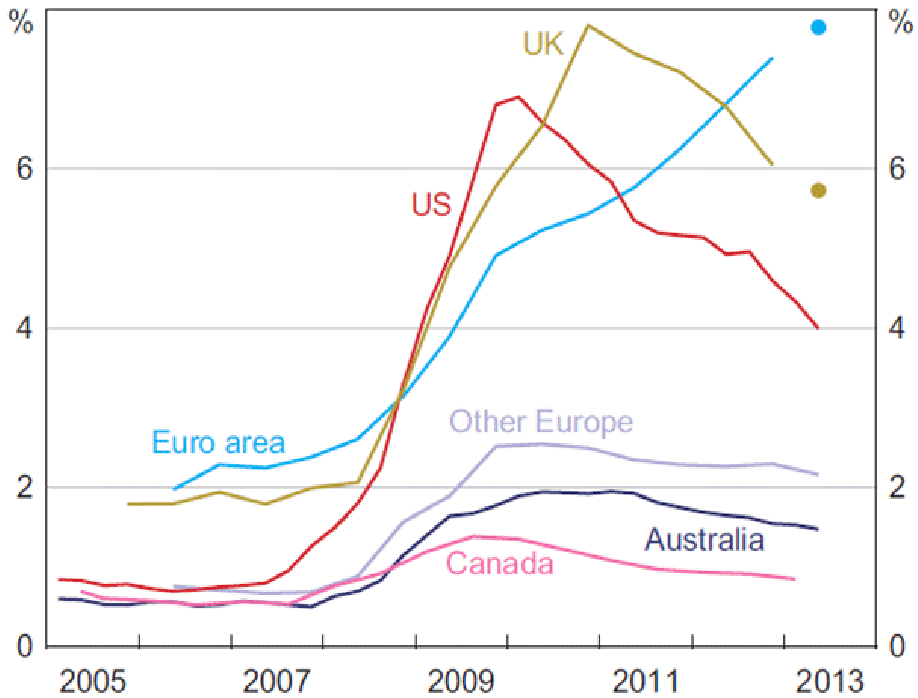


Australia In Perspective

Reality: well positioned financial system

Large Banks' Non-performing Loans*

Share of loans

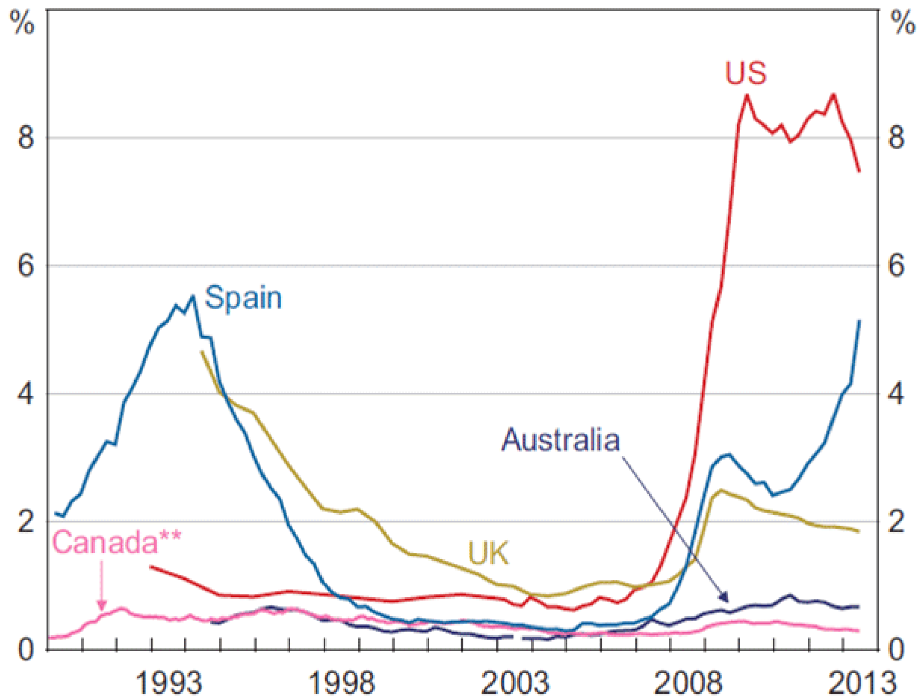


* Definitions of 'non-performing loans' differ across jurisdictions, sometimes including loans that are 90+ days past due but well secured and in the case of Australia small amounts of non-loan assets; includes 18 US banks, 41 euro area institutions, 10 other European banks, four UK banks, six Canadian banks and four Australian banks; latest available ratios have been used for some euro area and UK institutions where June 2013 data are unavailable

Sources: APRA; RBA; SNL Financial; banks' annual and interim reports

Banks' Non-performing Housing Loans*

Share of all housing loans



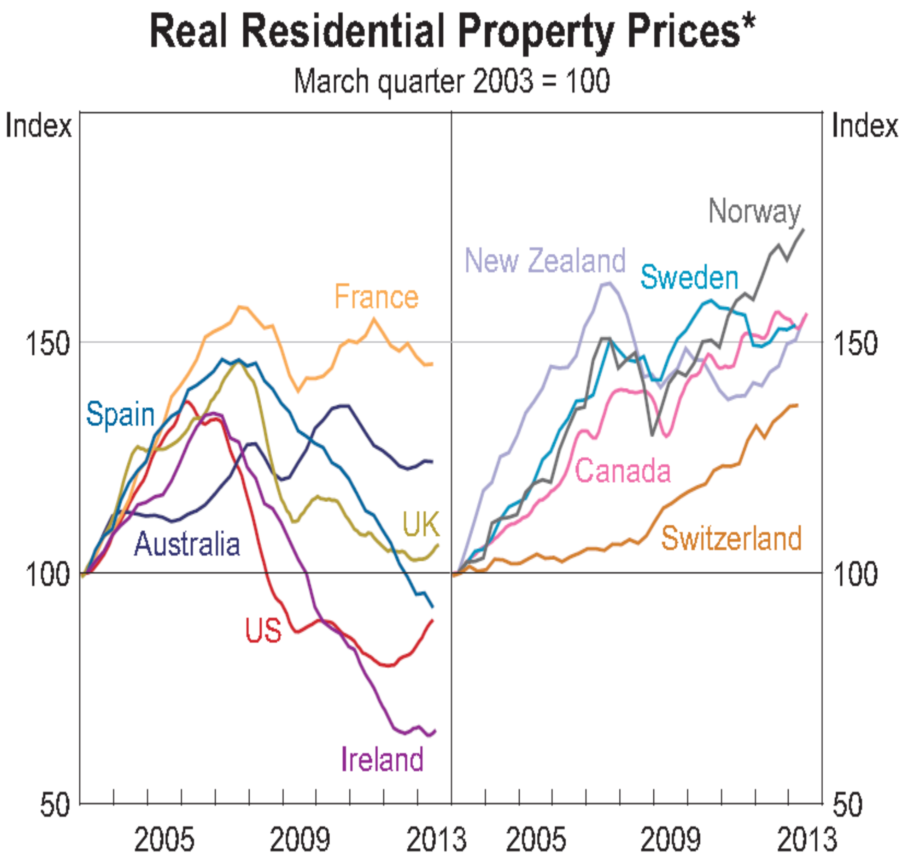
* UK and Spain include some non-bank lenders

** Includes only the six large Canadian banks, HSBC Canada and Manulife Bank

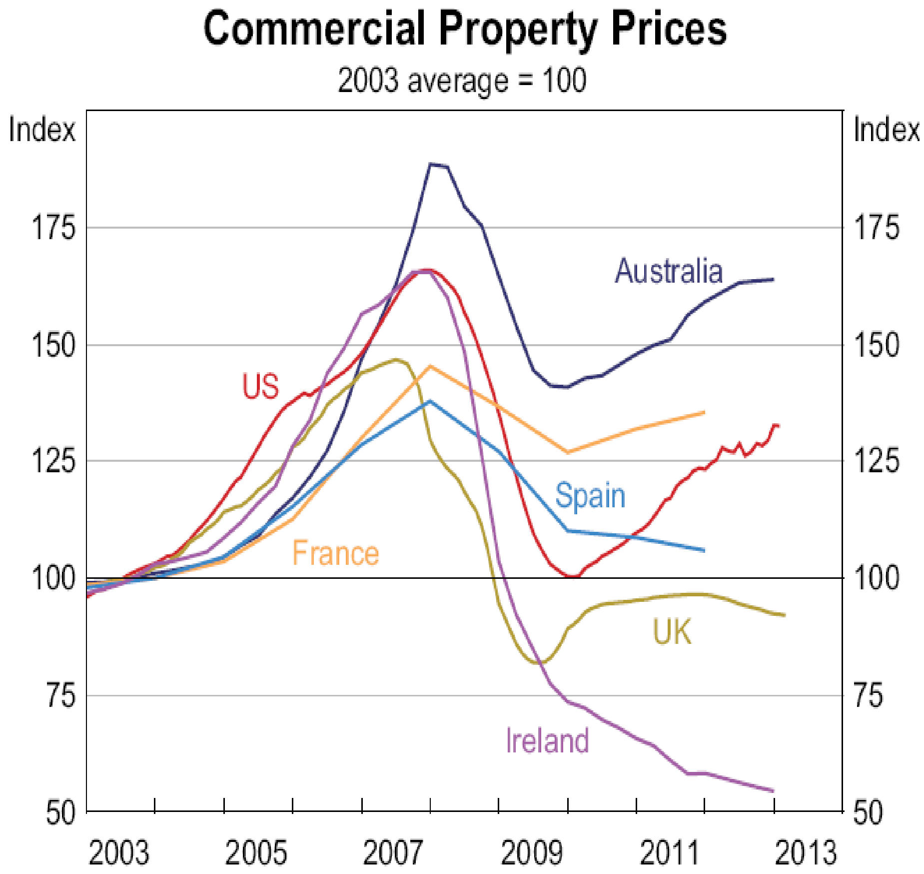
Sources: APRA; Bank of Spain; Canadian Bankers' Association; Council of Mortgage Lenders; FDIC; RBA

Australia In Perspective

Reality: less property stress

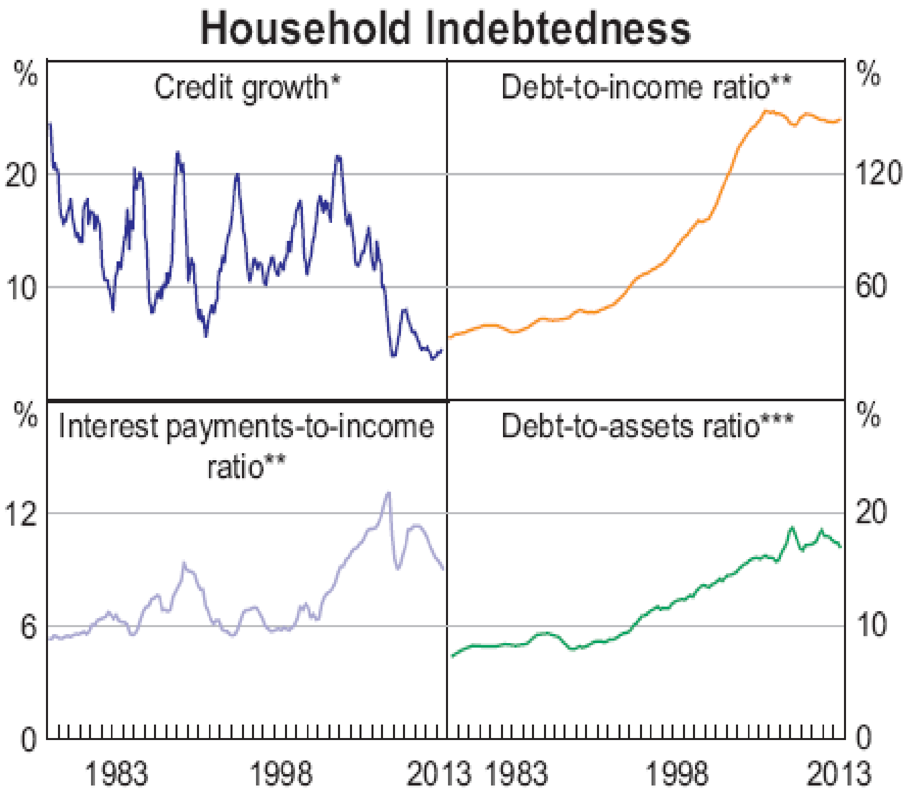


* Deflated using consumer price indices
Sources: BIS; Bloomberg; RBA; REINZ; RP Data-Rismark; SNB; Teranet-National Bank; Thomson Reuters

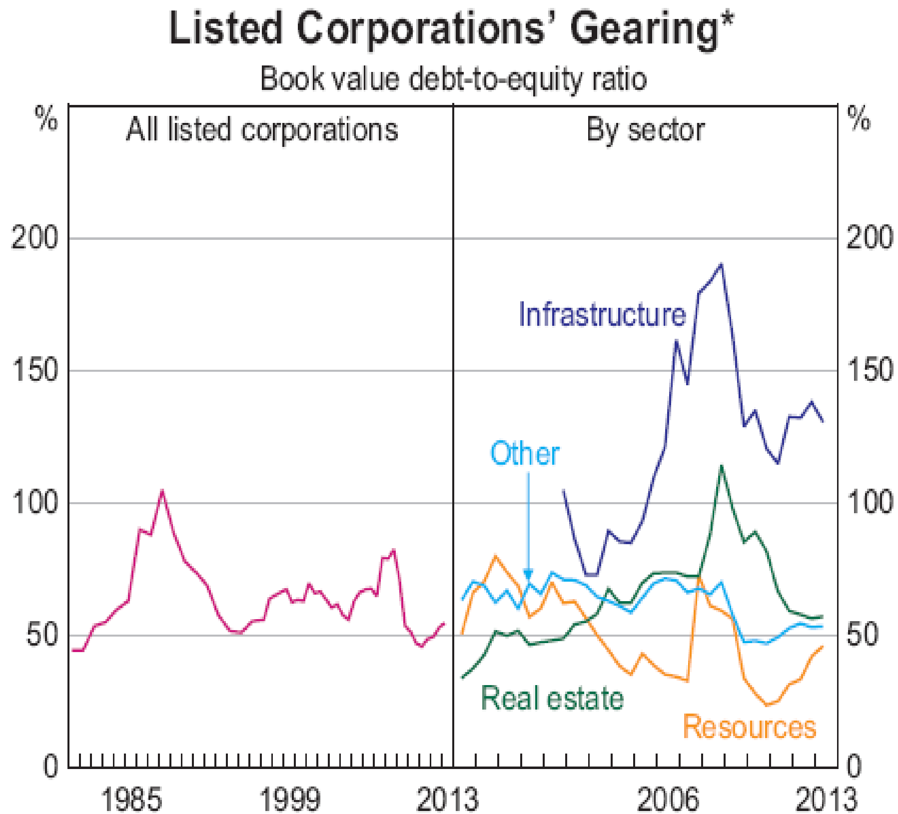


Sources: Bloomberg; Jones Lang LaSalle Research; Moody's and Real Capital Analytics; RBA

Reality: stronger balance sheets



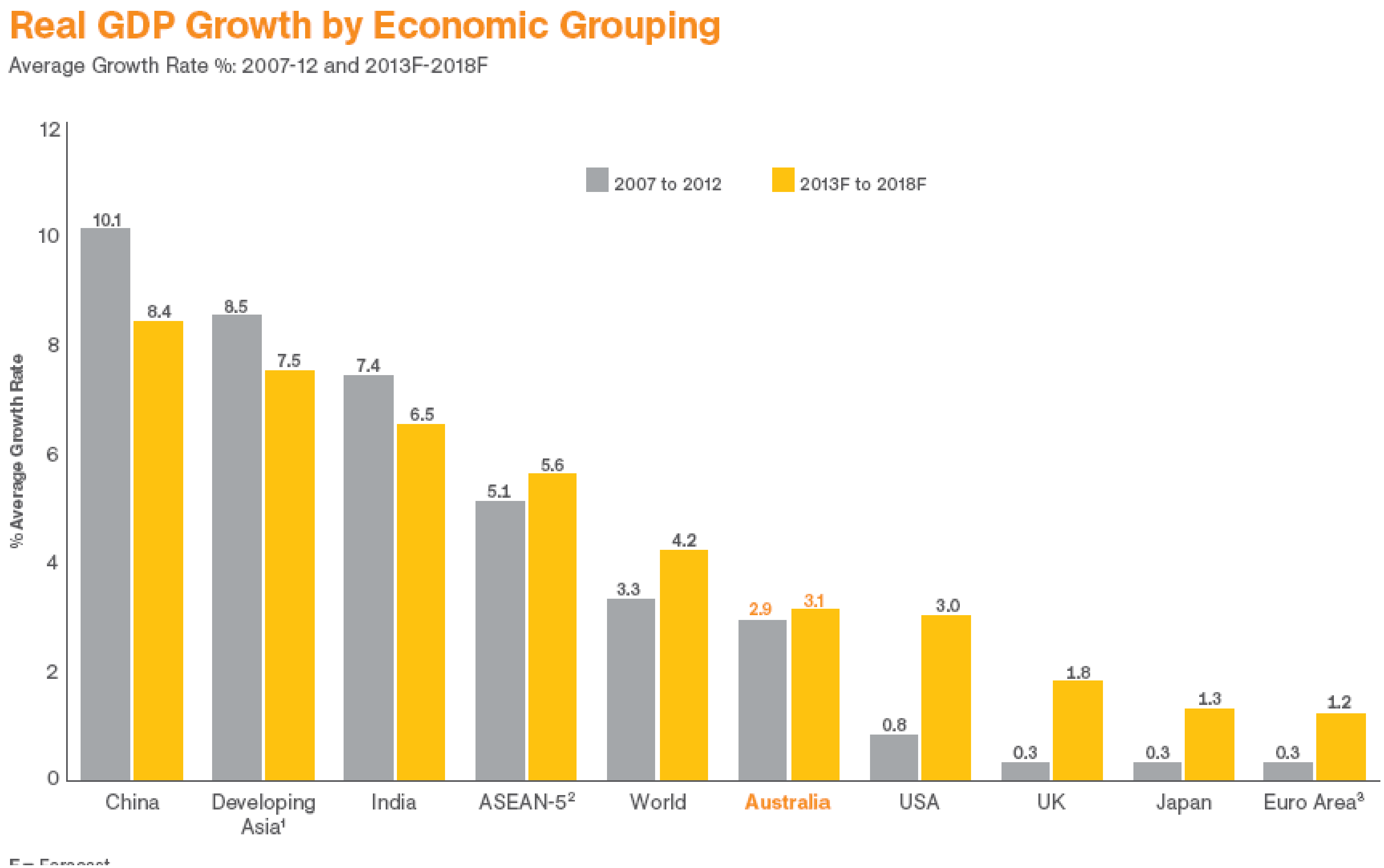
* Six-month annualised
** RBA estimates for September quarter 2013
*** RBA estimates for June and September quarters 2013
Sources: ABS; APRA; RBA; RP Data-Rismark



* Excludes foreign-domiciled companies; final observations are estimates based on a matched sample of companies that have reported to date
Sources: Bloomberg; Morningstar; RBA; Statex

- **Household and business balance sheets are significantly stronger than before the 2008-09 financial crisis.**

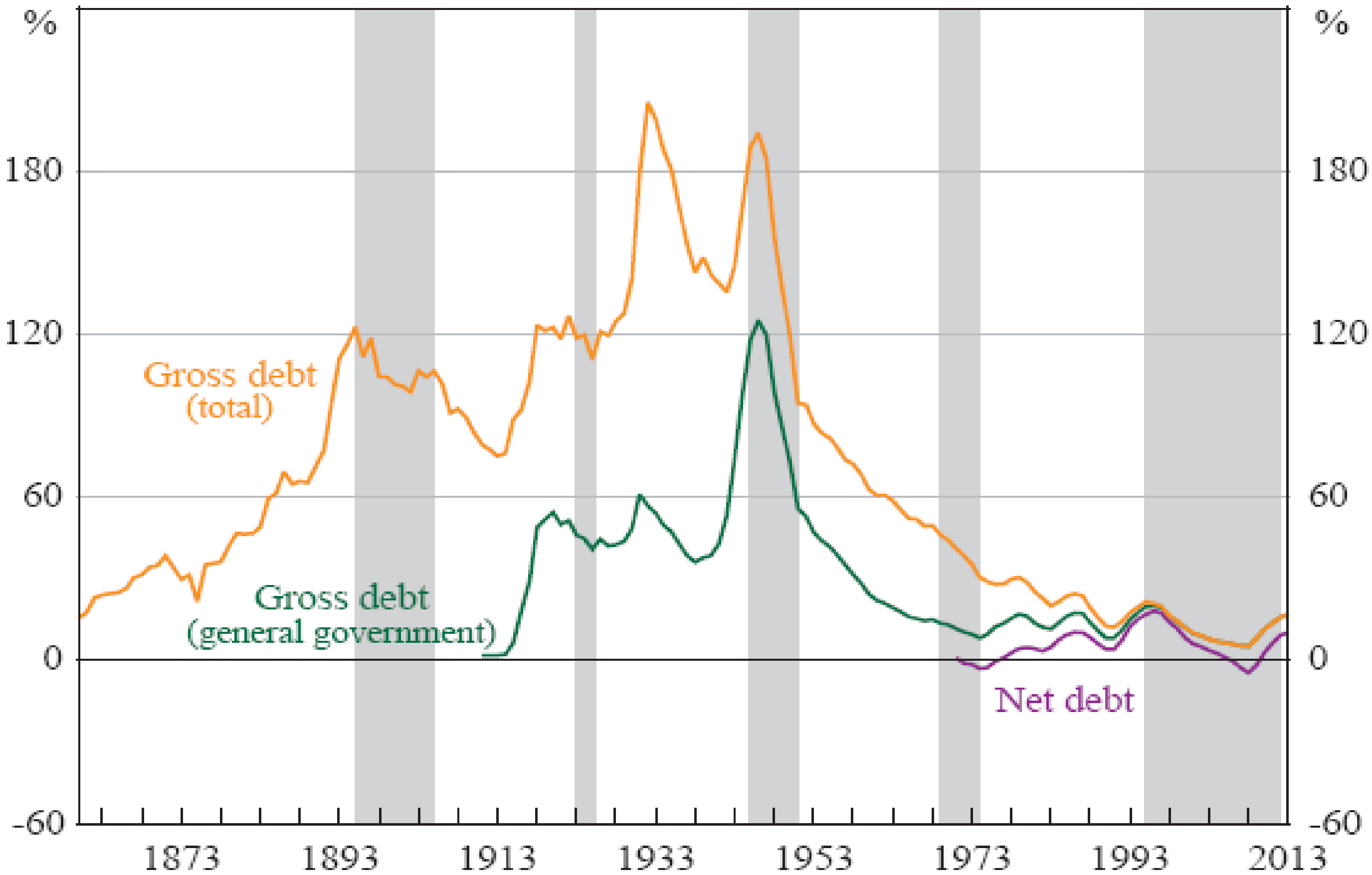
Australian Economy Outperforms Advanced Economies - post GFC



Australia has miniscule levels of public debt - despite populist fears

Figure 14: Public Debt in Australia

Per cent of GDP



Notes: Federal, state and local governments; financial years; shaded regions denote expansionary phases of the terms of trade

Sources: ABS; Australian Government budget papers; Australian Office of Financial Management; Australian Treasury; RBA; Vamplew (1987); authors' calculations

Offshore Perspective of Australia's Economic Performance

Australia one of only eleven AAA rated economies by all three Ratings Agencies

AAA Rated Economies

- Australia
- Germany
- Finland
- Norway
- Singapore
- Sweden
- Canada
- Switzerland
- Hong Kong
- Netherlands
- Denmark

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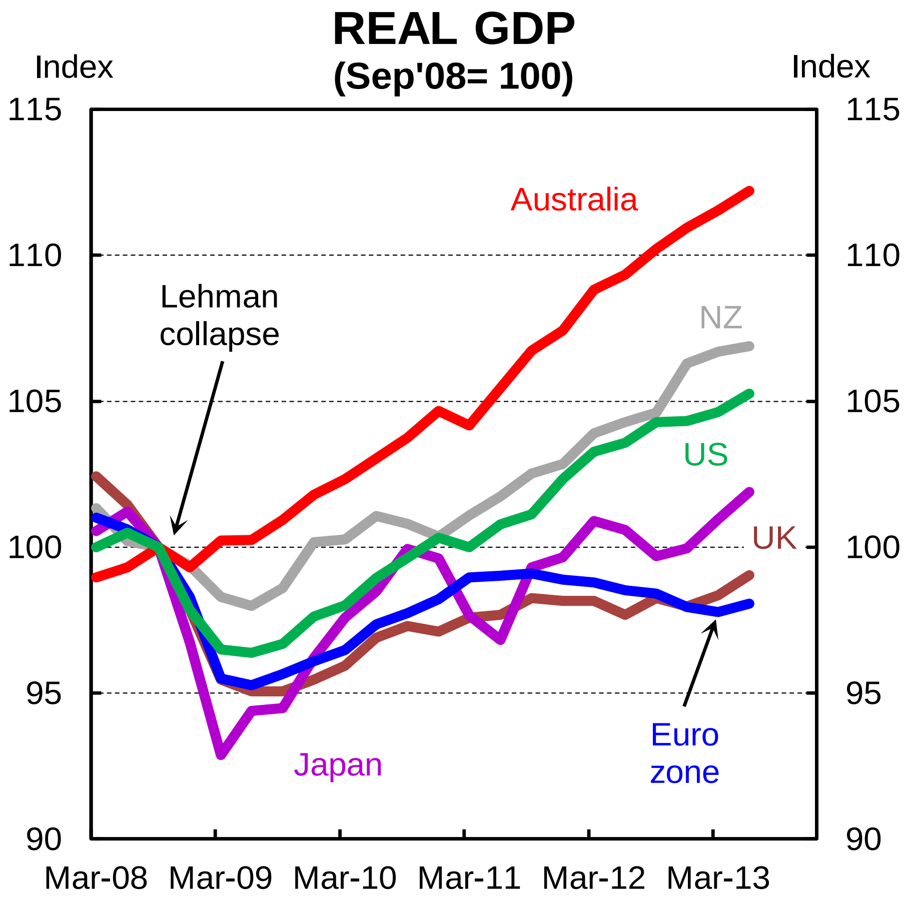
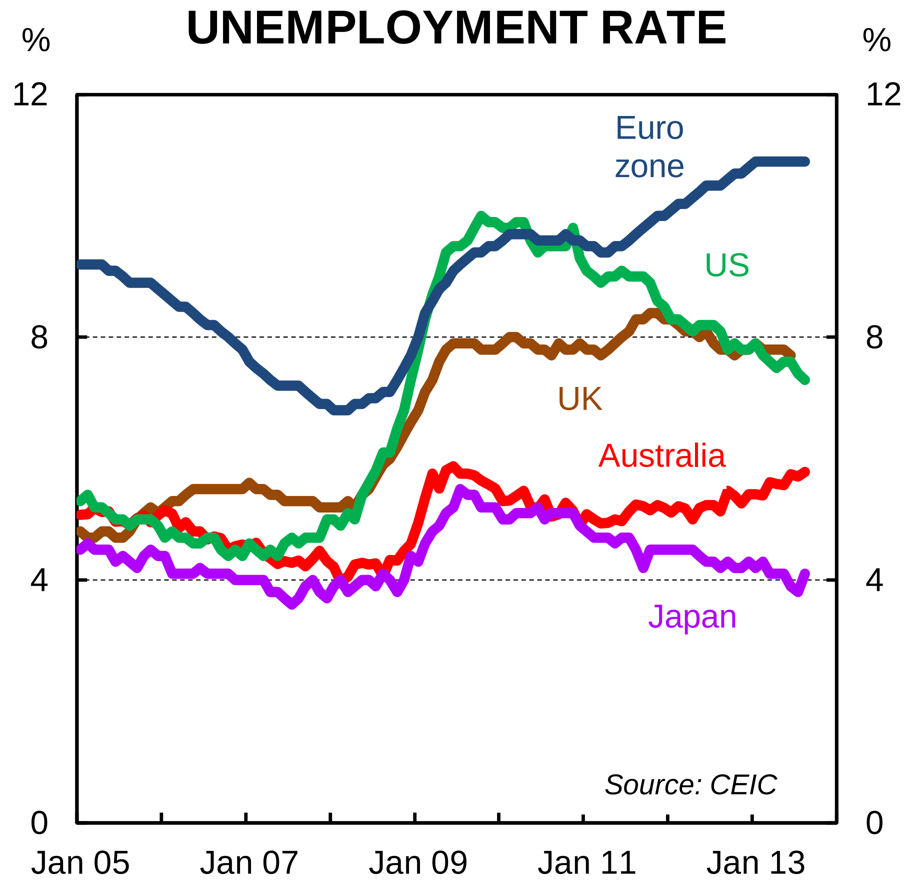
The Big Picture

Five years after Lehman's



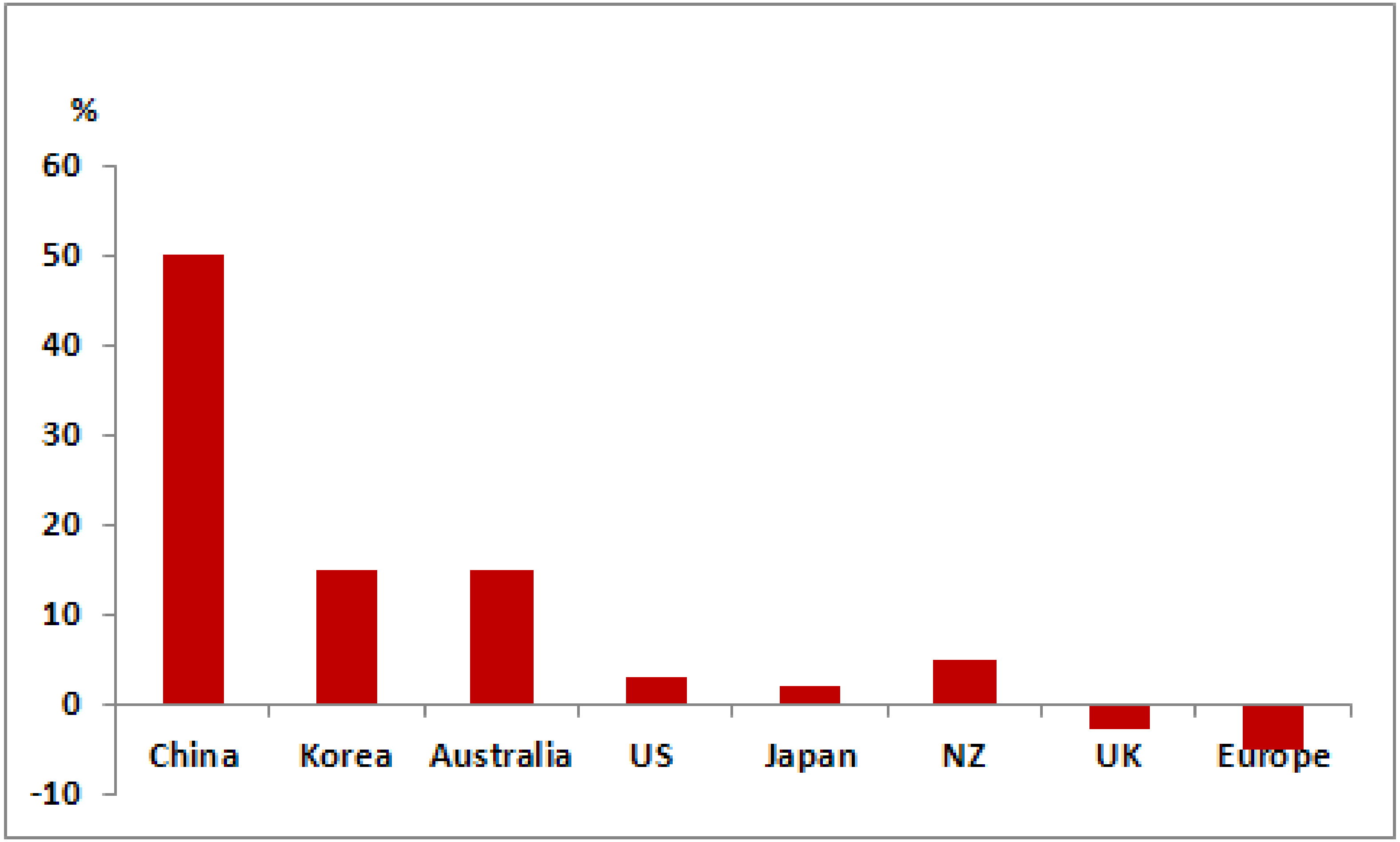


- **Damage to the advanced economies/regions persists and some are yet to regain pre-Lehman's output levels.**
- **The US is in better shape.**
- **Australian economy has continued to outperform other advanced economies.**

Australia In Perspective

Outperforming & overachieving!

% GDP Growth since 2008



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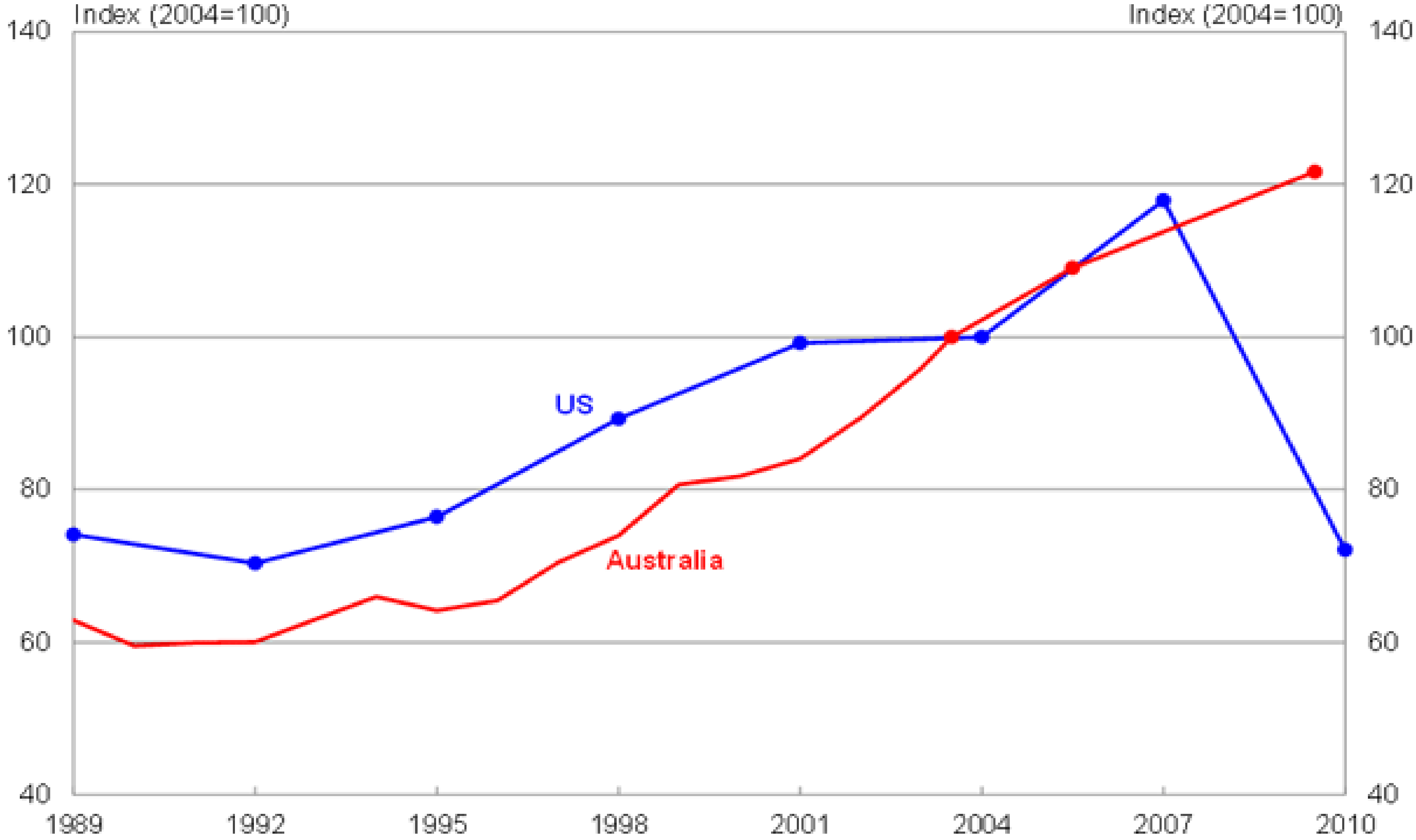
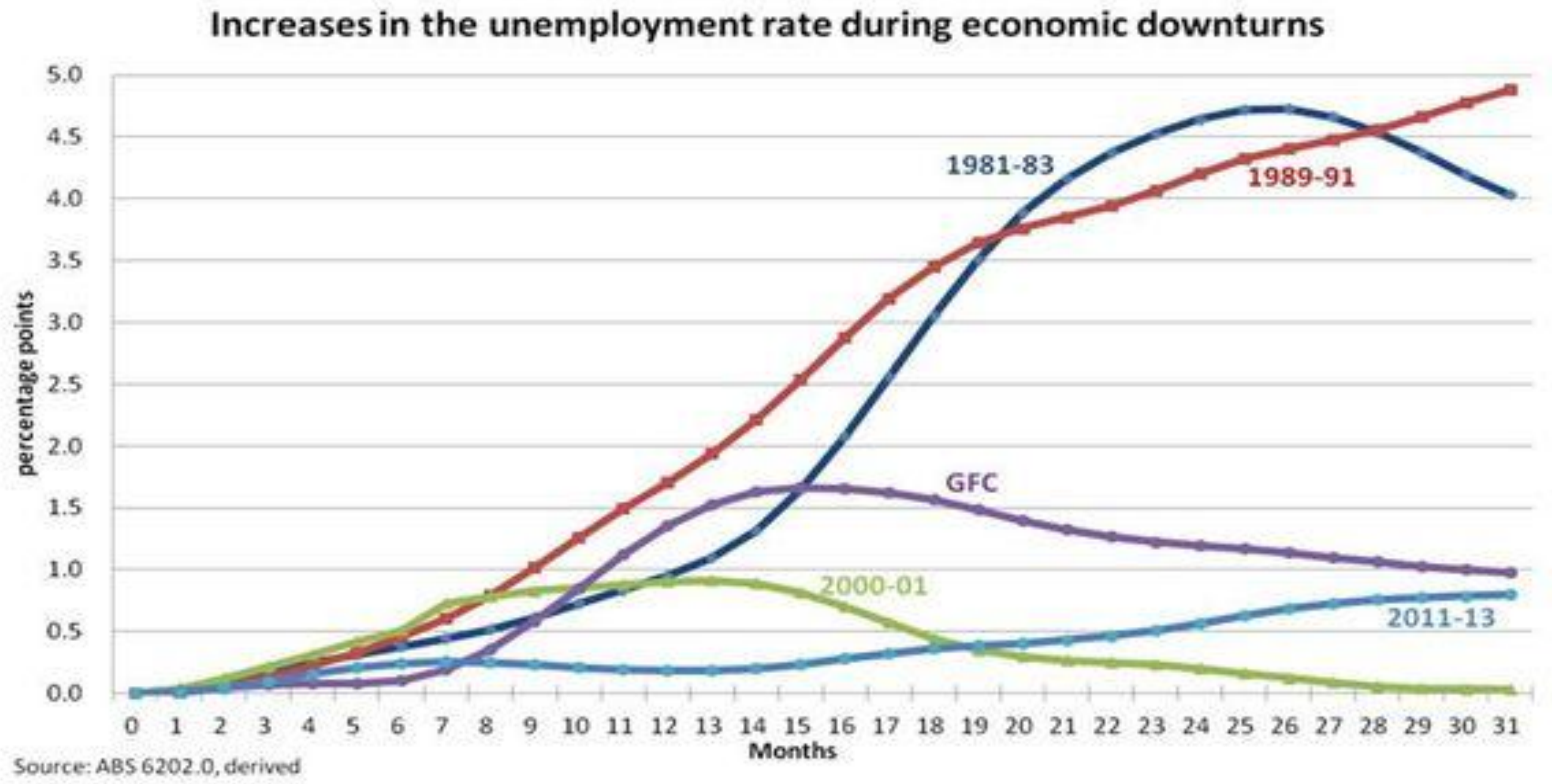
Australia In Perspective

Real median household wealth



Source: RBA :

Some Perspective of Australia's Stellar Economic Performance



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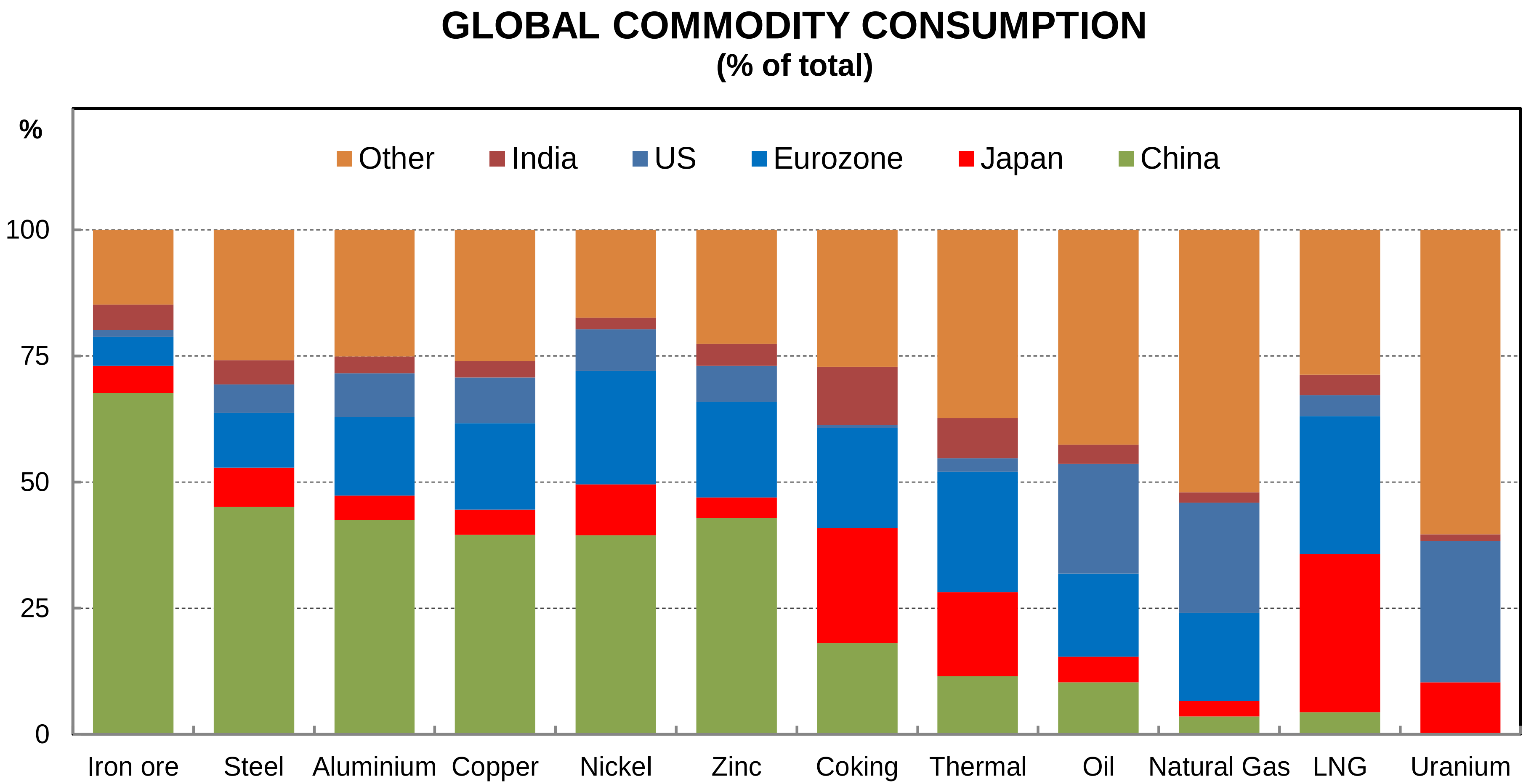
A Fourth Boom?

The 4th boom & commodities – the importance of mid-late cycle commodities

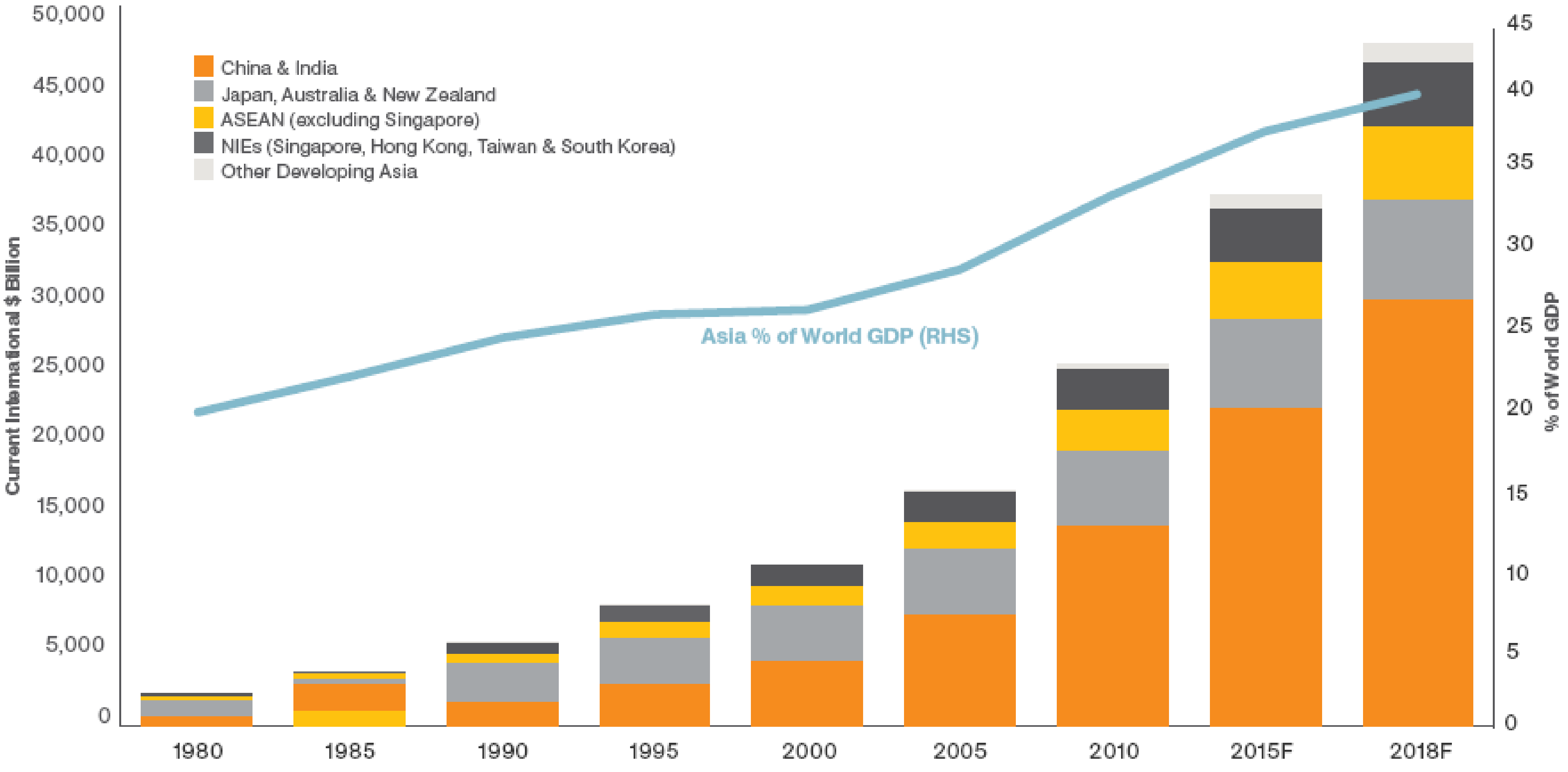


- **China dominates early-mid cycle commodities (iron ore, steel, coal) but consumption mix changes as incomes rise. Advanced economies more important for mid-late cycle commodities (zinc, nickel, copper, LNG). Australian LNG well placed as Chinese incomes rise.**

Australia at the epicentre of current and future global growth

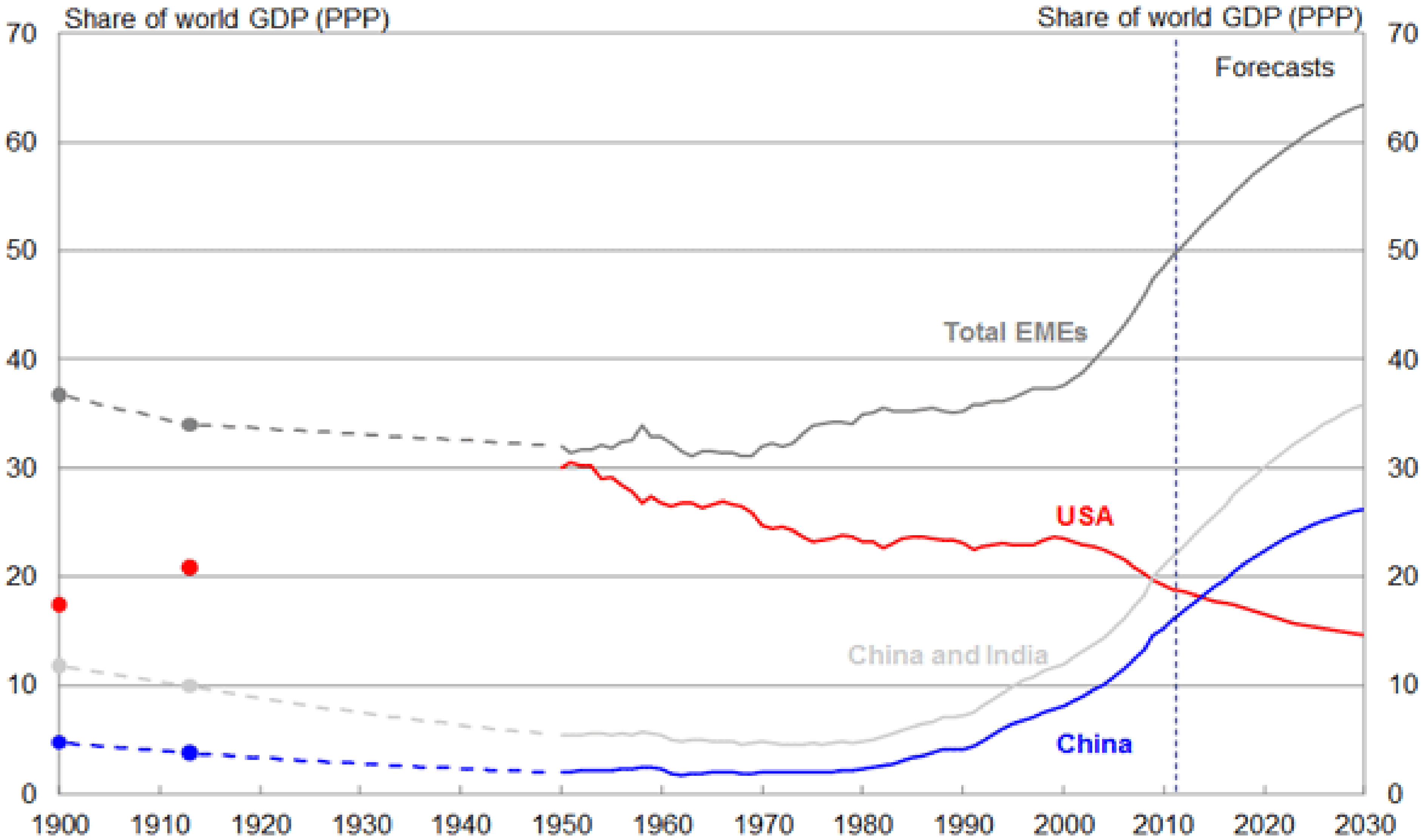
Asian Economic Growth

GDP based on Purchasing Power Parity Valuation (Current International Dollar Billion)[1]



It’s a Brand New Day!

Global Reweighting Underway

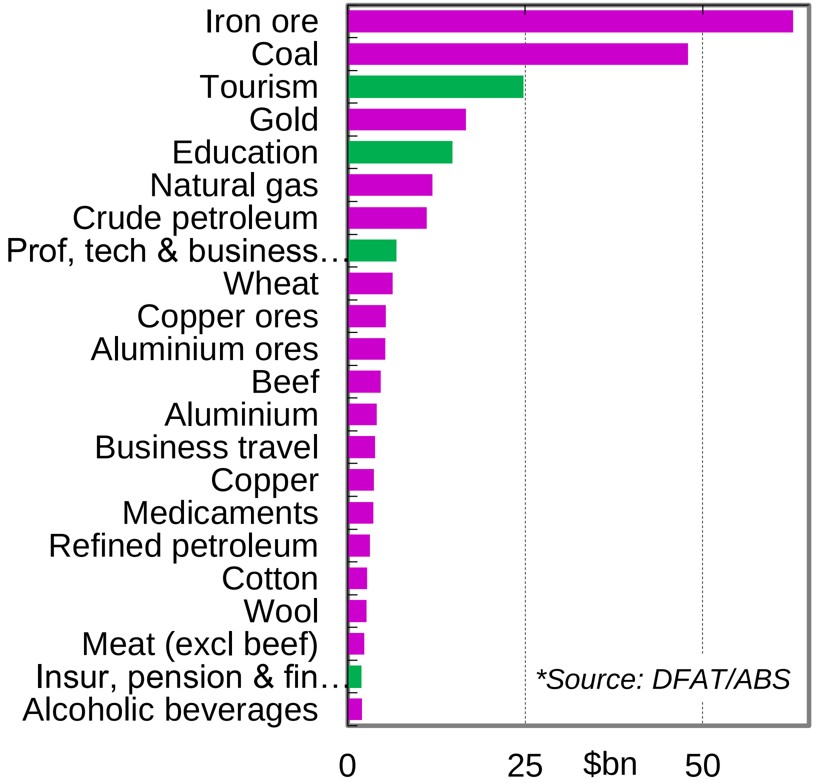


Source: The Conference Board Total Economy Database, Maddison (2010), IMF World Economic Outlook Database and Treasury.

Australia in the Box Seat as Asian Growth Explodes!

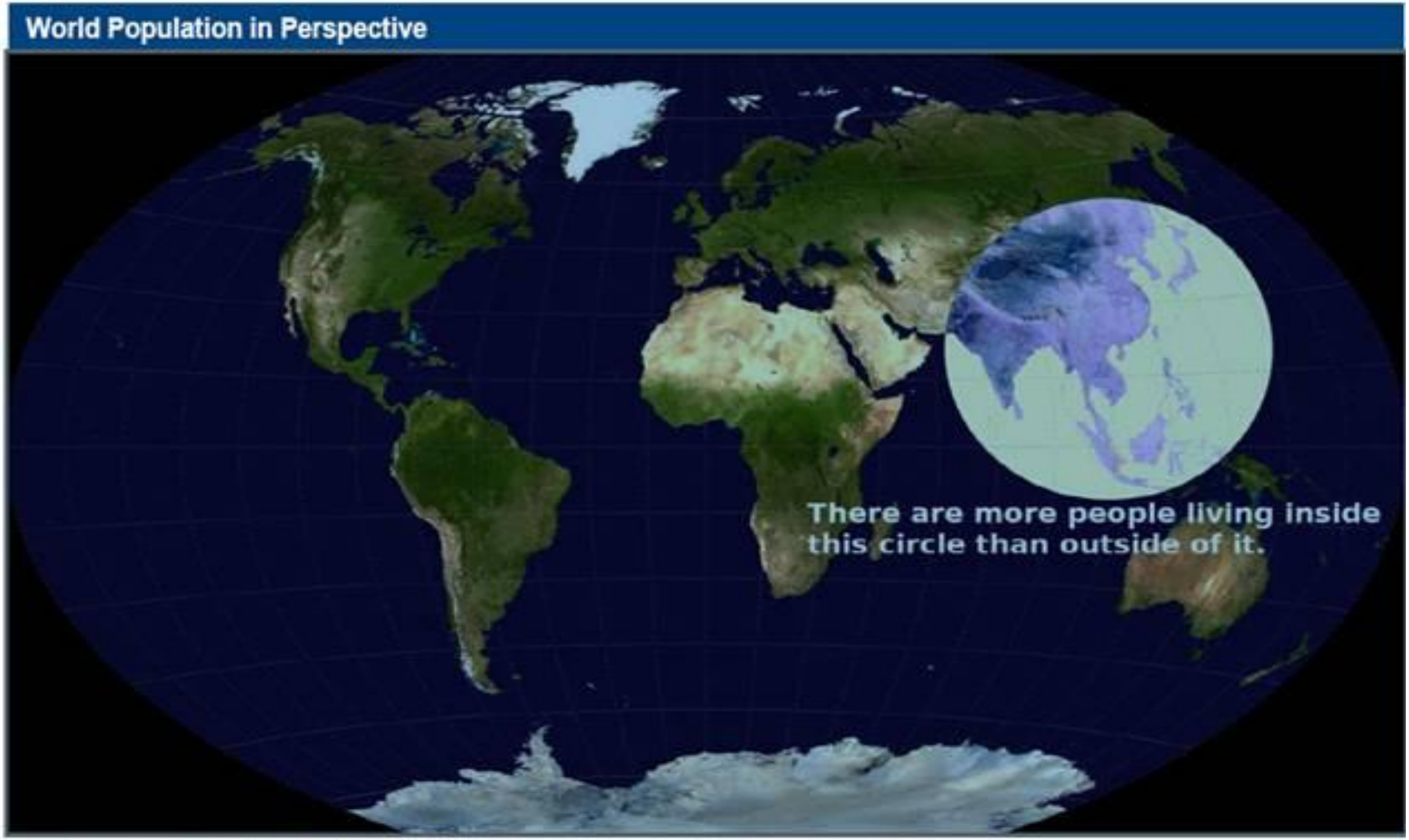
Australia is already more than just a quarry and a farm

AUSTRALIAN TRADE
(top export categories, 2011/12)



- **The middle income group in the Asia-Pacific region is expected to treble to 1½bn by 2020.**
- **Middle income populations want:**
  - larger and better quality housing;
  - more and better quality food;
  - more consumer durables;
  - more financial & health services;
  - more education services;
  - more holidays.

Australia definitely living in the right neighbourhood.



From *Emerging Consumer Survey 2013* by Richard Kersley

The real issues facing *Australia today*

- The *emergence of Asia* as the global centre of economic gravity
    - *Australia's strong economic links to emerging economies.*

- The *structural shift up in AUD* – which has resulted in significant structural change across sectors of Australia's economy.

- *Born again savers* – consumers are now saving 11.5% of income for first time since early 1980s.
- - Bad news for *retailers & domestic tourism* used to consumers spending more than their incomes (as they have in past 20 years or so).
  - Also *State governments* suffering due to sharply lower GST revenues.

- *Labour market structural issues* – skill shortages, productivity issues, population growth and imminent retirement of boomer generation (ie 30%of current workforce).

- Substantial fiscal tightening at Federal & State levels

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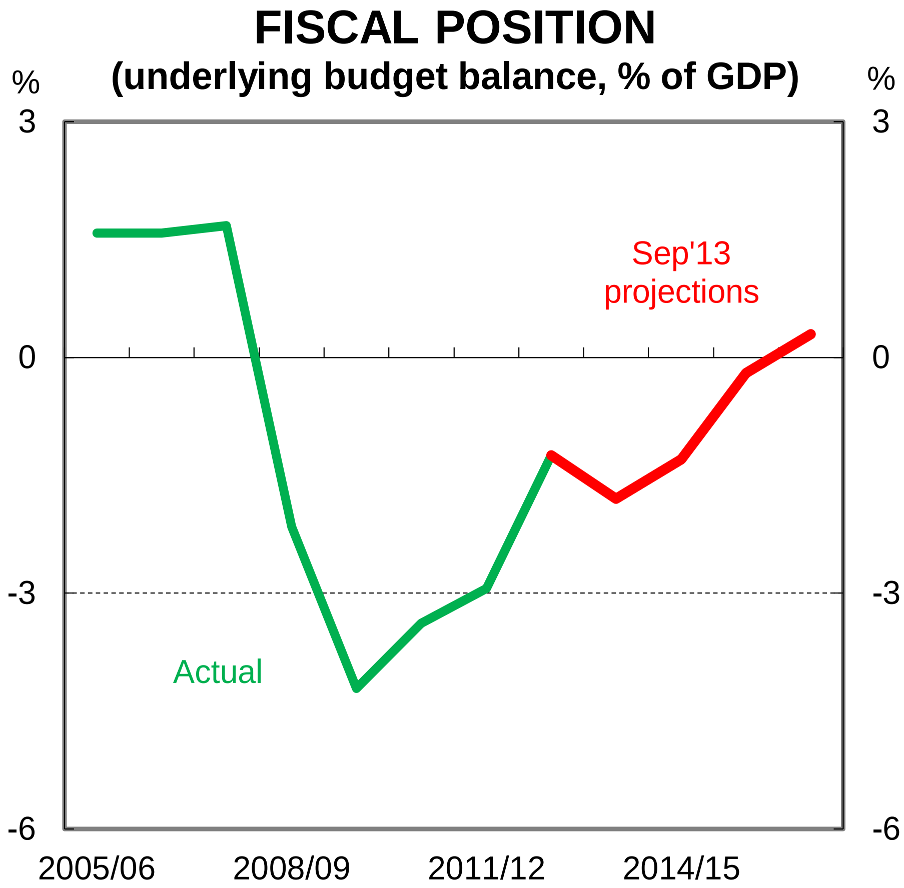
Australia After The Election

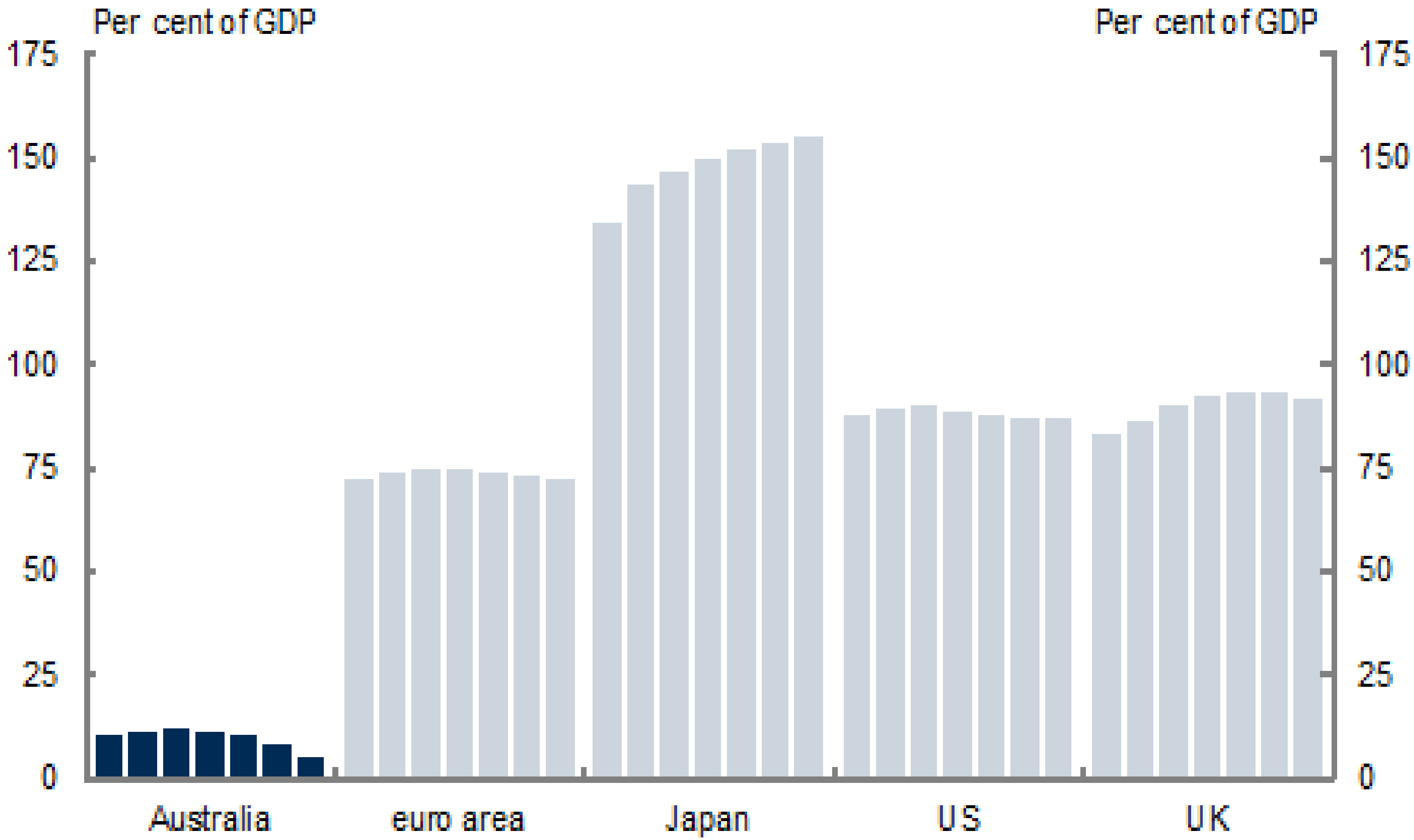
A new broom?



- **The key economic policies won't change:**
  - independent RBA will set interest rates;
  - markets will determine the AUD; and
  - a Budget surplus will remain a medium-term aim.
- **Other "constants" include revenue weakness limiting the scope for new spending and the need to manage the transition from a mining capex boom to other sources of growth .**
- **Coalition costings imply an improvement in the Budget balance of just $6bn over the four years to 2016/17.**
- **Public debt would be some $16bn lower (ie totals $300bn) than otherwise in 2016/17 based on Coalition costings.**

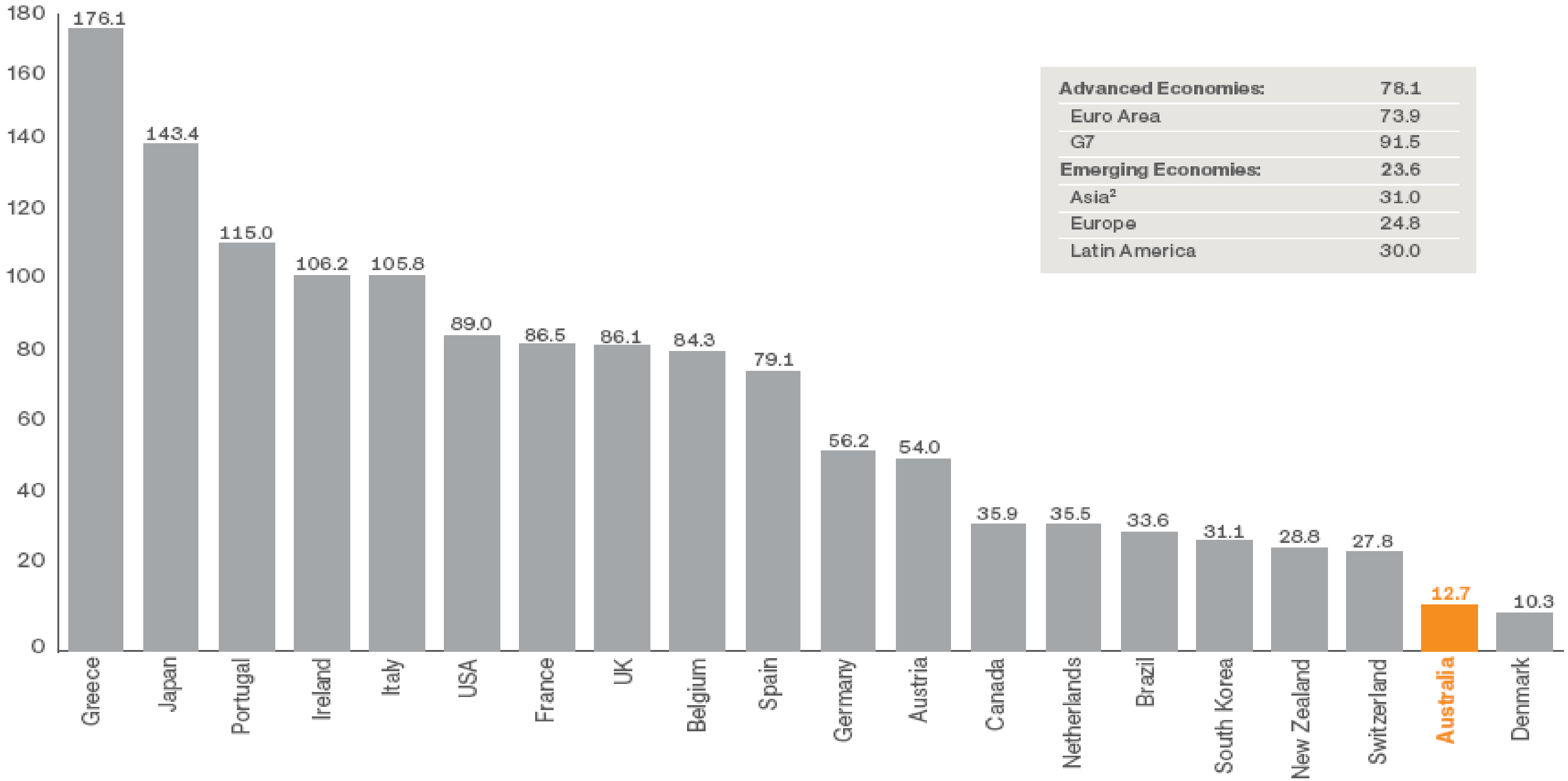
Australia's Sound Fiscal Position

Comparison of Government net debt for selected economies, 2012-2018



Source: Treasury, IMF Fiscal Monitor, April 2013

Economic Background : Australia's Government Net Debt Levels Miniscule



Advanced Economies:	78.1
Euro Area	73.9
G7	91.5
Emerging Economies:	23.6
Asia[2]	31.0
Europe	24.8
Latin America	30.0

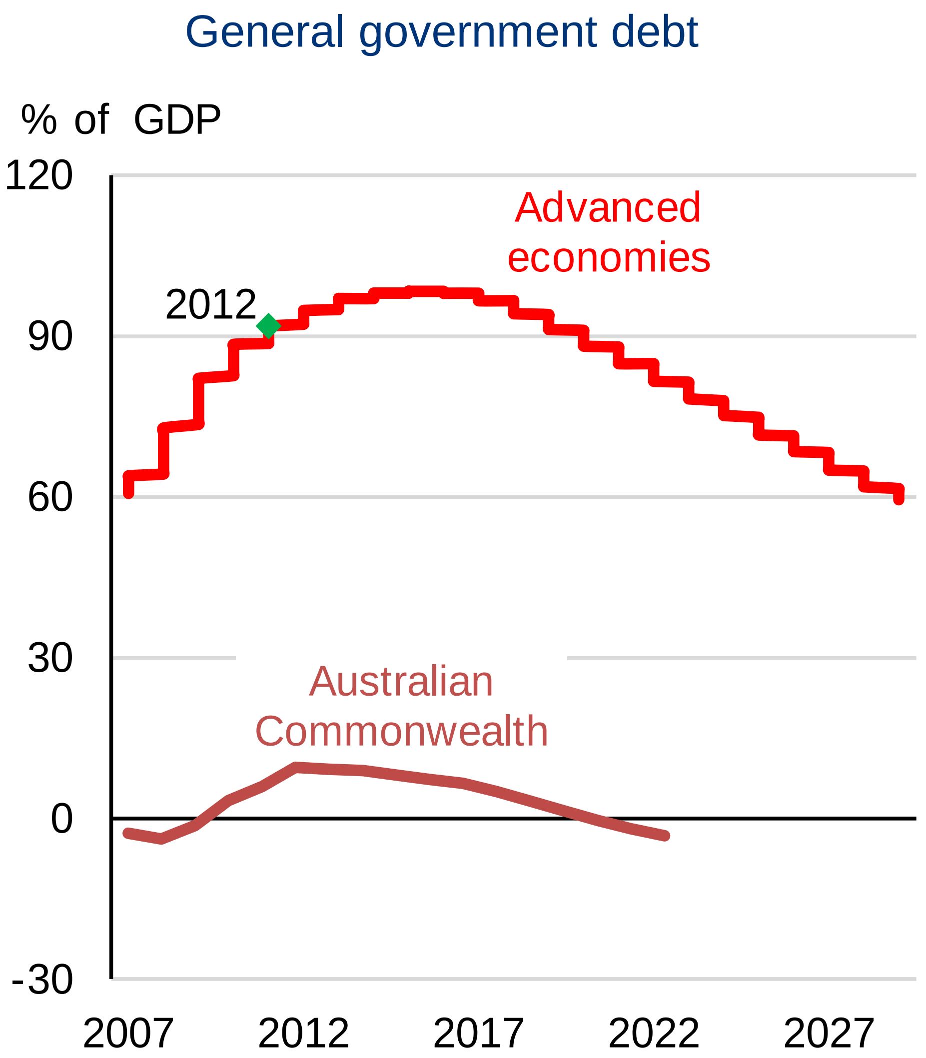
1. International Monetary Fund (IMF) staff estimates and projections. Projections are based on staff assessment of current policies.
2. Gross debt as a percentage of GDP.

Sources: International Monetary Fund (IMF) Fiscal Monitor database, April 2013, Statistical Tables 4 and 8; Austrade

Source: Australian Trade Commission: *Australia Benchmark Report - June 2013*

Australia's Government debt a "mole hill" not a "mountain".

Special

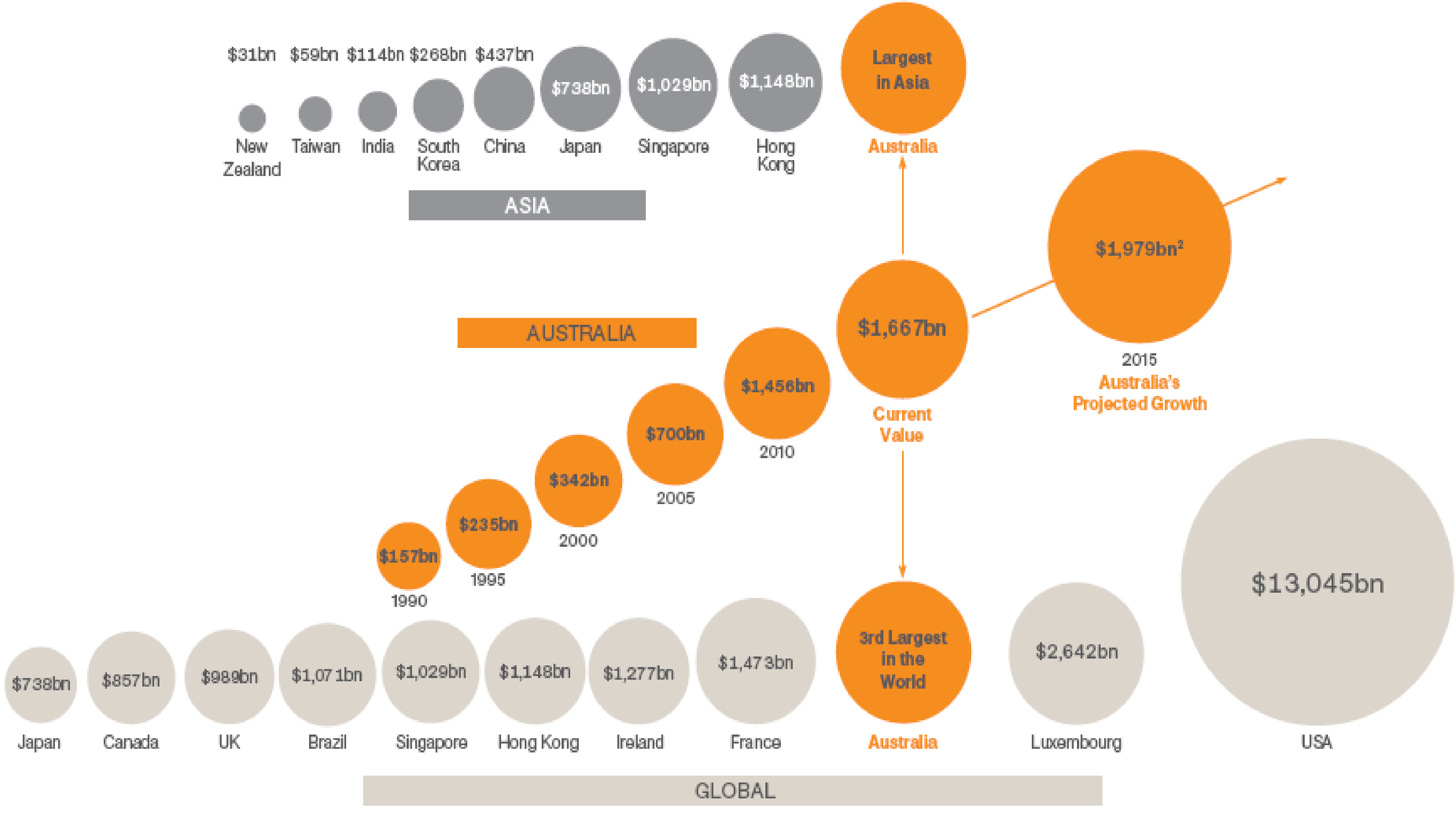


- High debt in advanced economies constrains growth as well as credit quality.

Economic Background : Australia's Superfunds Pool 3rd Largest in World

Global Significance of Australia's Investment Fund Assets Pool

Investment Fund Assets[1], US$, December Quarter 2012

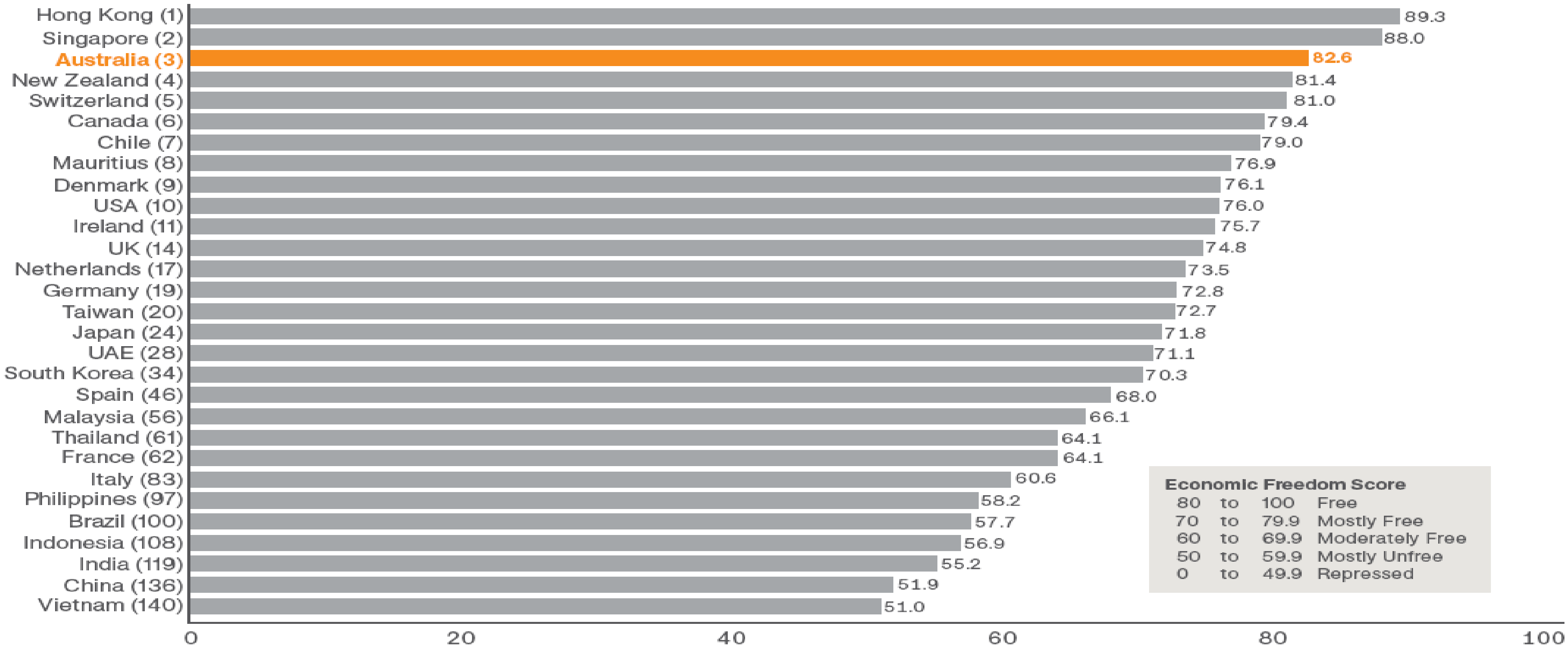


Source: Australian Trade Commission: *Australia Benchmark Report - June 2013*

Australian Economy: Top Notch

Index of Economic Freedom World Ranking[1] – 2013

The higher the score, the better the ranking

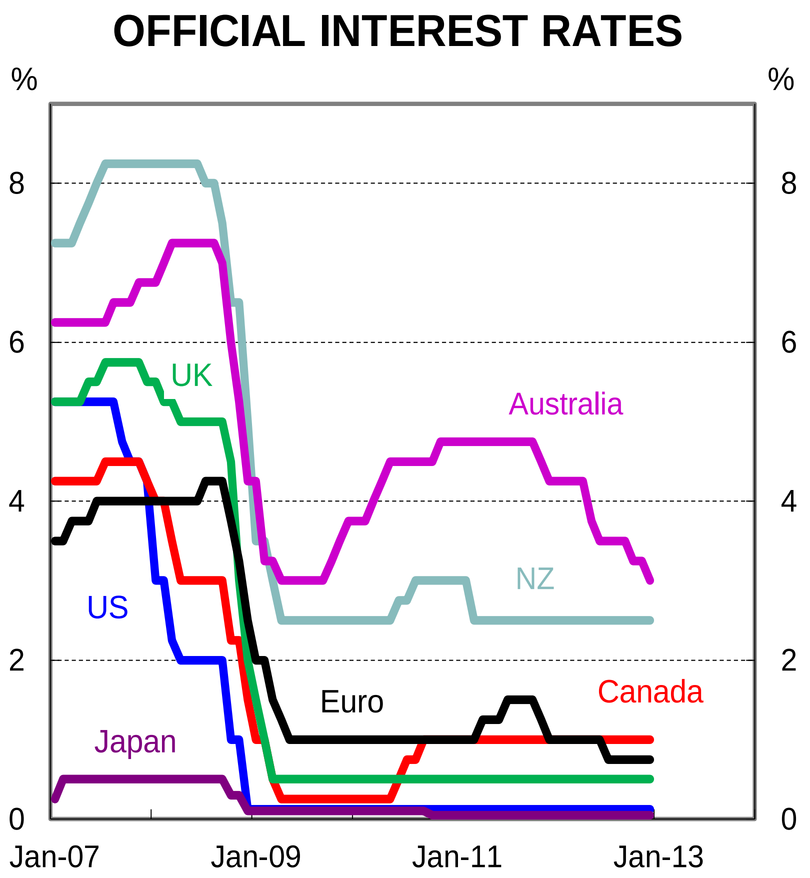


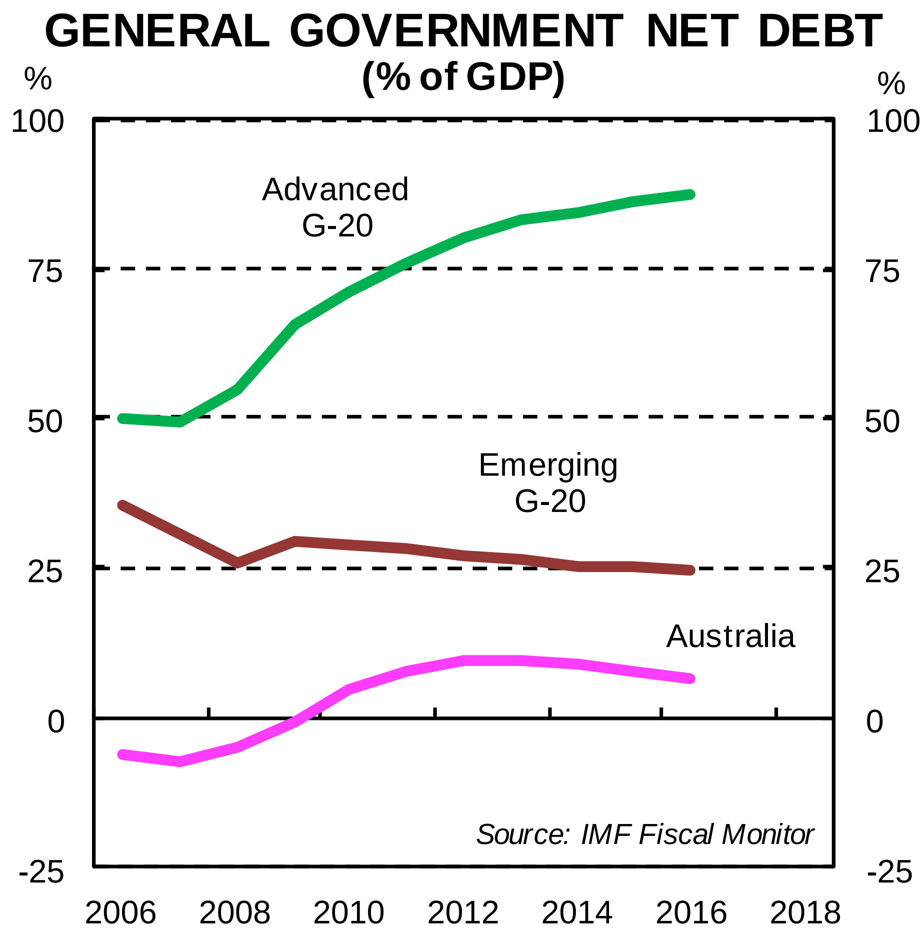
1. The *2013 Index of Economic Freedom* covers 185 economies and measures 10 separate components of economic freedom (Business Freedom, Trade Freedom, Fiscal Freedom, Government Spending, Monetary Freedom, Investment Freedom, Financial Freedom, Property Rights, Freedom from Corruption and Labour Freedom). The 10 component scores are equally weighted and averaged to get an overall economic freedom score for each economy. The number in brackets in the chart indicates the country's world ranking.

Sources: The Wall Street Journal and The Heritage Foundation, 2013 Index of Economic Freedom; Austrade

Plenty of shots left in monetary and fiscal policy lockers!!

Policy ability – but appetite and effectiveness to vary?





- Monetary and fiscal policy have plenty of room to move.
- But appetite and effectiveness likely to vary between monetary and fiscal policy.

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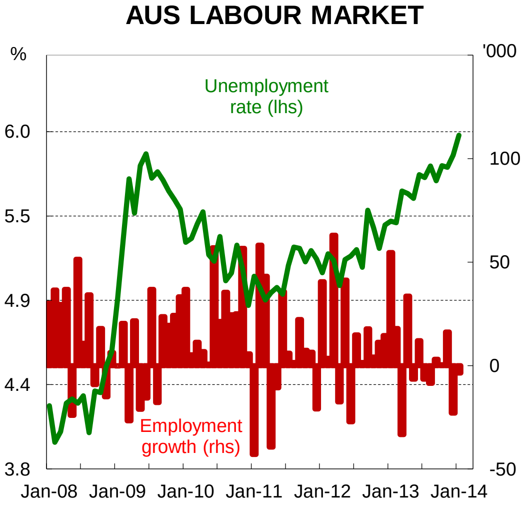
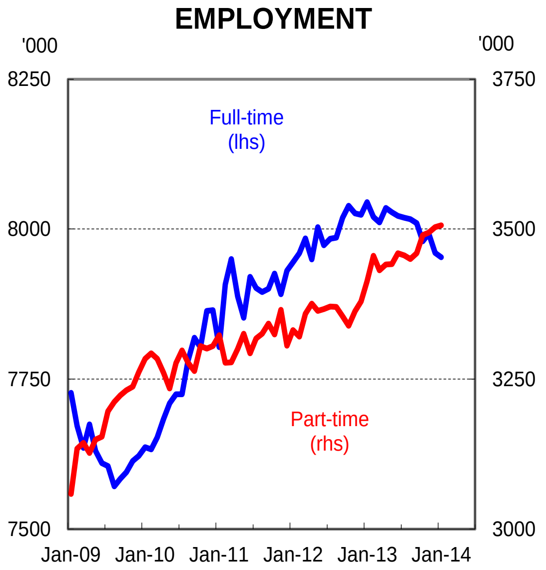
Labour Market: Slows But Resilience Underestimated

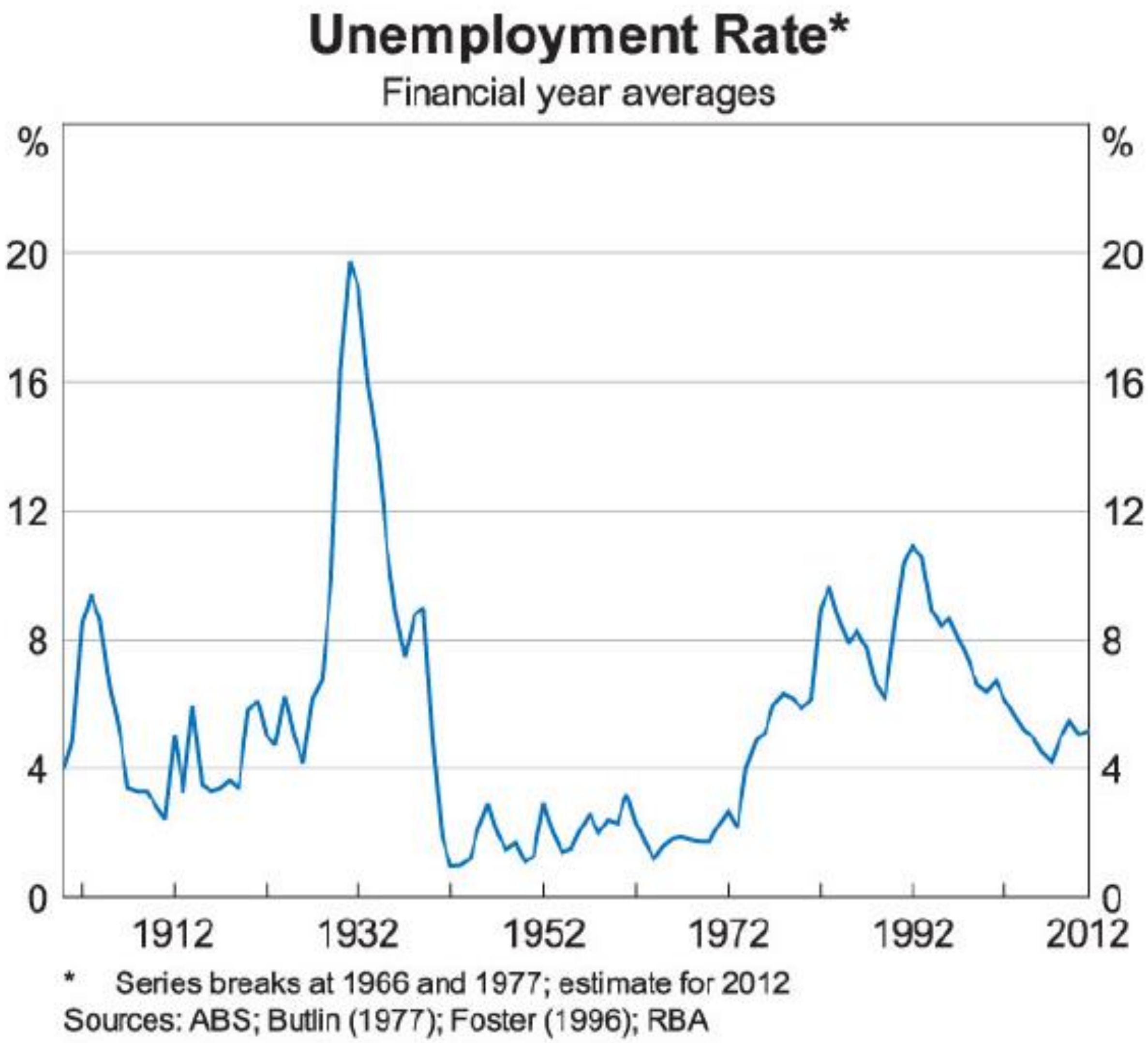
Jobs growth softened in HII 2013





- **In January, employment shrank by 3.7k - (full -time -7.1k: part-time +3.4k.**
- **Unemployment was 6.0% in January (cyclical peak). Despite the lack of jobs growth, the unemployment rate has held around 5¾-6.0% over the past six months.**
- **Over the year to Jan 2014, there were no net jobs created. Very tepid growth. But falling participation rate keeping cap on unemployment rate.**
- **Unemployment rate has been in tight 4.9-6.0% range since mid 2011 (ie past 2½ years).**
- **Low by global standards: US 6.6%; UK 7.0%; Euroland 12.2%; Germany 6.9%; Ireland 15%; Spain & Greece 27%.**
- **Commercial construction, retail & manufacturing weak.**
- **Mining, gov't & other services rising.**

Economic Background



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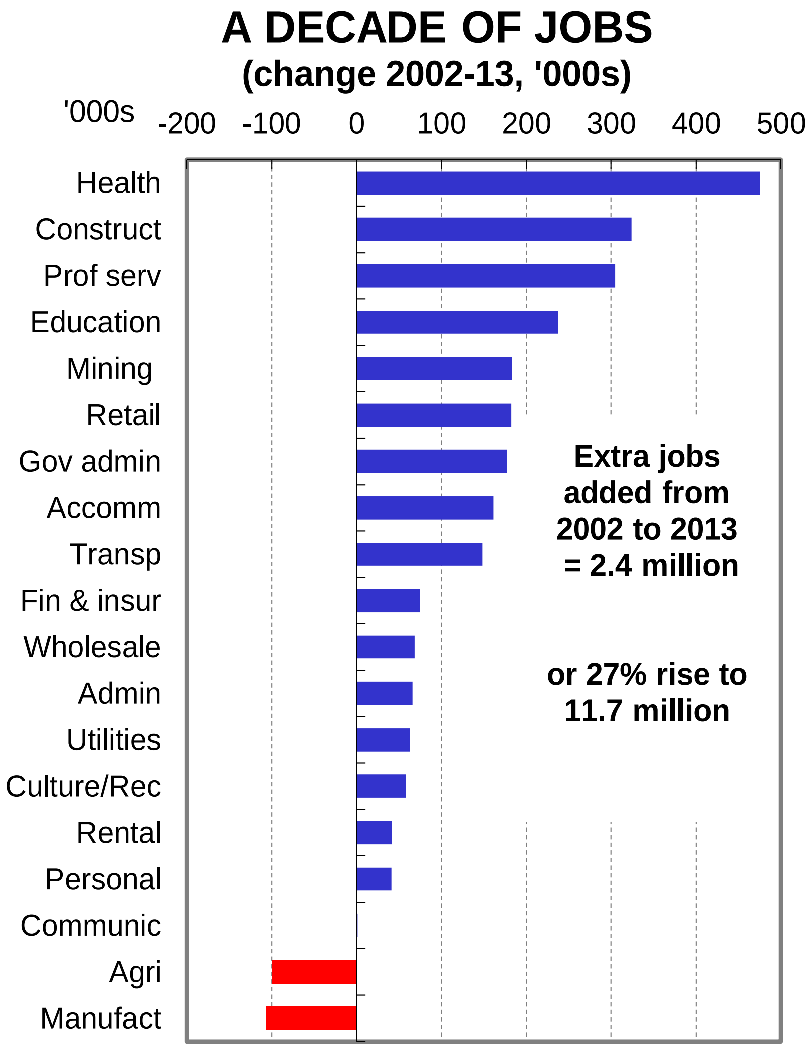
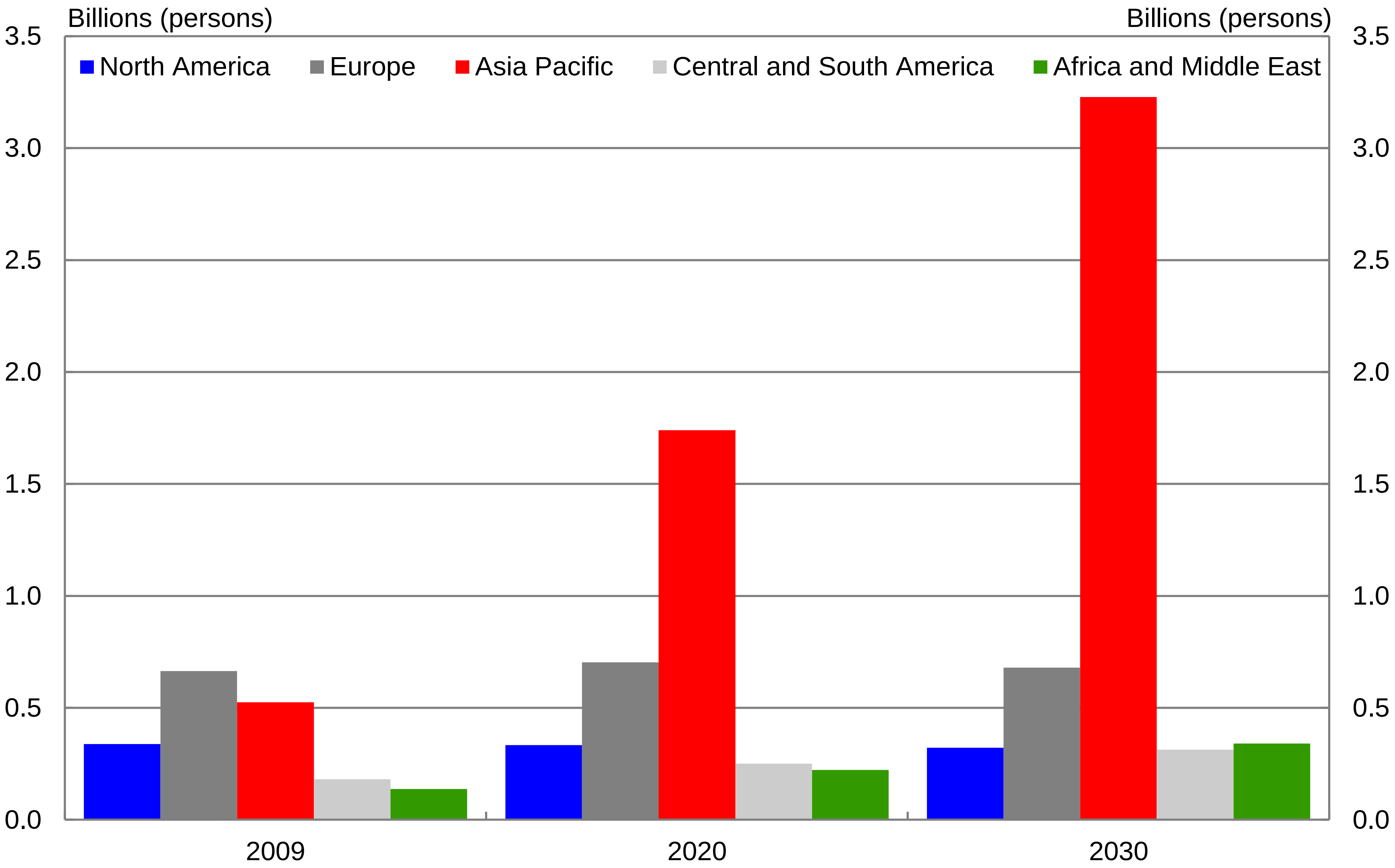
Jobs *Growth By Sector* : 11 years August 2013

Services sector jobs growth dominant over past decade



Asia Pacific Growth Outlook

Projection of the global middle class by region, persons



Asia Pacific Growth Outlook

Areas of Great Potential for Australia in coming years and decades

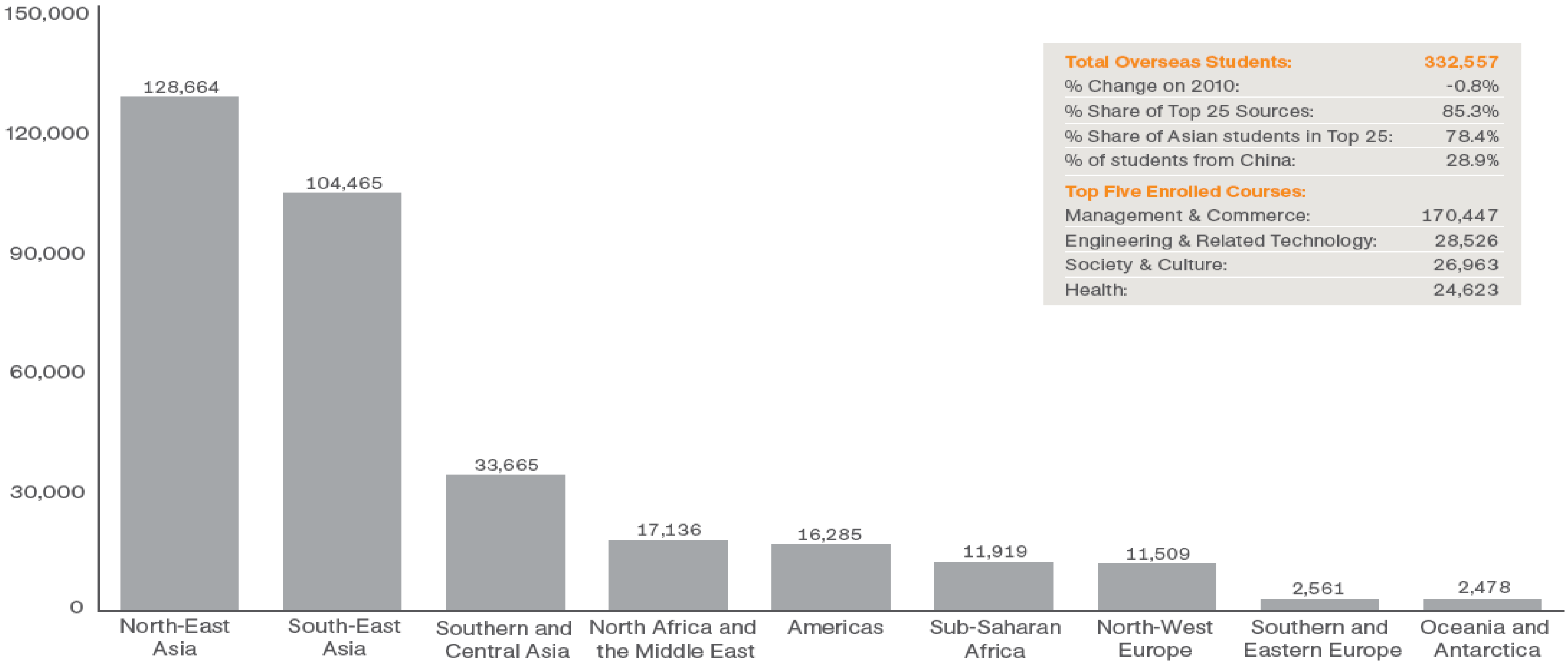
- **Mining will remain robust as Asia continues to develop/industrialise/urbanise**
- **New waves of strong growth/prosperity in the following areas:**
  - *Agribusiness;*
  - *Gas;*
  - *Tourism;*
  - *International Education;*
  - *Wealth Management*
  - *Health Services;*
  - *Transport Services*

Asia Pacific Growth Outlook

Education and Tourism - Big winners from rapidly expanding Asian middle class!

All Overseas Students by Region Grouping

Enrolled in Australian Higher Education Courses – Onshore and Offshore, Full Year 2011

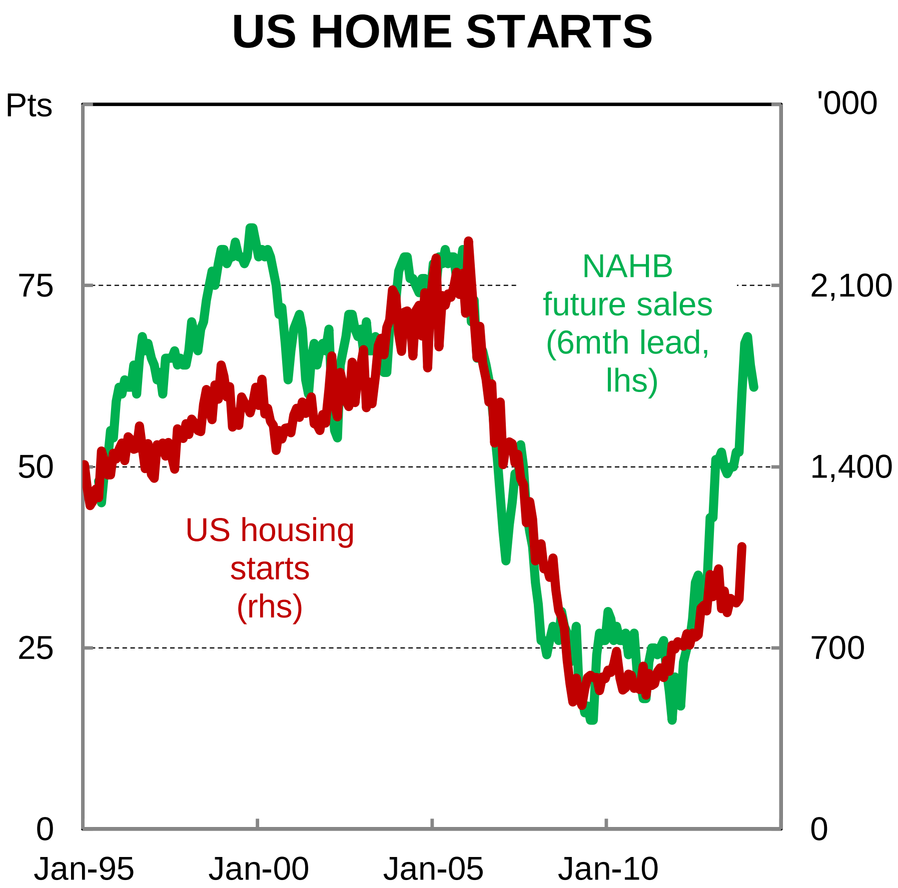


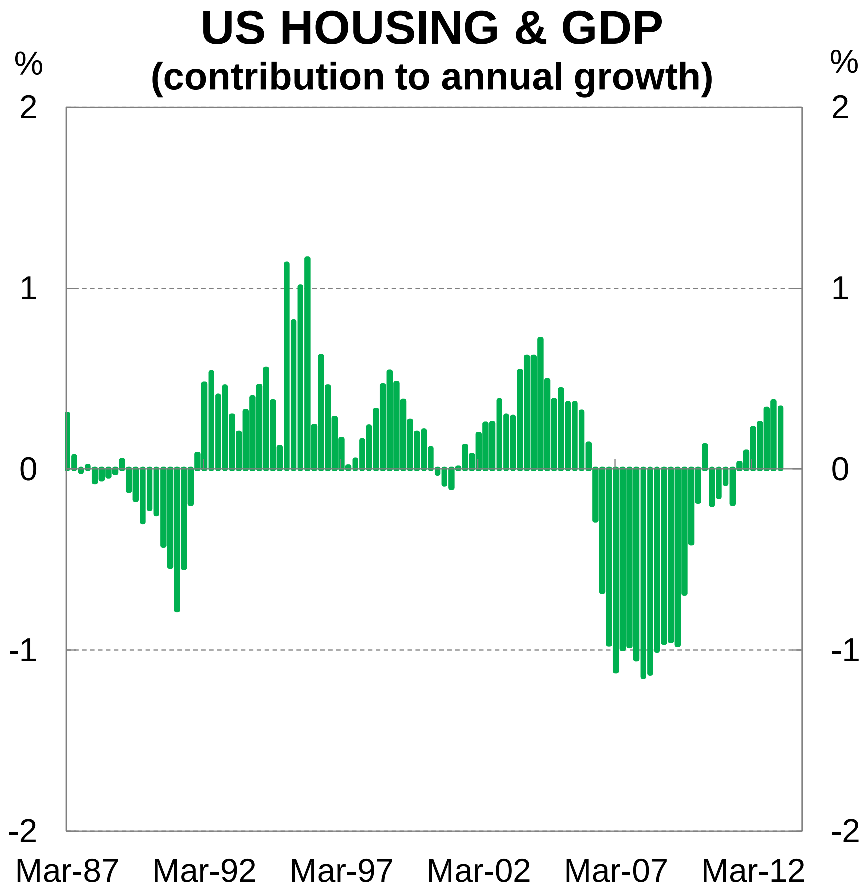
Total Overseas Students:	**332,557**
% Change on 2010:	-0.8%
% Share of Top 25 Sources:	85.3%
% Share of Asian students in Top 25:	78.4%
% of students from China:	28.9%
Top Five Enrolled Courses:	
Management & Commerce:	170,447
Engineering & Related Technology:	28,526
Society & Culture:	26,963
Health:	24,623

Sources: Department of Industry, Innovation, Climate Change, Science, Research and Tertiary Education, Selected Higher Education Statistics, Table 7.4; Austrade

The US Economy is picking up after GFC near death experience

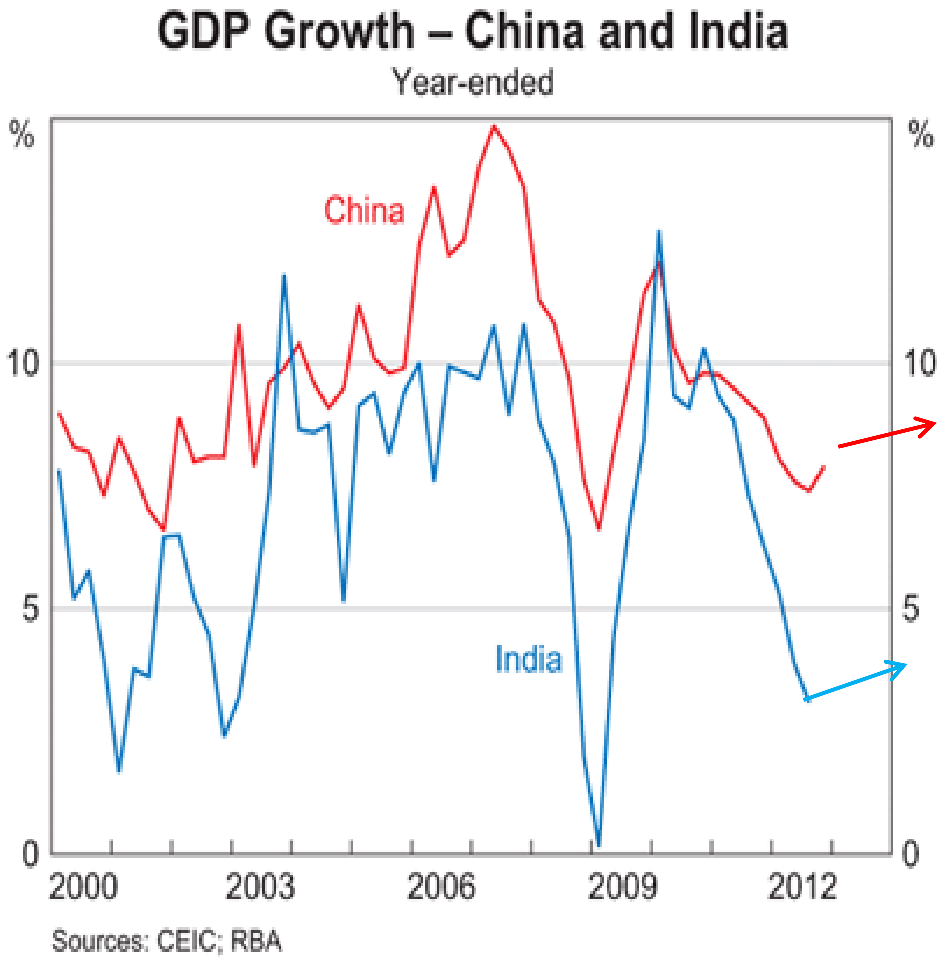
US housing adding to growth

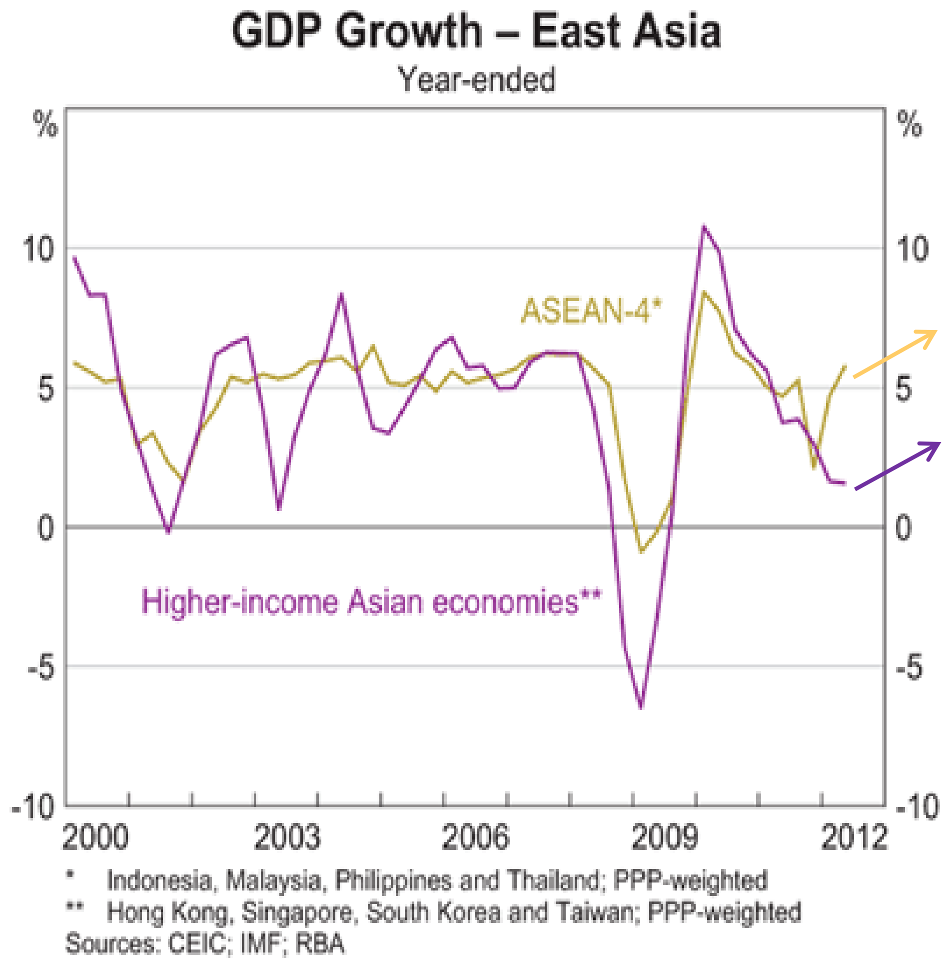




- **Leading indicators of US housing activity have turned up – prices are rising.**
- **Housing activity now adding to growth rather than dragging on it.**

Asian Economy picks up momentum?

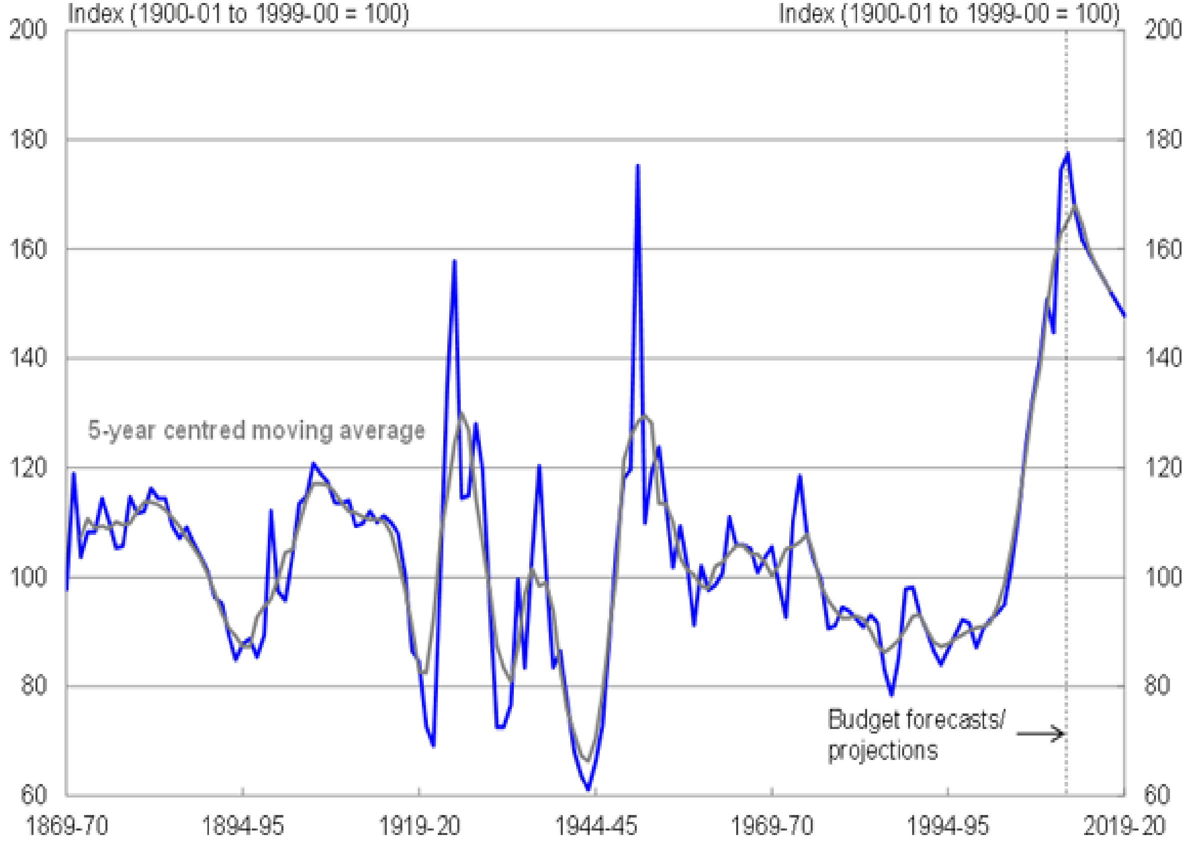


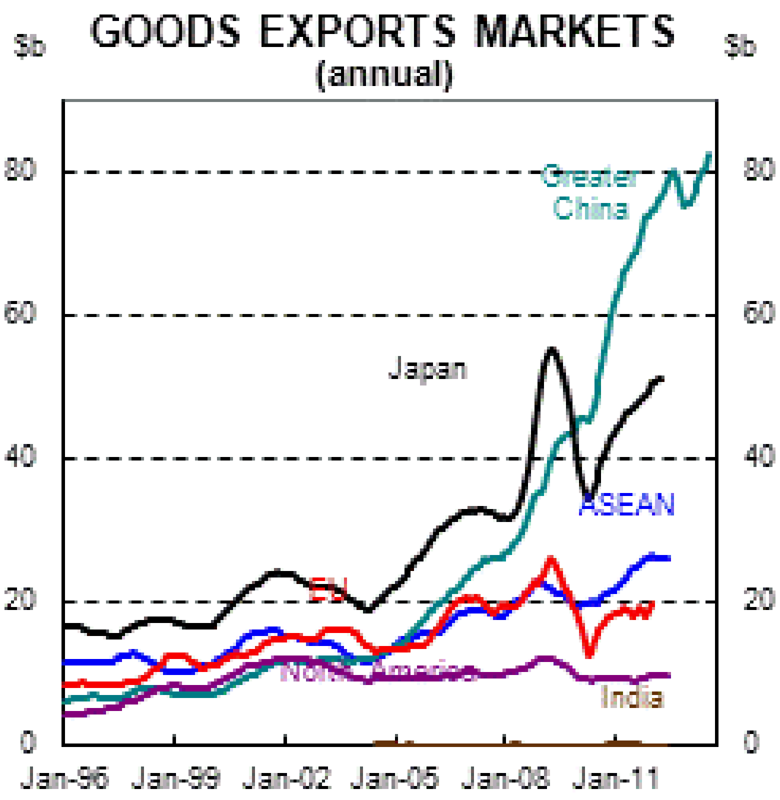


- **Asia has slowed – but outcomes vary across the region.**

It's a Brand New Day!

Sustained higher terms of trade
(Price exports/price imports)





Source: ABS Catalogue Number 5206.0, RBA and Treasury

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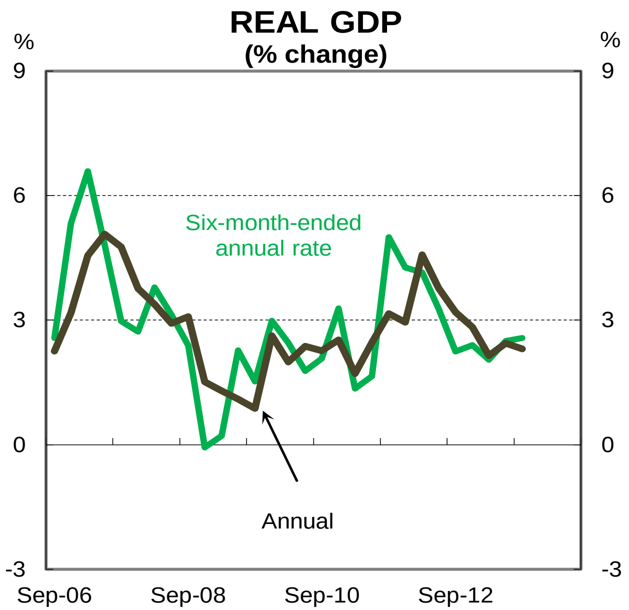
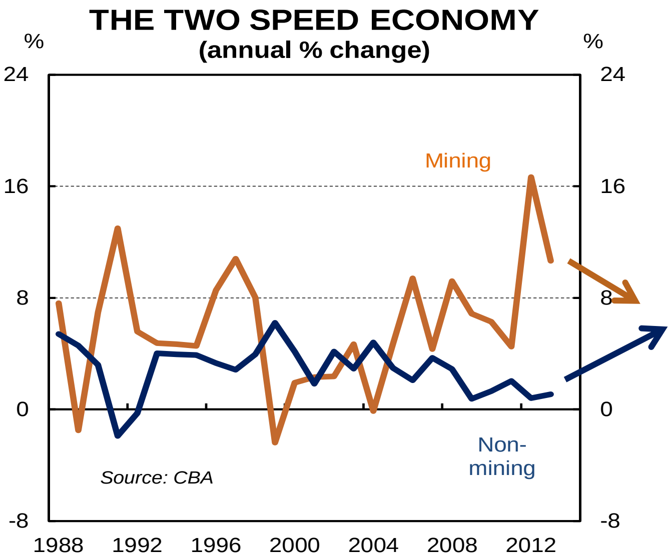
Australian Economy: GDP to grow by near 3% in 2014 &2015





STRONGEST GROWTH OUTLOOK

- LNG projects, construction & exports. Iron ore exports.
- Mining operation, related equipment & services.
- Infrastructure – roads, rail, water, power, utilities.
- related construction, engineering & services.
- Outbound tourism & internet buying, ***imported*** car sales.
- Cafes, restaurants, education & health services.

MODERATE TO LOW GROWTH OUTLOOK

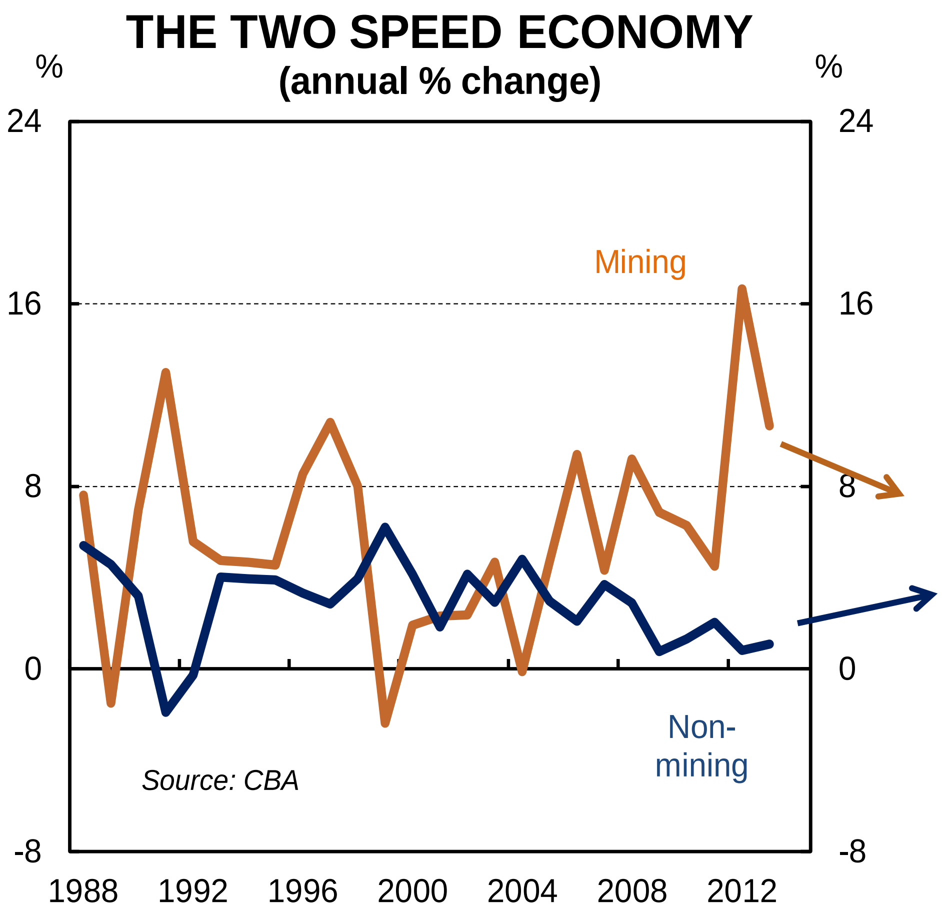
- Staples – groceries, food, hardware, communications
- Defence.
- Commercial construction, rentals (?) & fit-outs
- Discretionary retail – clothing/shoes, cosmetics, a/visual.
- Manufacturing – mining, metals & wood related.
- Housing construction, alts & adds.
- Domestic & Inbound tourism. Some tertiary education.

SECTORS WITH DOWNSIDE RISK

- Coal & iron ore mining –construction & exploration.
- Retail exposed to internet-based alternatives.
- Manufacturing – local car industry, textiles & food groups.

What Needs to Go Right? The Growth Transition Needs To Succeed

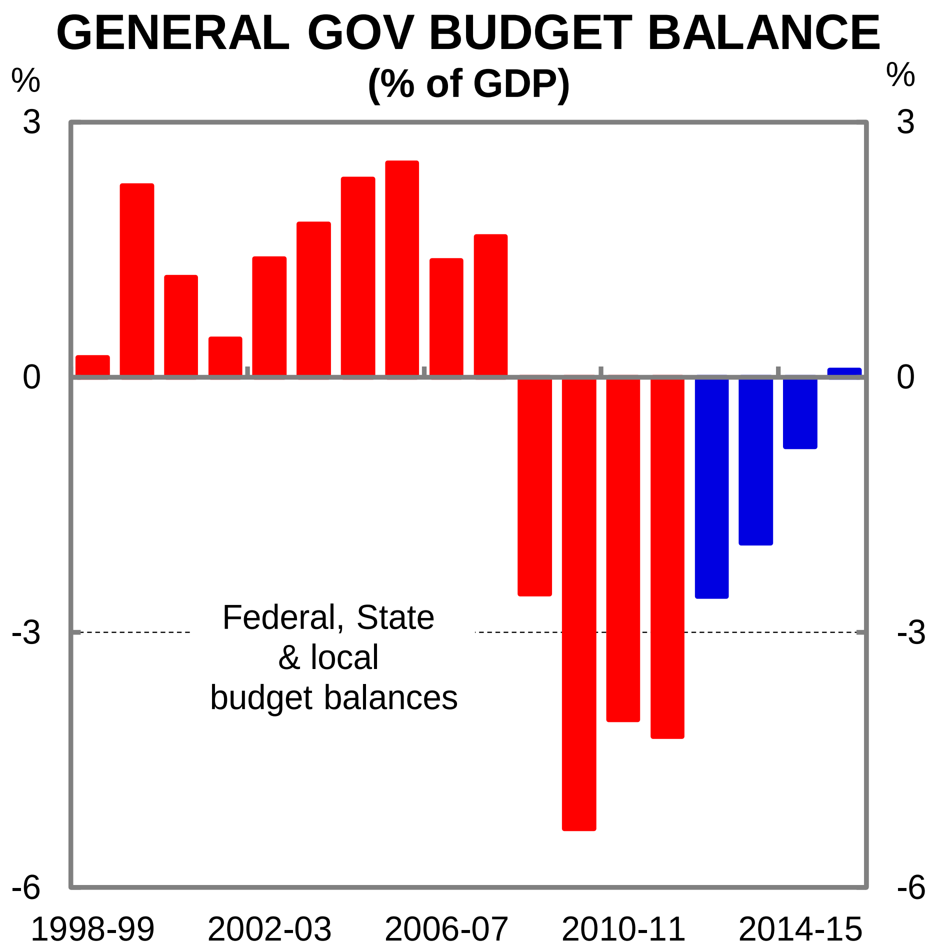
Finding new sources of growth



- Resource construction activity is slowing.
- The non-mining economy will have to make a larger contribution.
- Household spending (inc residential construction) and non-mining business capex potential domestic drivers
- Other opportunities lie with the older middle income Asian consumer in agriculture, education, tourism, manufacturing, health and financial services.
- Some of these transitions are underway.

What Needs To Go Right? The Australian Fiscal Cliff Needs to be Negotiated

An Australian fiscal cliff?



- **A significant fiscal tightening is underway at the Commonwealth and State & local level.**
- **But very sensibly, the Commonwealth surplus commitment has been abandoned for the next couple of years.**
- **The swing in the underlying budget position, a proxy for the policy stance, is equivalent to 0.6% of GDP in 2013/14.**
- **This marks a significant easing in the pace of fiscal consolidation from the 1.6% of GDP reduction in 2012/13.**

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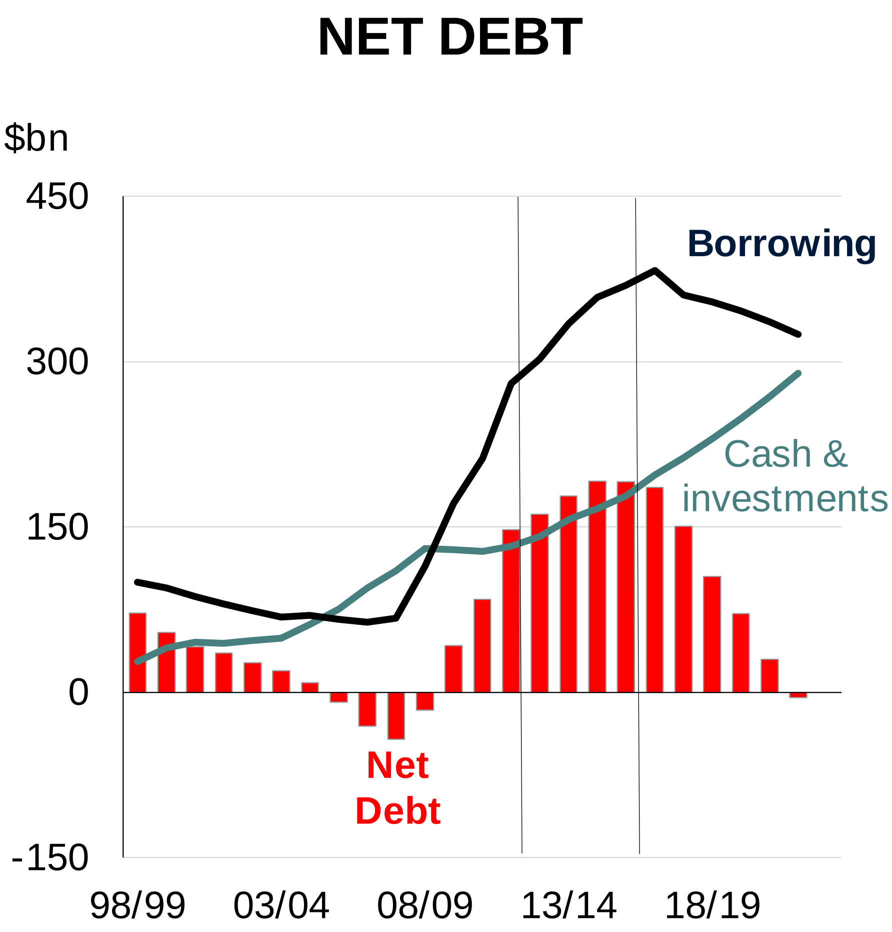
Federal Budget & Debt

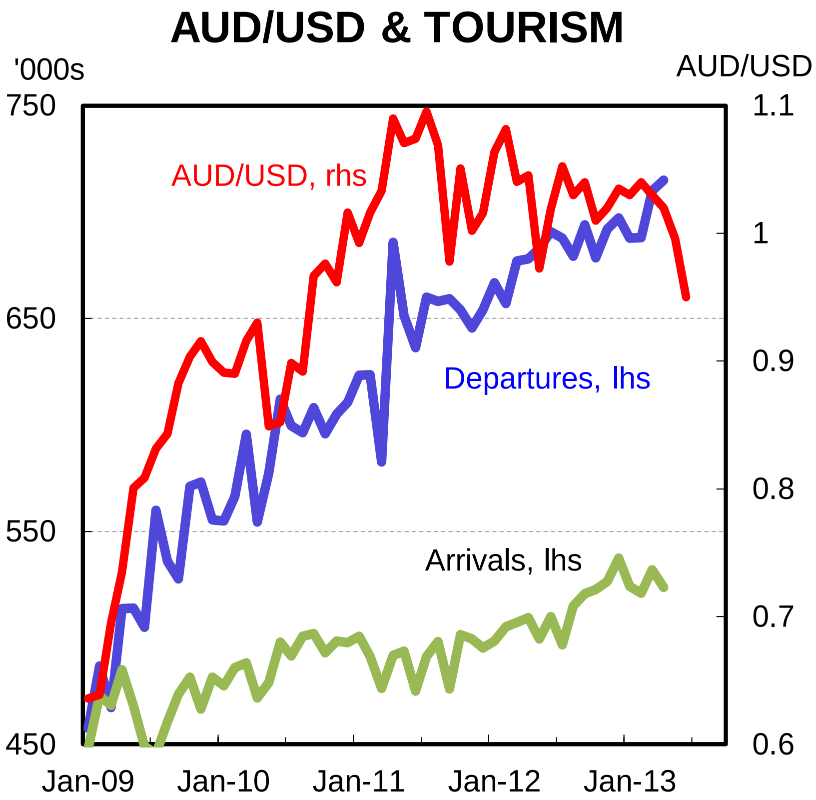
Asset growth

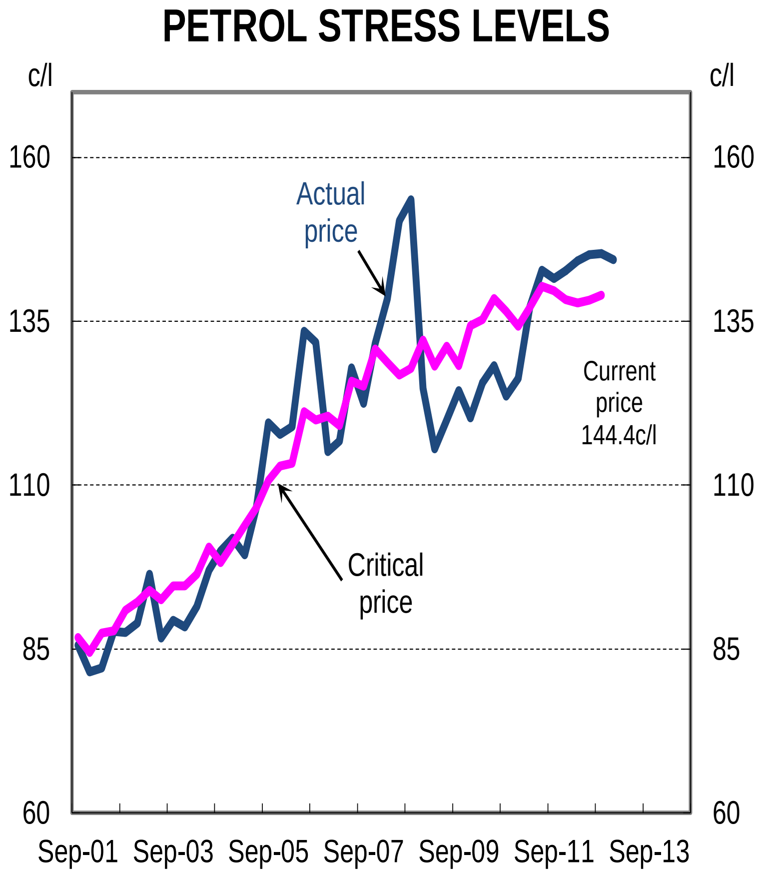


- Net debt peaks in 2015/16, when the surpluses start.
- Total borrowing grows a little faster reflecting the impact of the growth in cash and investments.
- The long-term projections imply negative net debt from 2021/22.
- But the Govt. also plans to maintain bonds on issue at 12-14% of GDP:
  - That level is not in danger of being breached until around 2020.
  - Total borrowing is forecast to fall from 2016/17 until 2020, but would need to rise thereafter to meet the required proportion of GDP.

Consumer Caution – Leakages?

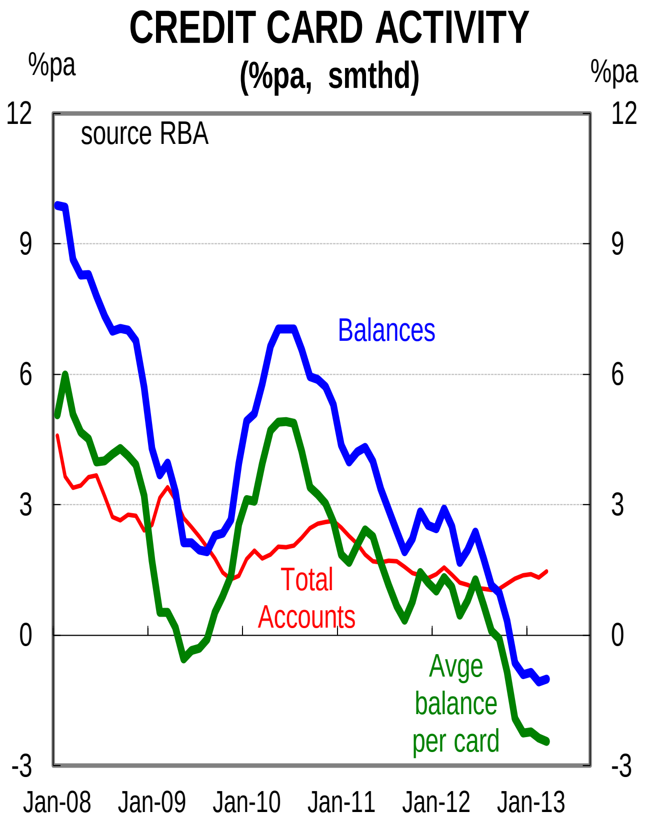
More travel.

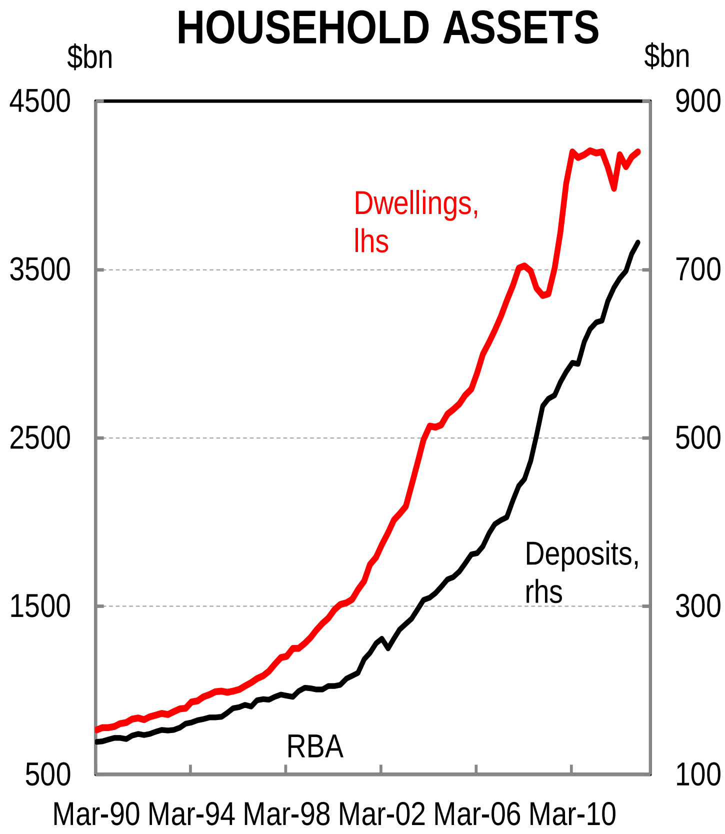


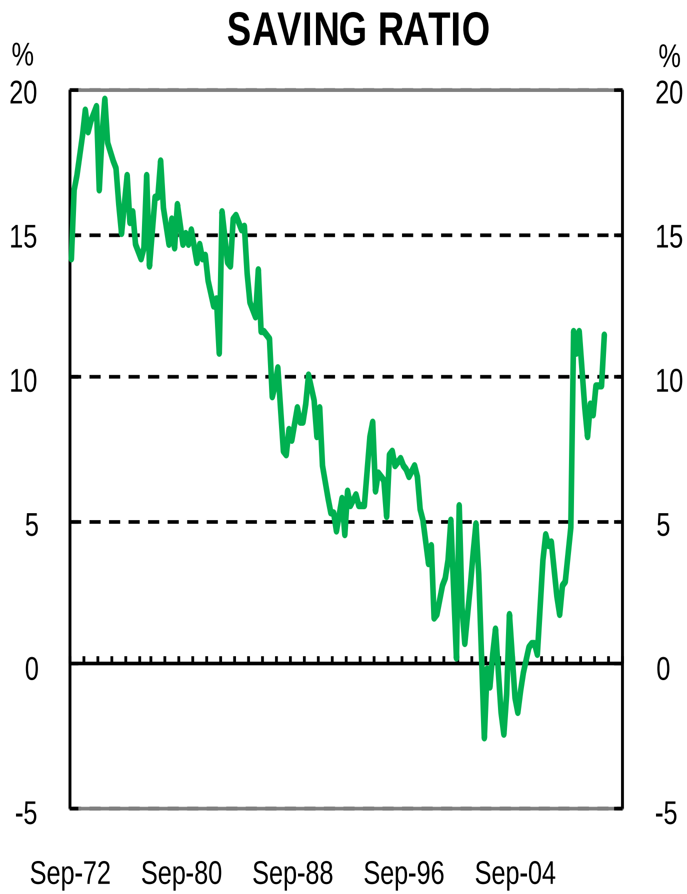


- **Overseas departures were 736k in November (8.8 million annualised), up 8.0%pa - nearly 40% above arrivals of 541k (up 4.3%pa).**
- **Higher power bills are reducing scope for discretionary spending.**
- **Petrol prices becoming a restraint on spending, especially when AUD hits 0.85.**

Consumer Caution – Deposits To $710bn, Up 8% pa.



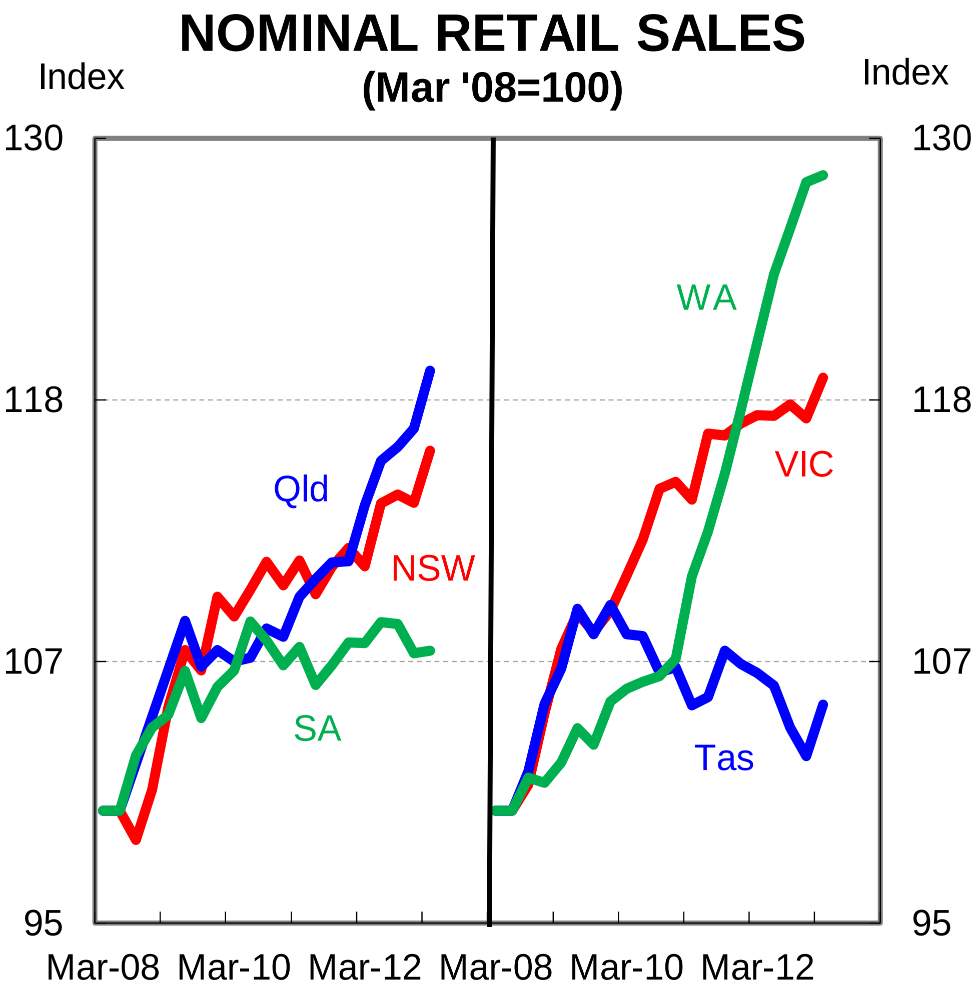




- Consumers using credit cards less…..but using phones, debit cards more.
- Higher cash deposits shows precautionary savings rising.
- Saving ratio at 10%, highest since 1980s.

Retail Trade

Growth in the big non-mining states is picking up



- **Retail trade in the mining states outperformed the rest of Australia over 2012. But, the increase in retail sales growth over 2013 has been concentrated in the big non-mining States (NSW and VIC). This suggests that lower interest rates are boosting economic activity and that consumers do respond to price and other economic signals.**
- ***Growth in QLD retail trade remains strong while WA growth has flattened*.**
- **We see a pick up in retail trade growth in the big non-mining states over 2013.**
- **The outlook for retail sales growth in the small non-mining states (SA and TAS) is poor given the weak labour markets in these states.**
- **Consumers are spending, but they are selective in where that spending is occurring. Retail spending is running at the lower end of the range.**

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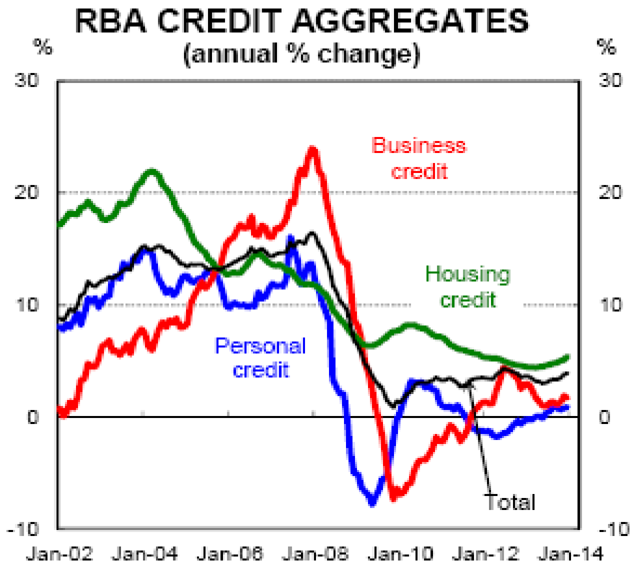
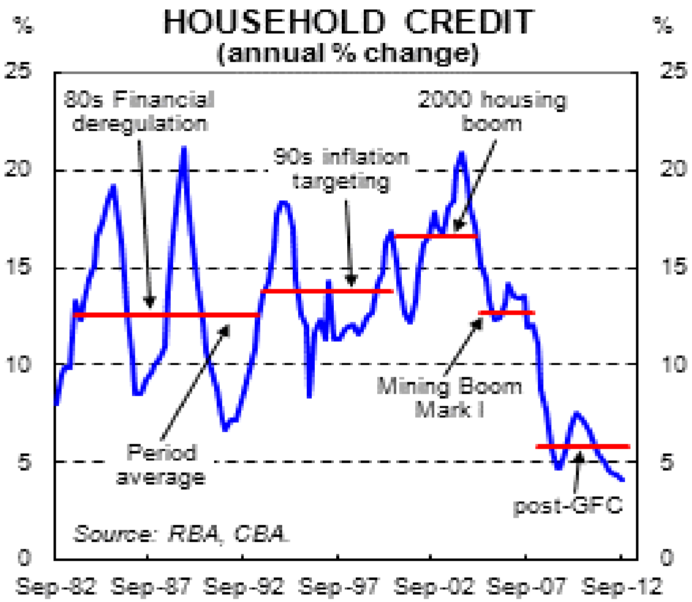
National Credit Growth Weak – Post GFC

Cautious consumers remain in bunker in terms of borrowing & spending





- **Private sector credit grew by 0.5% in December, to be up a tepid 3.9% pa.**
- **Housing credit lifted by 0.6% to be up 5.4%pa. Housing credit growth rate currently at lowest levels since series began in 1977.**
- **Business credit rose by 0.4%, with annual growth a still lacklustre 1.7%;**
- **Other personal lending rose by 0.2%, to be up a paltry 0.9% on a year ago.**

- Confirms "born again saver" & "fiscal prudence" mentality of consumers/business still reigns.

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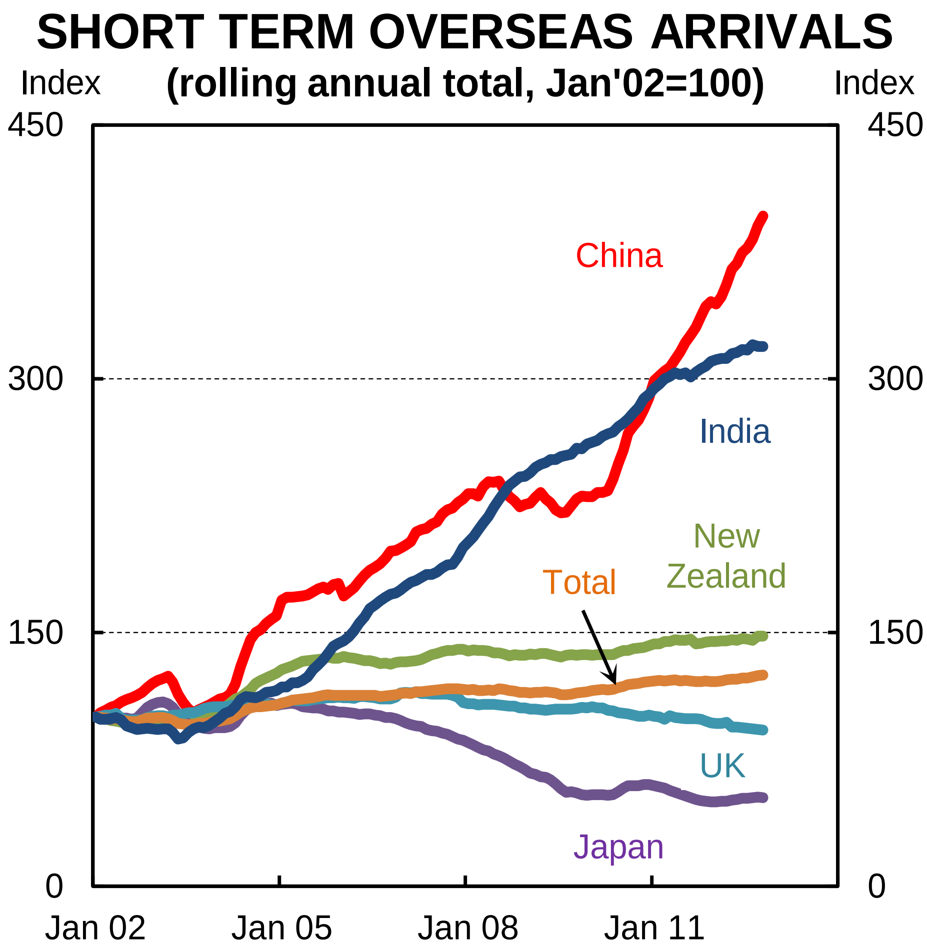
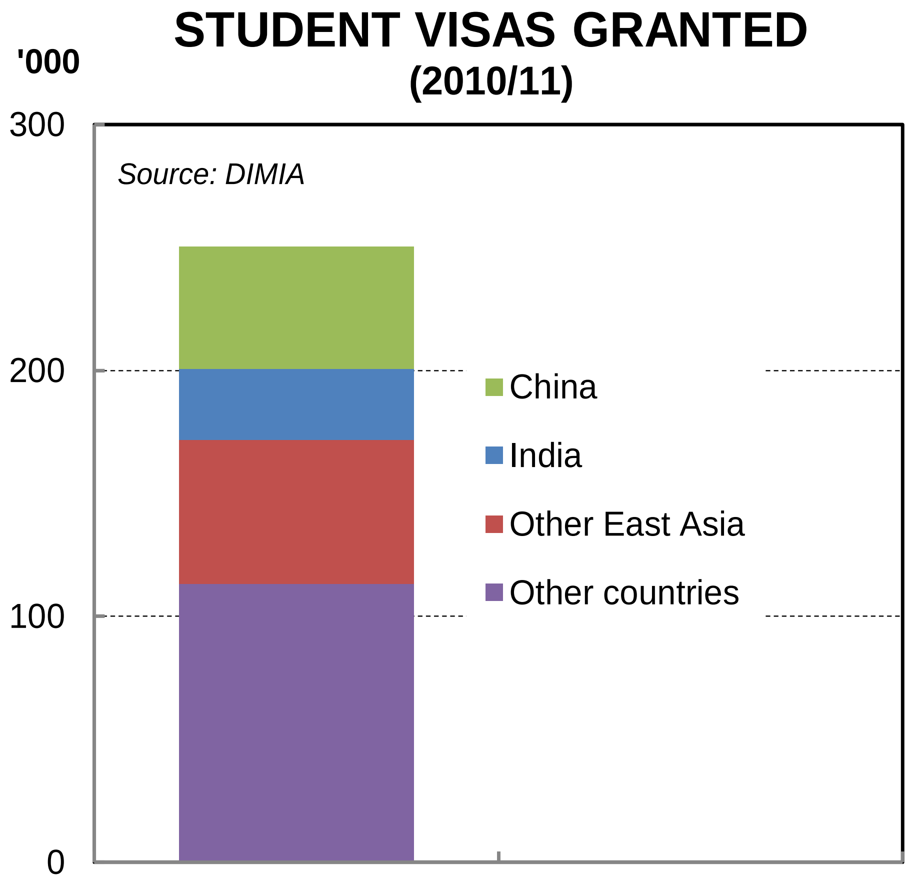
Asia Pacific Growth Outlook

Education and Tourism - Big winners from rapidly expanding Asian middle class!





The Growth Transition Needs To Succeed

Relativities still matter

RANKING OF COUNTRIES FOR MINING INVESTMENT BY KEY DECISION CRITERIA: 2012 (highest ranking for each category is 10 so maximum score is 70) Source: Behre Dolbear Mining Survey									
RANK	COUNTRY	ECONOMIC SYSTEM	POLITICAL SYSTEM	SOCIAL ISSUES	PERMITTING DELAYS	CORRUPTION	CURRENCY STABILITY	TAX REGIME	TOTAL POINTS
1	Australia	9	8	8	8	10	9	5	57
2	Canada	9	9	4	4	10	9	7	52
3	Chile	9	9	7	6	8	8	4	51
4	Brazil	7	8	5	5	5	9	6	45
5	Mexico	7	7	3	7	6	6	7	43
6	USA	8	8	3	2	9	7	4	41
7	Colombia	6	7	6	6	5	5	4	39
8	Botswana	6	5	5	5	5	5	6	37
9	Peru	6	6	4	4	5	6	5	36
↕									
25	Russia	1	1	3	3	1	2	5	16

- **Global investment decisions depend on a range of factors.**
- **New government set to remove the mining tax, which has been seen as a disincentive for Australian projects.**

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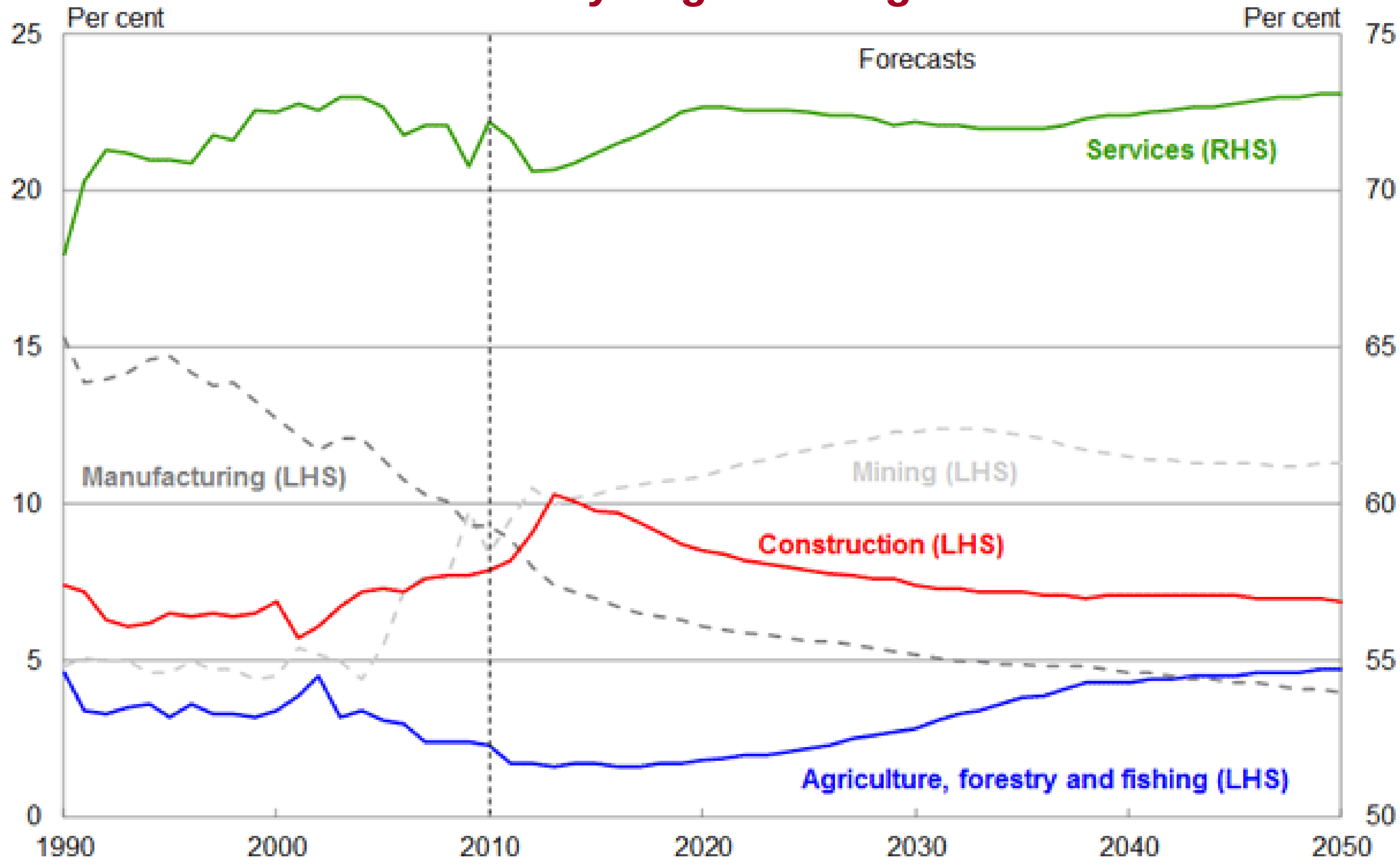
Significant Structural Change Under Way "Down Under"

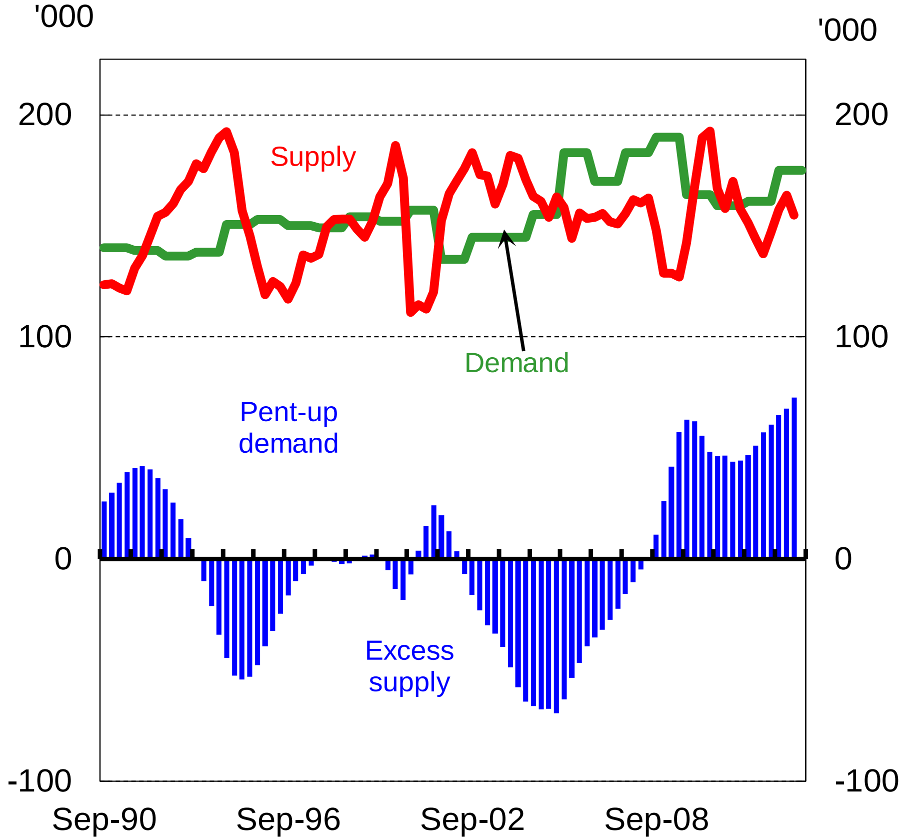
Permanently larger mining sector



Note: Shares are the total gross value added. MMRF estimates after 2010 are spliced onto historical ABS.
Source: *Strong Growth, low pollution* report (2011), ABS and Treasury estimates from MMRF.

Excess demand for housing

CBA: HOUSING DEMAND & SUPPLY



- Demographics suggest underlying housing demand of 170k pa – lower than recent years but still well ahead of new construction.
- An *excess* demand and a *pent-up* demand for new dwellings should limit price downside.
- Financial intermediaries willing to finance housing activity.

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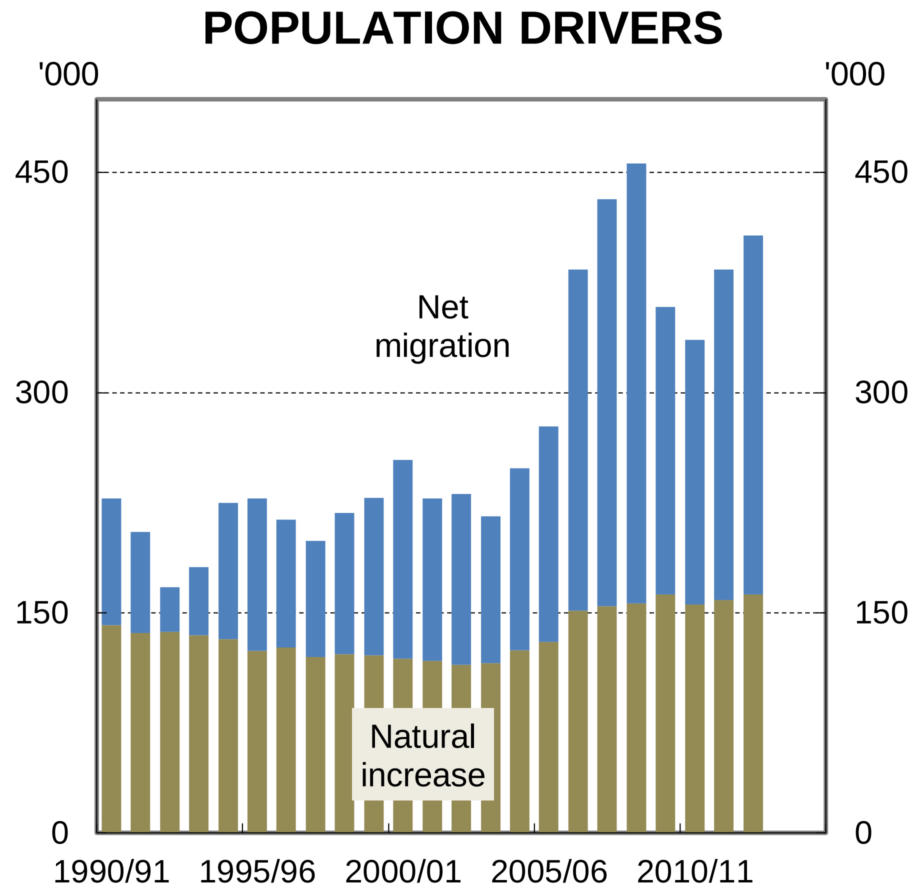
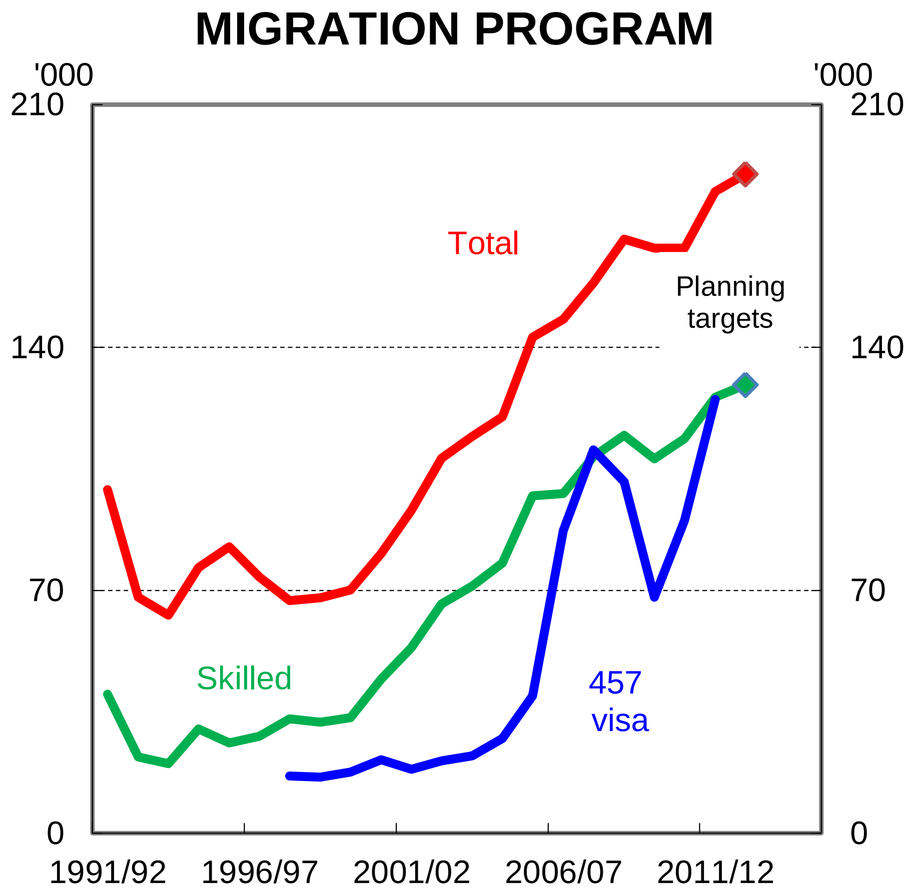
The Growth Transition Needs To Succeed

Residential construction – smart policy – supportive demographics

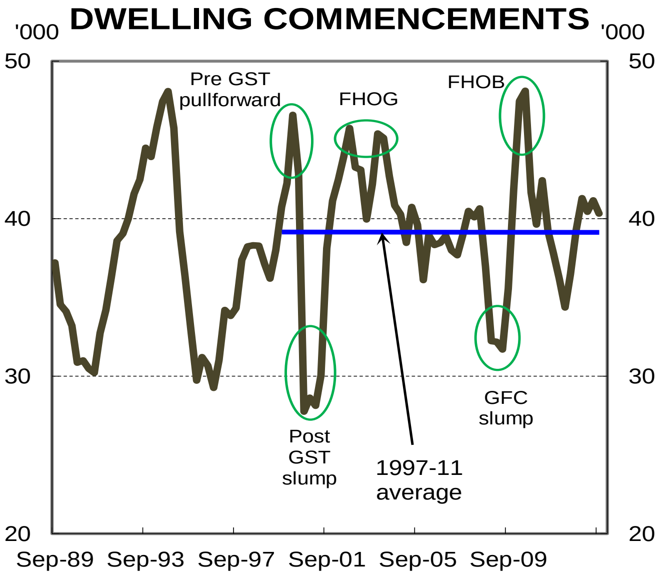


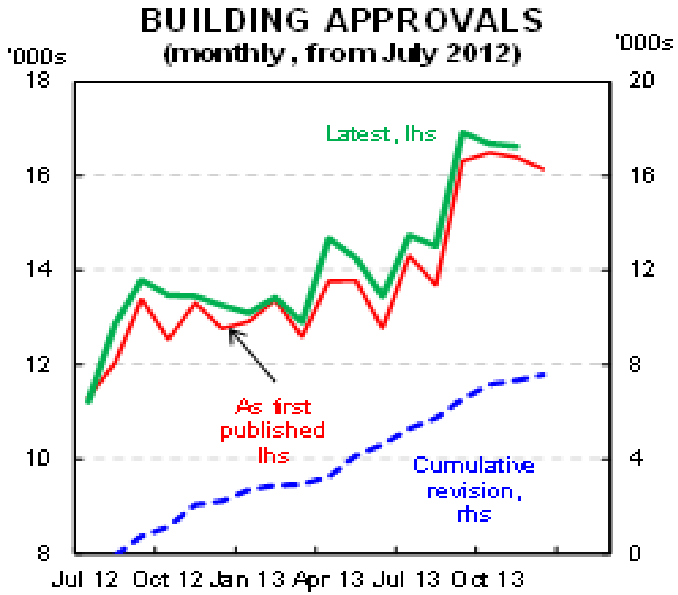


- **Population growth lifting again.**
- **Migrant intake still skewed towards (cashed up) skilled workers – typically bring 5x the funds of other migrants.**

The Growth Transition Needs To Succeed

CBA Forecasts



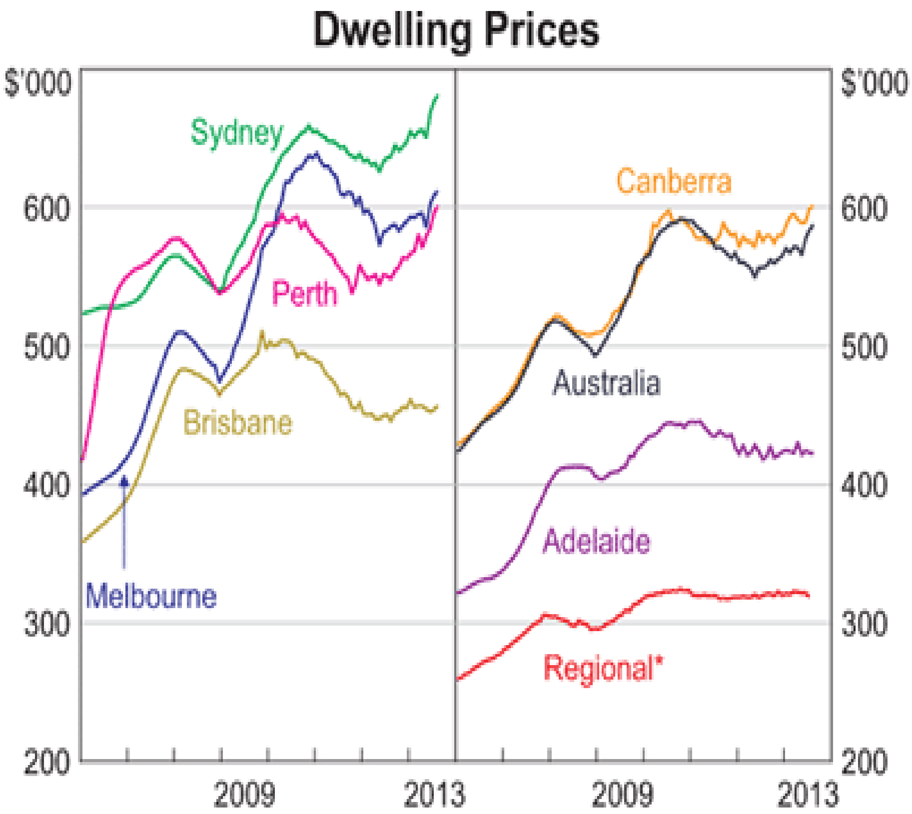


- **The main drivers of the residential construction cycle are government policy or external shocks.**
- **Excluding these events, the construction cycle had been remarkably muted over the past fifteen years – averaging around 150k per annum.**
- **NSW, Vic, SA and Tas have schemes designed to favour new construction.**
- **CBA dwelling starts forecasts:**
  - 2013: 177.4k
  - 2014: 180k

CAN

Housing

Prices in perspective



* Excluding apartments; measured as areas outside of capital cities in mainland states

Sources: RBA; RP Data-Rismark

- Price gains are concentrated in Sydney (where real prices were little changed from 2004) and Perth (where population growth is still strong).
- Prices in Melbourne (where excess demand pressures are weaker) remain below previous peaks.
- Price trends in other capitals and regional areas are more restrained.

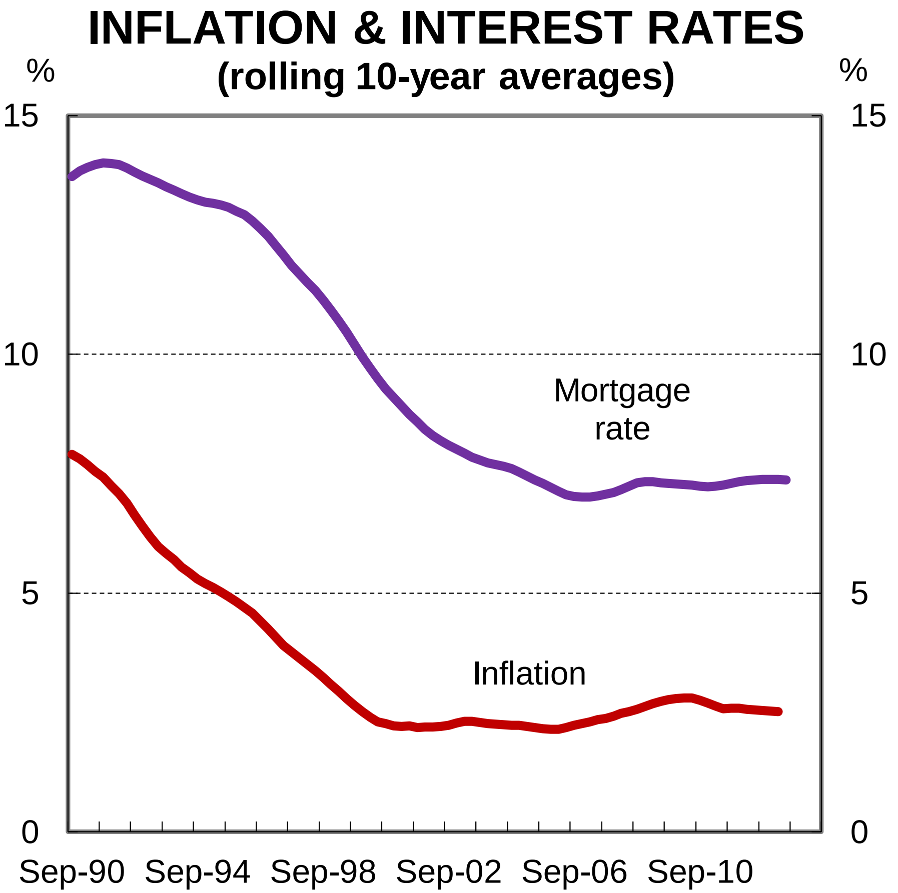
Housing Outlook

Issues & Drivers of Domestic Property Markets in 2014/15

Economic Growth	+	Positive for Property
Monetary Policy	+ +	Low rates positive for Property
Underlying CPI	+	In check for now - bottom line positive
Unemployment	+ +	To head down towards 5% or lower in 2014/15 **Big Positive
AUD Outlook	+ -	Mixed – given patchy impact on economy
Population growth	+	Strong growth via immigration – unequivocal positive
Demand Supply Gap	+ +	Yawning gap unlikely to close – big positive for housing

Housing

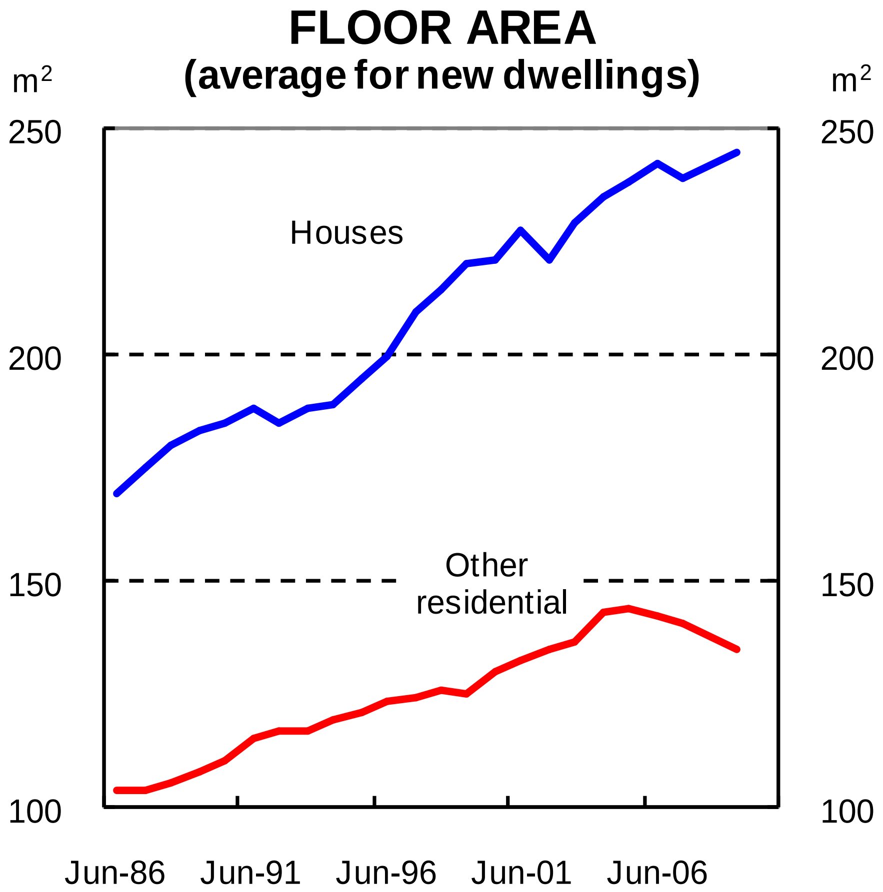
Shifting debt preference & ability to access finance



- **The adjustment to low inflation, and the low interest rates that went with it, produced a structural lift in housing demand in the late 1990s.**
- **Coincided with increased ease of access to credit.**
- **Potential size of housing market lifted by 600,000 households.**

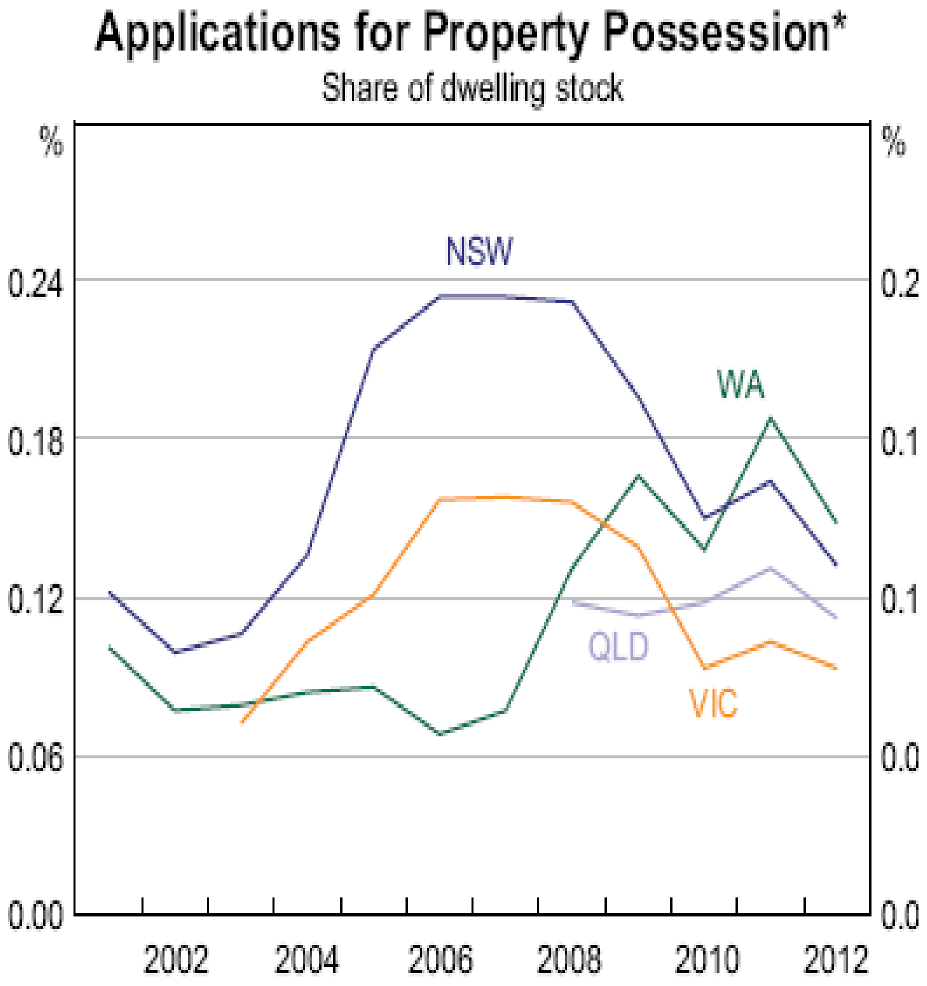
Housing

Shifting housing preference

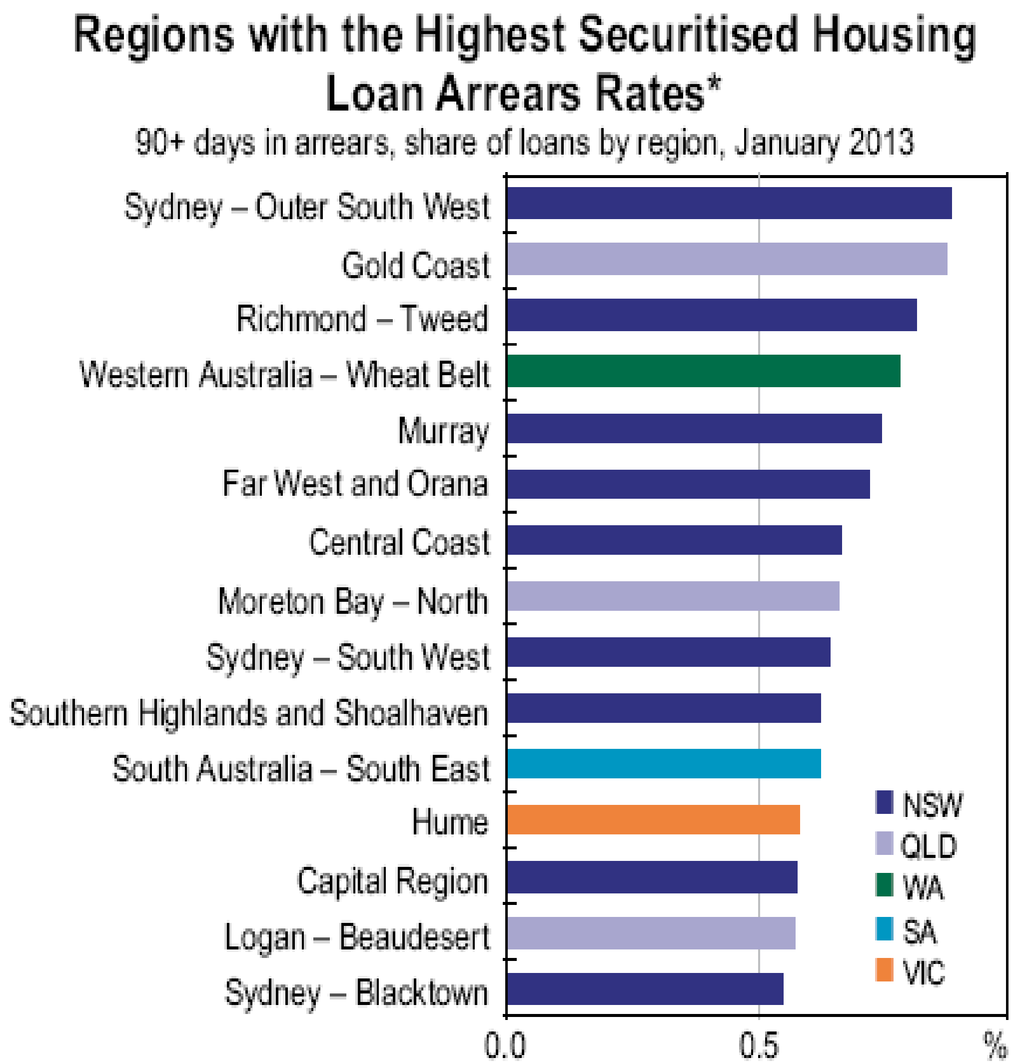


- **A structural shift in preference for housing type towards larger and more elaborate dwellings:**
  - average floor area of a new house has increased by 46% since 1986;
  - dwellings are now built out of more elaborate and expensive materials.

Housing Outlook: Still positive



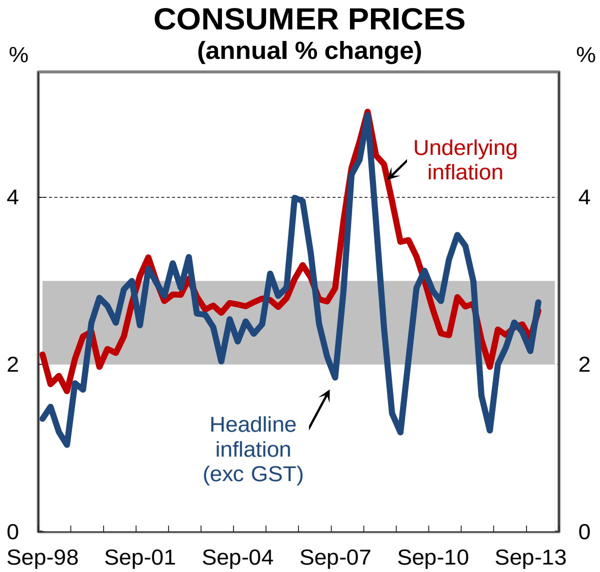
* Includes applications for some commercial properties
Sources: ABS; RBA; state supreme courts

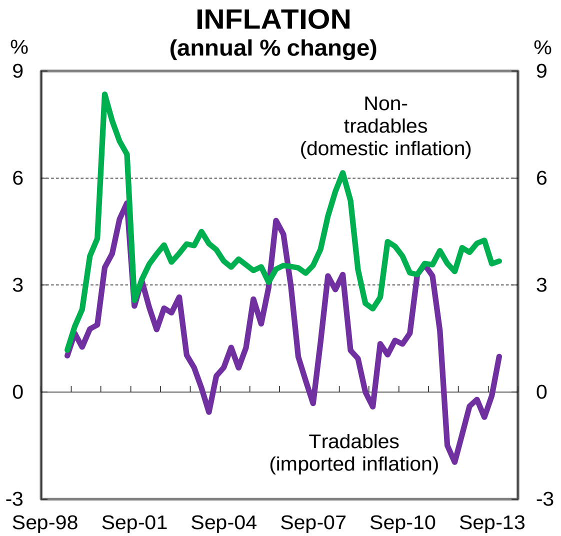


* Prime loans securitised by all lenders; includes self-securitisations; regions with at least 2 500 loans outstanding
Sources: ABS; Perpetual; RBA

Inflation Outlook: Tame Prices

Inflation: core measures well behaved

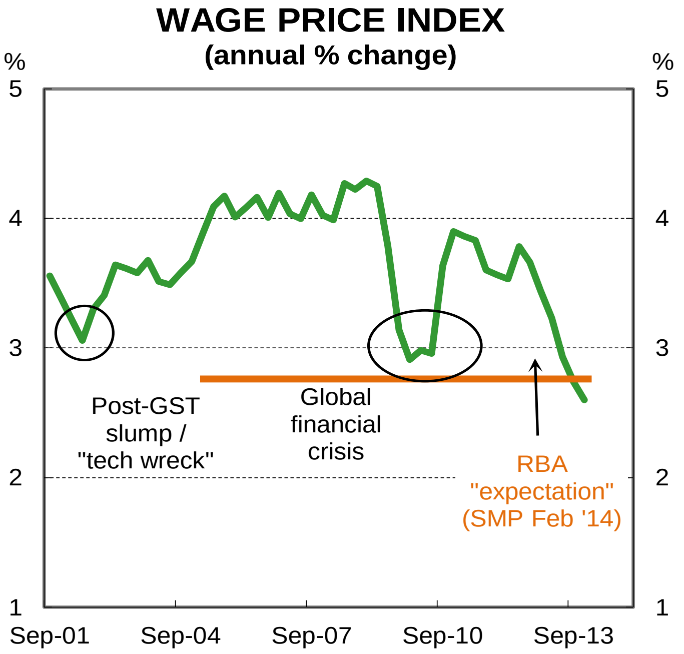


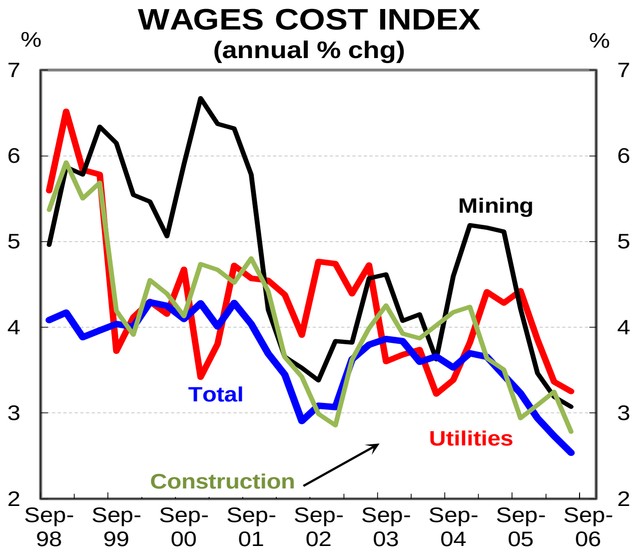


- **Underlying inflation (the RBA target) was running at 2.7%pa in QIV 2013;**
- **Headline inflation) was running at 2.6%pa in QIV 2013.**
- **weak productivity is boosting unit labour costs.**
- **the fully-employed economy still has to absorb strong income growth and a mining boom.**
- **structural inflation pressures remain.**
- **A lower AUD would pressure tradables inflation higher over time.**

An Inflation Transition Needed As Well

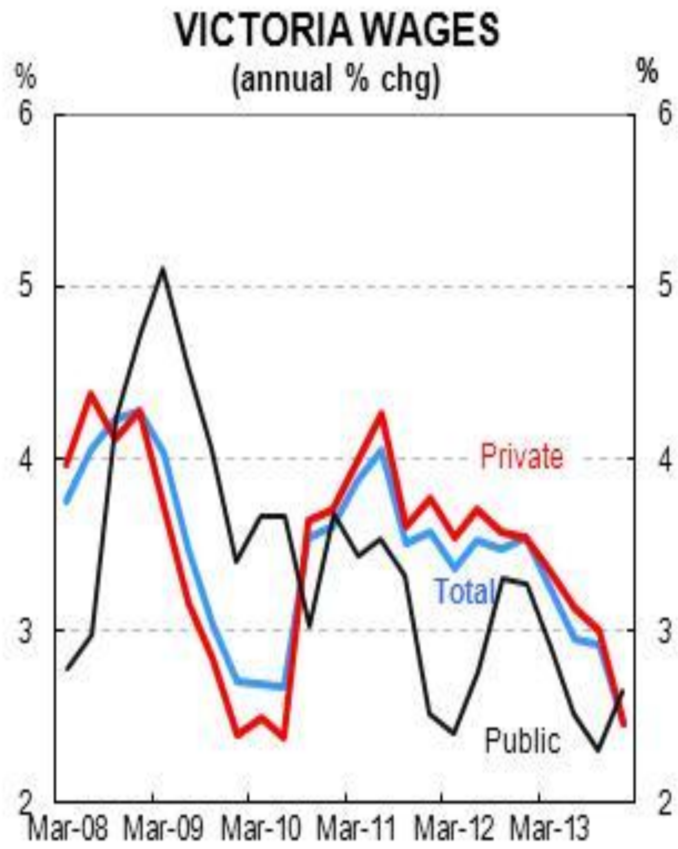
Mission accomplished?

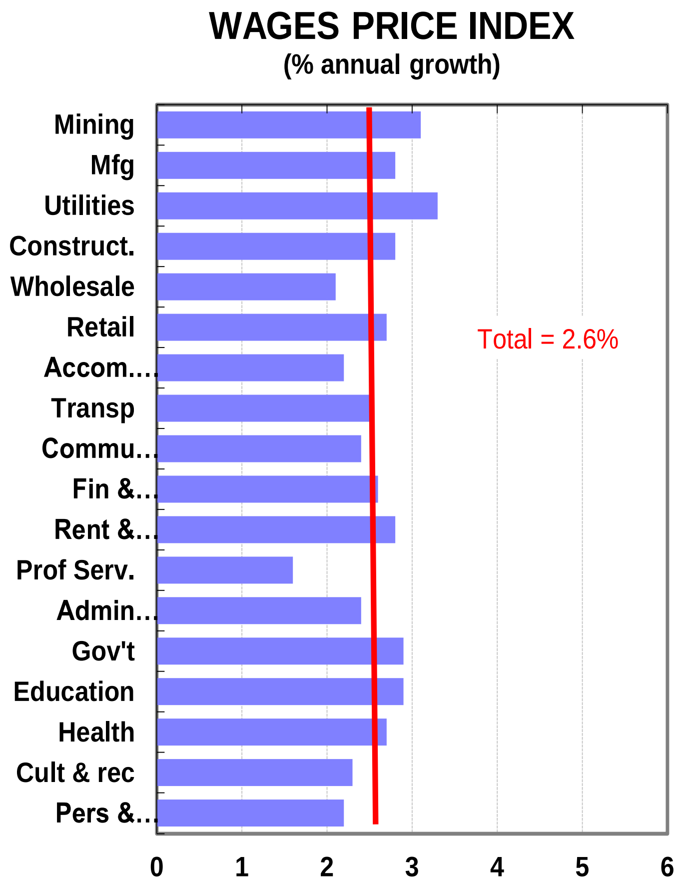


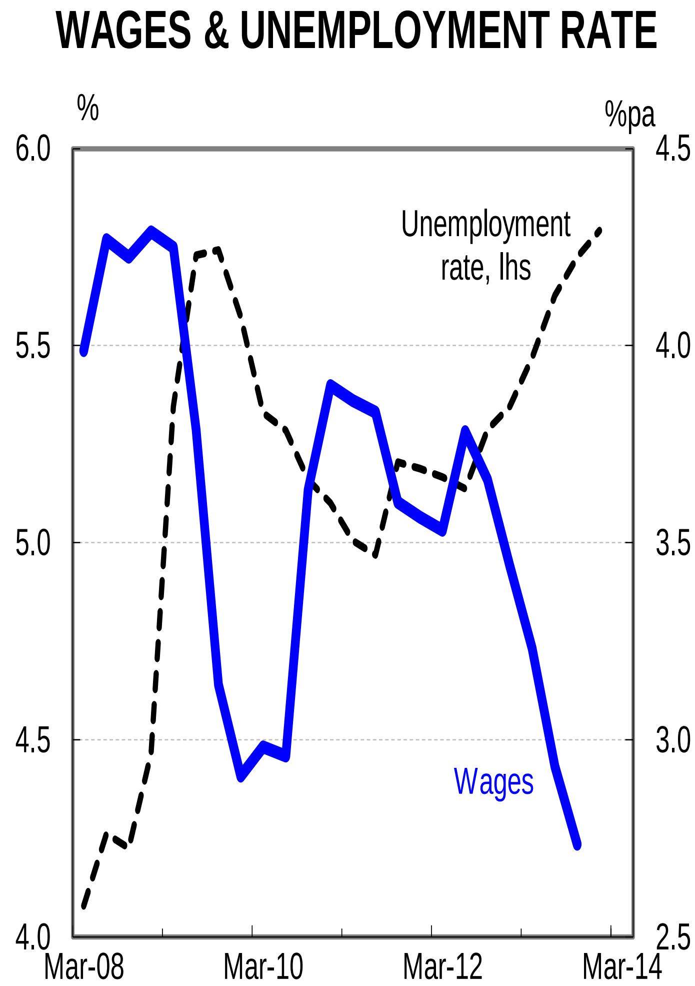


- **Domestic inflation is mainly about services – so labour costs are a key driver of domestic inflation.**
- **The RBA believes that wages growth will slow on the back of a soft labour market:**
  - RBA did not publish a wage forecast in the February SMP but did suggest it was "a little lower" than the sub 3% projection released in November.
- **Wages growth has slowed as expected over the past year.**

Wages slowing: Victoria up 2.5%pa.



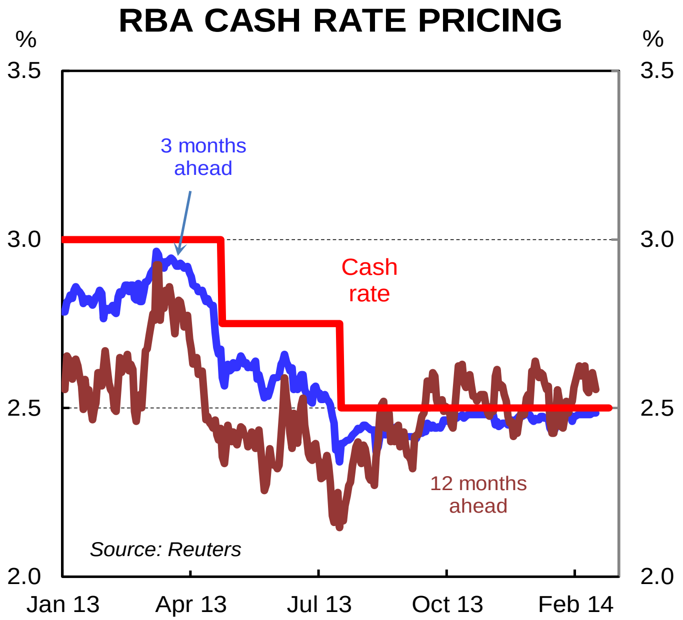


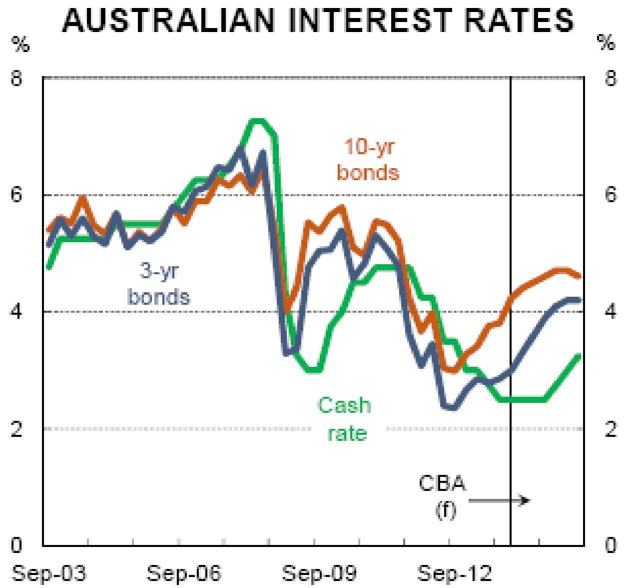


- Vic wages at 2.5%pa, just below national 2.6%pa over 2013. National wages growth of 2.6% driven by mining, utilities & health.
- Wages growth sliding as unemployment rate headed toward hits 6%.

The RBA & Monetary Policy

CBA view

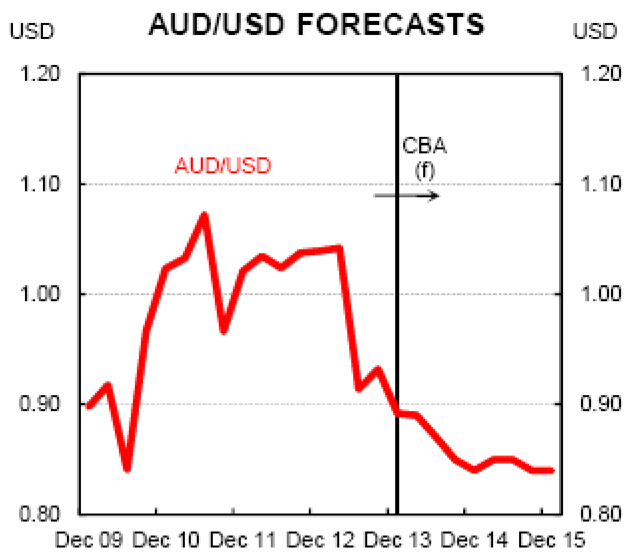


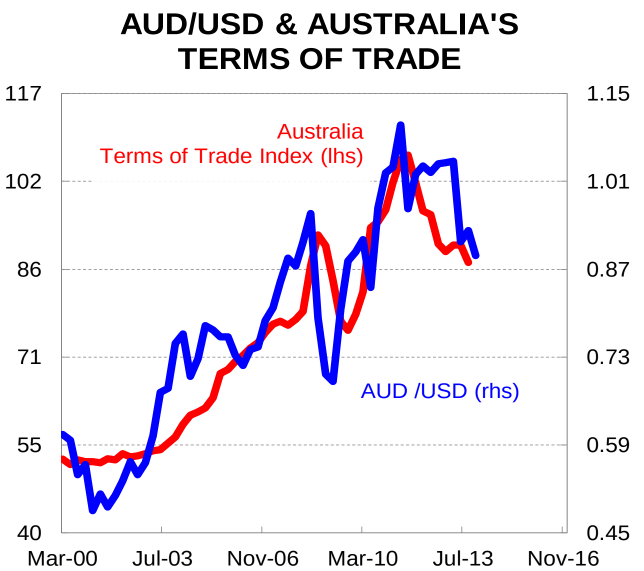


- **RBA policy settings are now neutral.**
- ***RBA's 2013 worry about downside risks to domestic growth has now morphed into 2014 concerns about upward risks to domestic inflation*.**
- **The QIV wages growth running at 2.6%pa, the lowest level since the ABS series began in 1997. The very tame wages data helps underscore why the RBA is content to run with *neutral policy stance rather than switching to a tightening bias*, in wake of the higher than expected QIV CPI**
- **Market View: Sees <10% chance of cash down to 2¼% by over next year.**
- **CBA view:**
  - **Current 2½% cash rate will ultimately be the low point for cash rate in current cycle.**
  - **We see RBA lifting rates by 0.25% to 2¾ by the end of 2014.**

The AUD

Testing the fundamentals





- **AUD medium-term fundamentals supportive:**

  commodity exposure;

  terms-of-trade at 140-year highs;

  Asian exposure;

  interest rate differential;

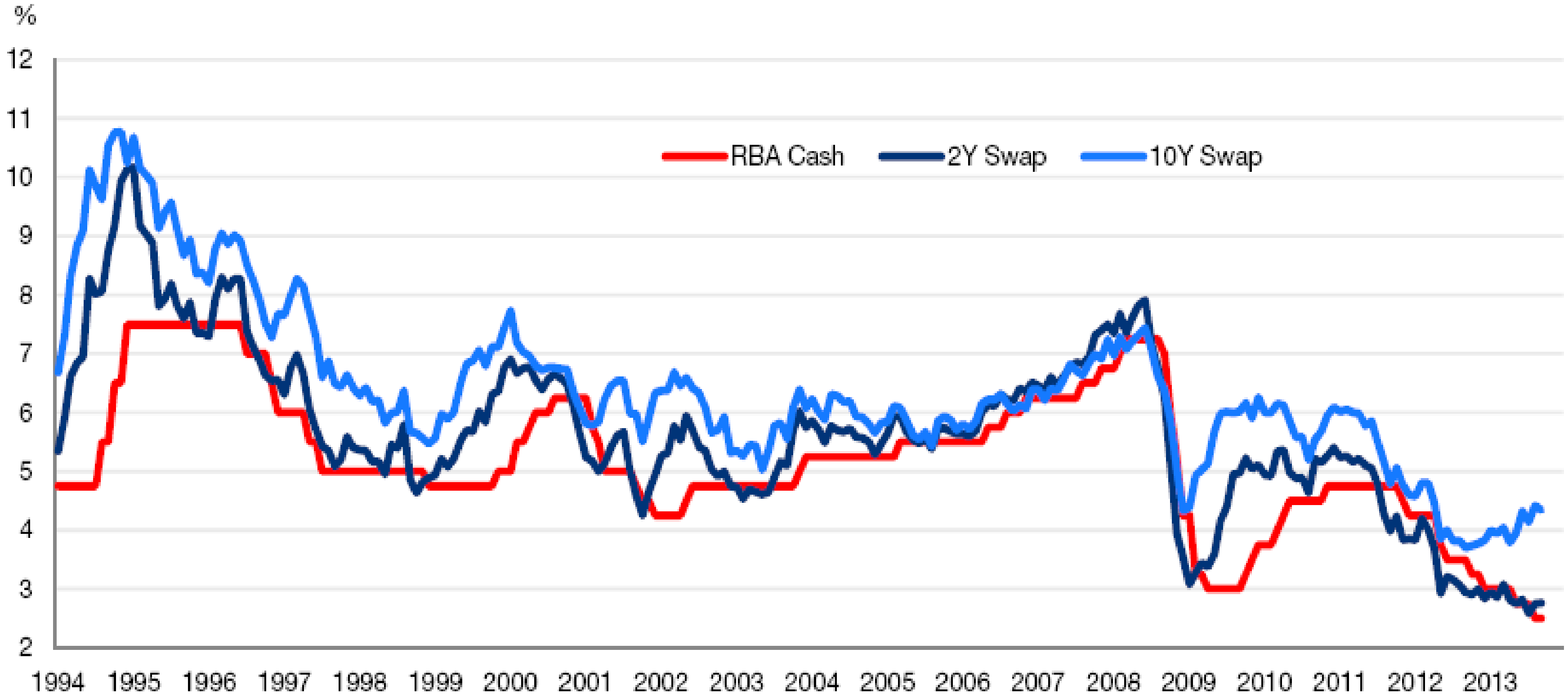
  exceptional fiscal position;

  AAA rating and sound financial system.

- **But the cycle is not dead. AUD will fluctuate around a higher average.**

Australian Swap Rates since 1994

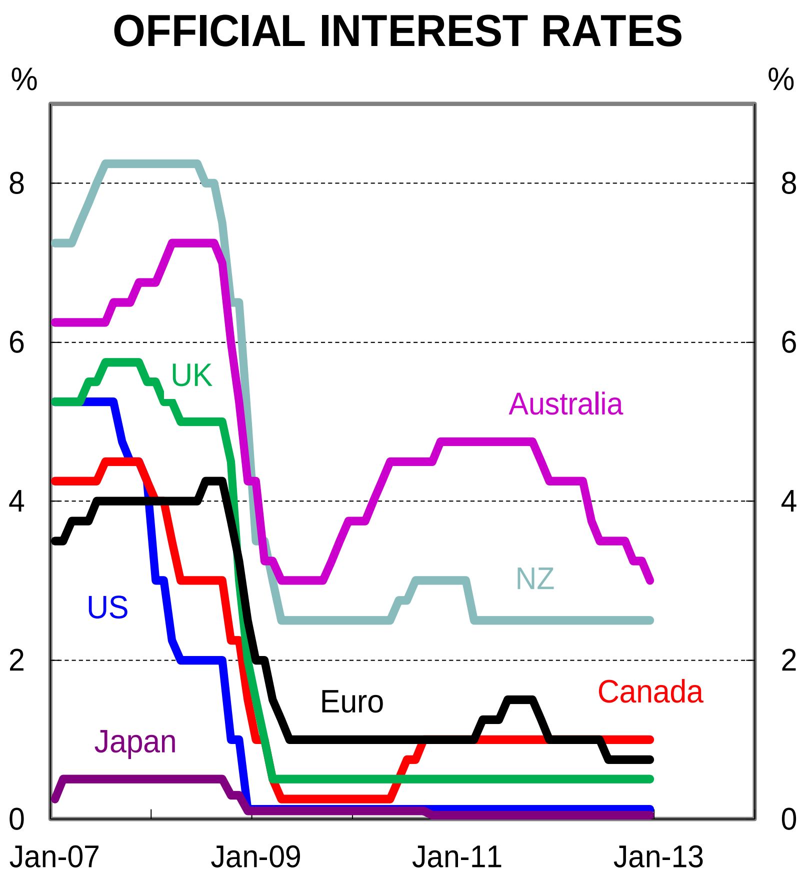
Australian swap rates over the long term

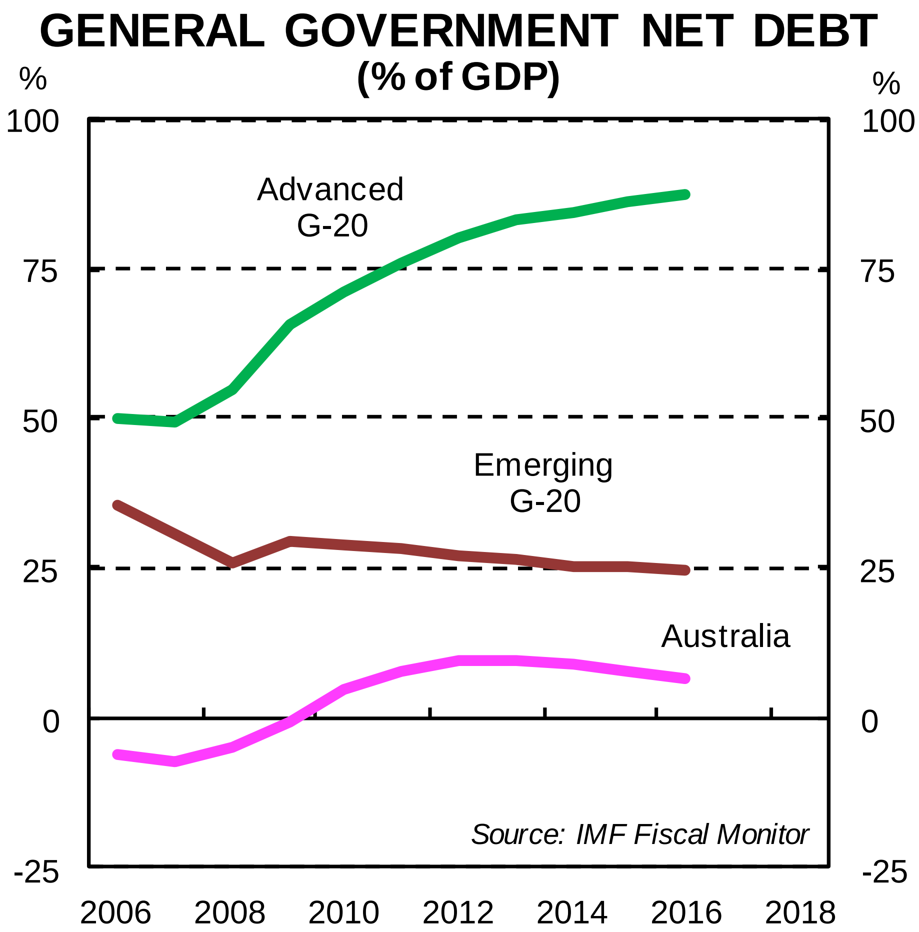


Source: CBA, Bloomberg

Plenty of shots left in monetary and fiscal policy lockers!!

Policy ability – but appetite and effectiveness to vary?





- Monetary and fiscal policy have plenty of room to move.
- But appetite and effectiveness likely to vary between monetary and fiscal policy.

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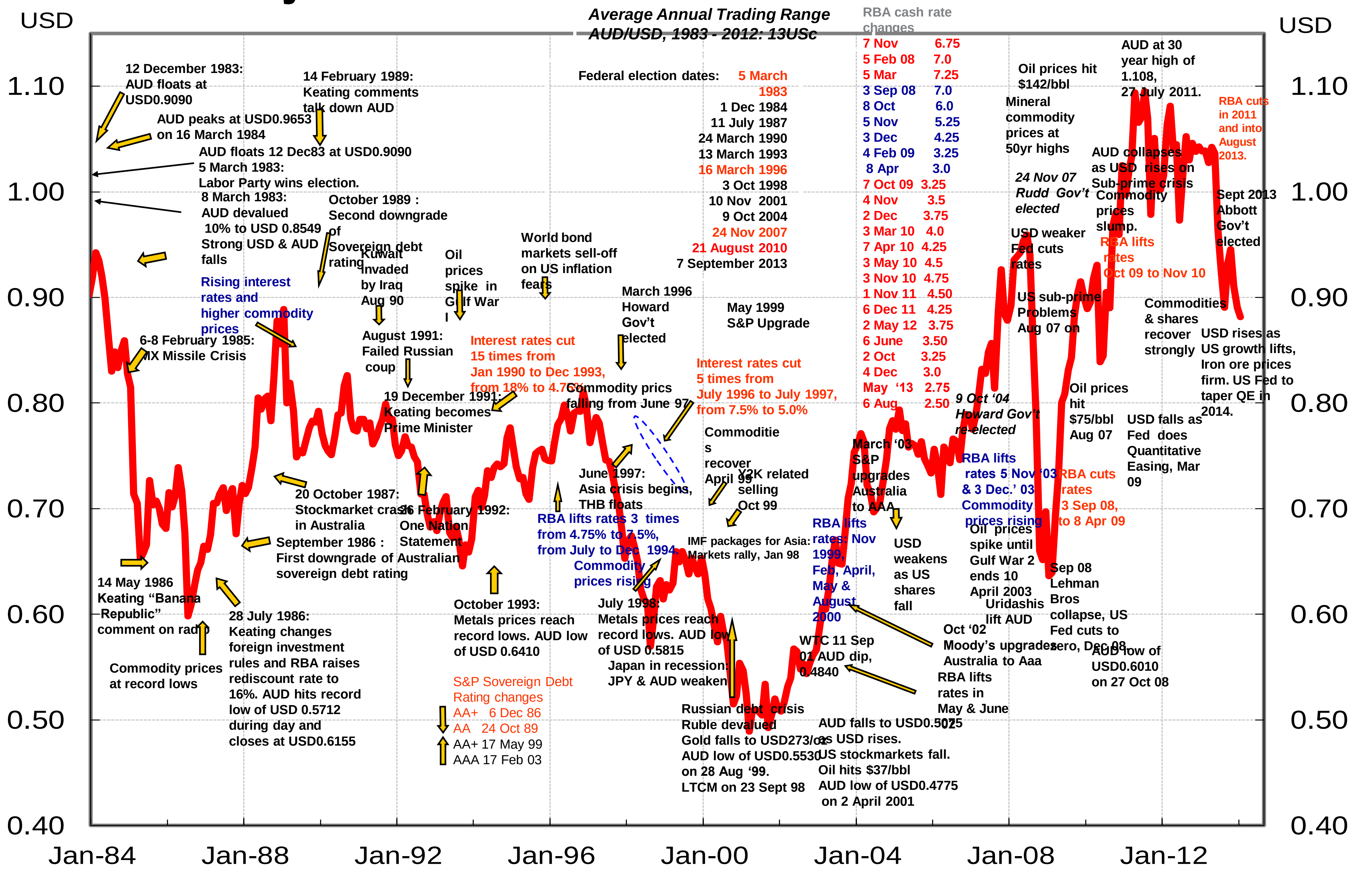
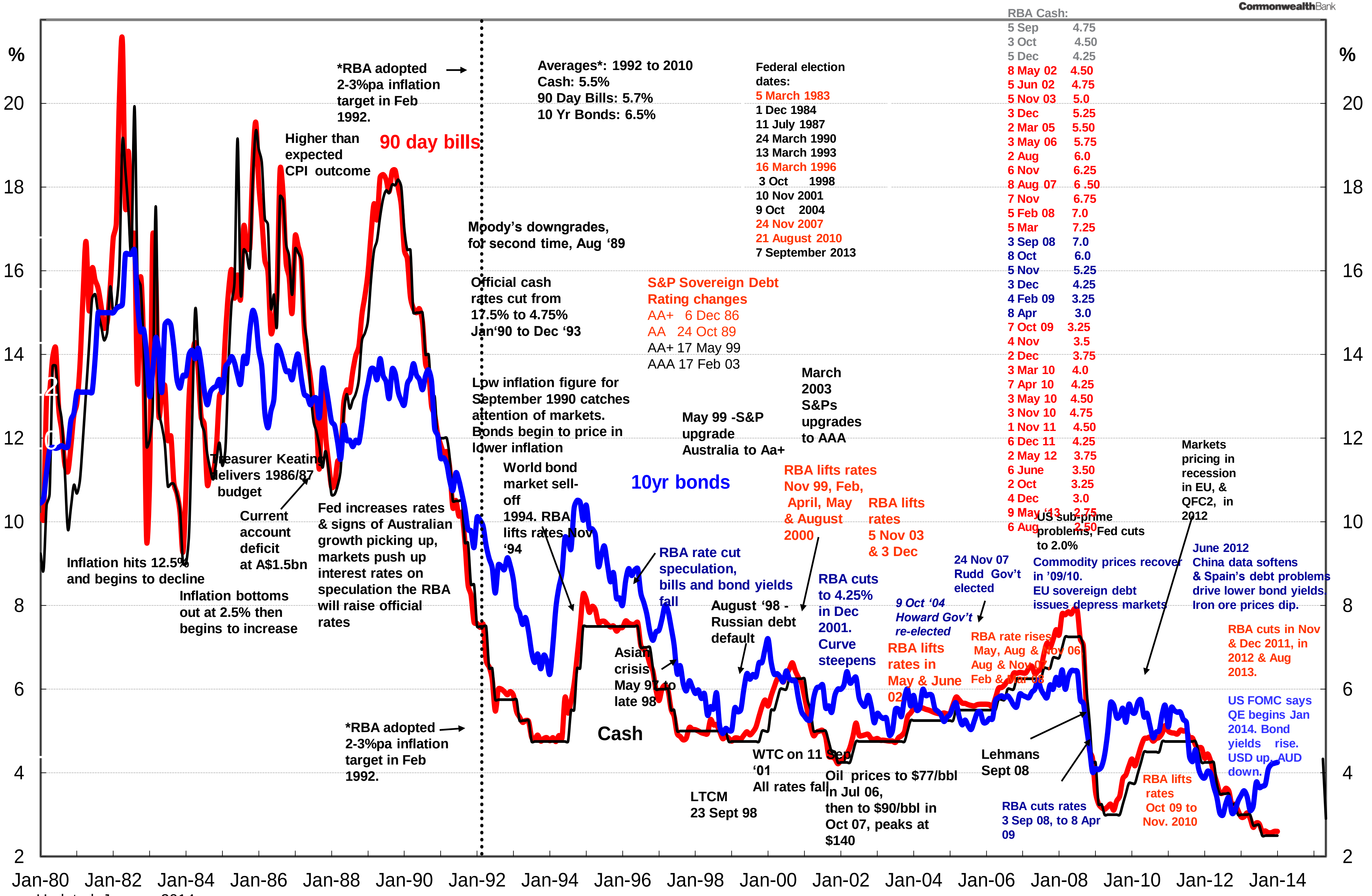
The AUD cycles 1983 - 2014



Updated January 2014

Interest rate cycles 1980-2014



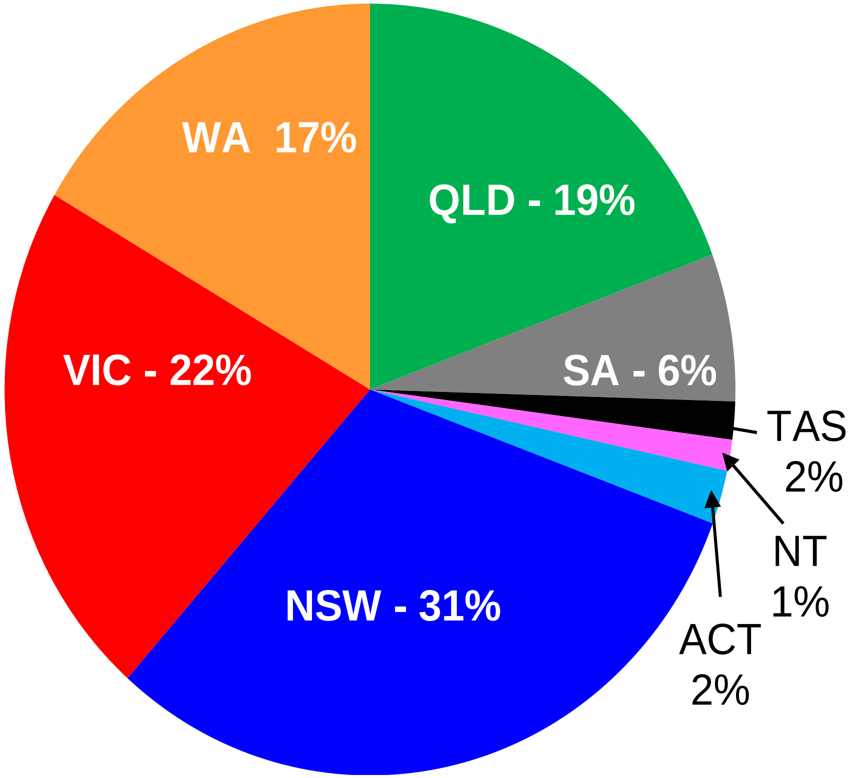
Updated January 2014

Wealth of Nations – Australia at top of wealth apex (Net Worth/Adult)

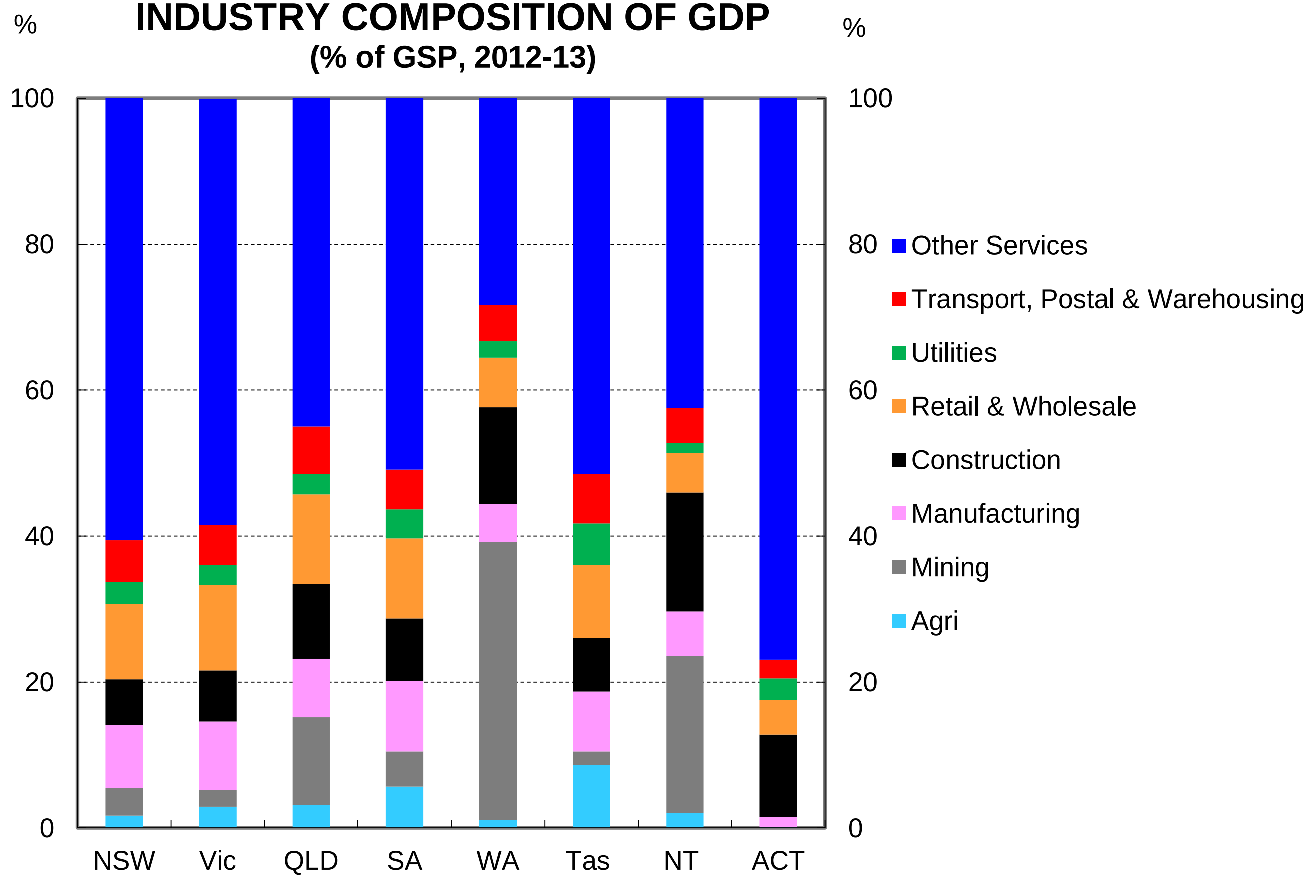
State Charts

State Structure

STATE SHARES OF GDP
(%, 2012-13)

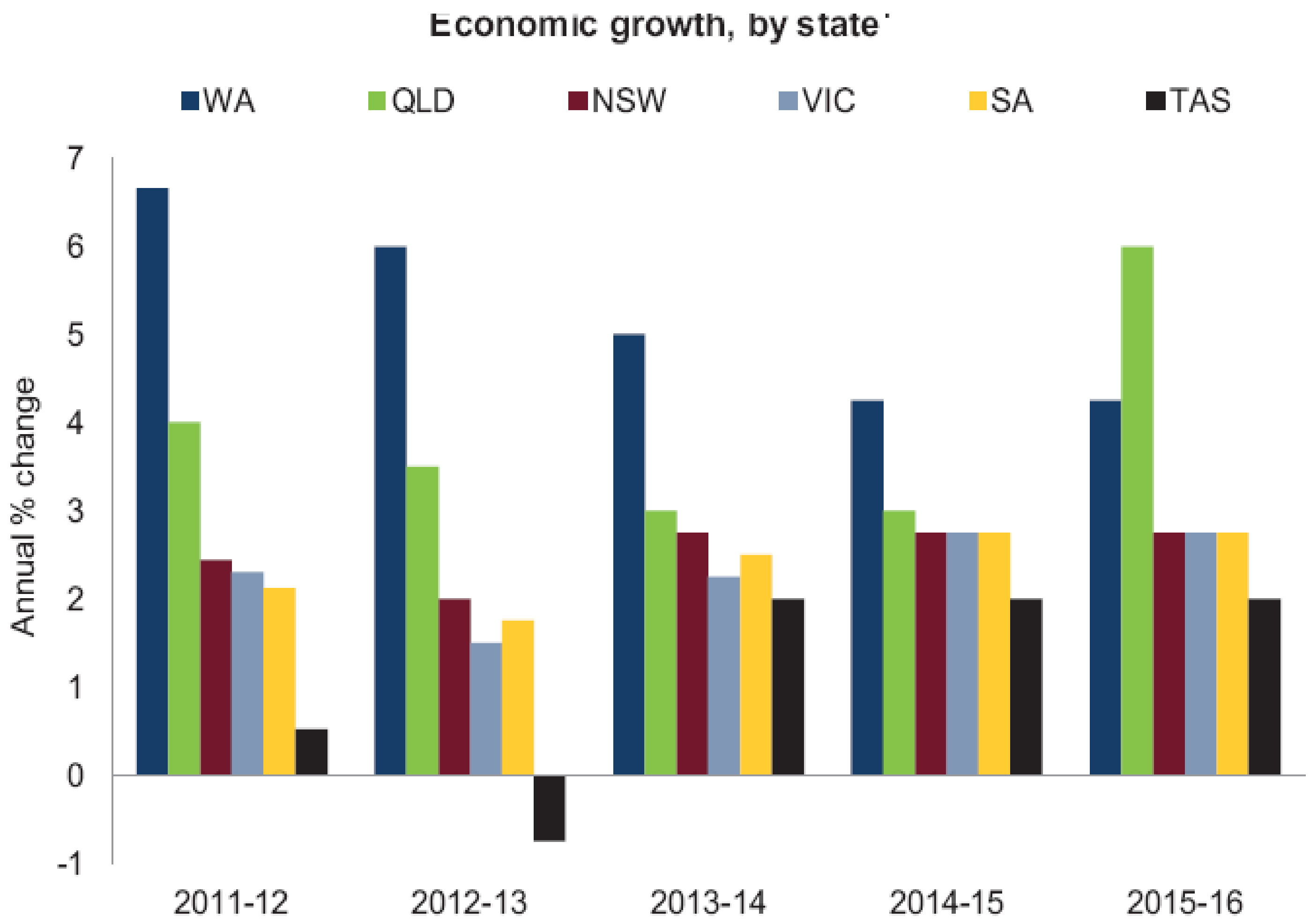


INDUSTRY COMPOSITION OF GDP
(% of GSP, 2012-13)



States' Growth

Vic growth in the middle of the pack



Note:

1. CVM, 2010-11 reference year. 2011-12 are actuals, 2012-13 onwards are forecasts/projections.

Sources: ABS 5220.0, various state Budgets, Mid-Year Review papers and Queensland Treasury and Trade.

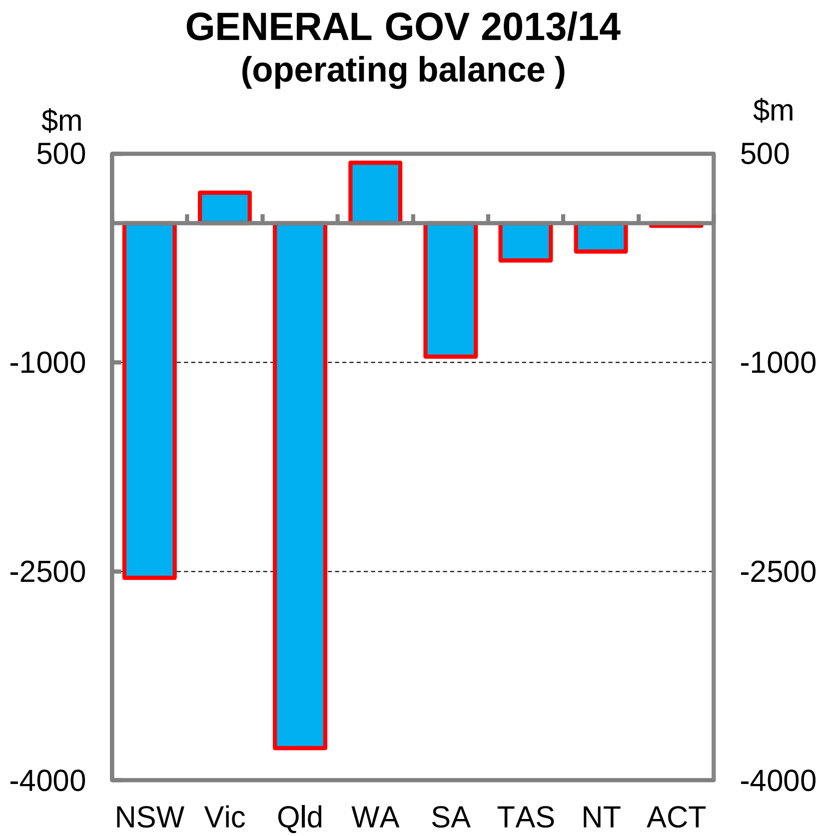
State Fiscal Outlook – 2013/14 Mid-year Budget Reviews

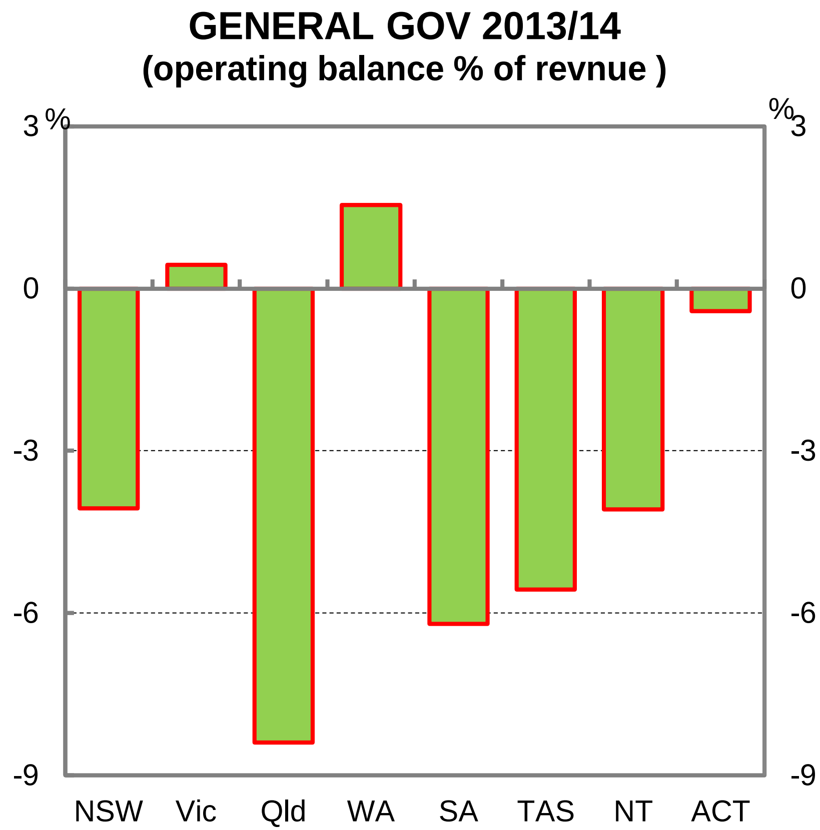
$m	2013/14 (f)	2014/15 (f)	2015/16 (f)	2016/17 (f)
NSW	-2,546	-1,051	-322	319
VIC	222	911	2,051	2,718
QLD	-3,769	1,909	2,025	1,473
WA	437	-123	264	10
SA	-956	-512	304	614
TAS*	-267	-165	-34	10
NT	-201	-208	-94	-92
ACT*	-18	49	208	215
Commonwealth	-38,137	-29,876	-18,596	-12,078
Total	-45,235	-29,066	-14,194	-6,811
Total % of GDP	-2.8	-1.7	-0.8	-0.4

Source: 2013/14 Mid-year State Budget Reviews, 2013 MYEFO
** 2013-14 Budget Papers*

- **All States bar VIC and WA expect to run an operating deficit in 2013/14.**
- **The forecast Federal deficit has increased since the PEFO due to weakness in the nominal economy and some expansionary fiscal policy decisions.**
- **Without significant expenditure cuts, the automatic stabilisers mean that State and Federal deficits are largely unavoidable in the near term.**
- **For the States, a credible plan to move towards operating surpluses over the forward estimates period is necessary.**

State Fiscal Outlook



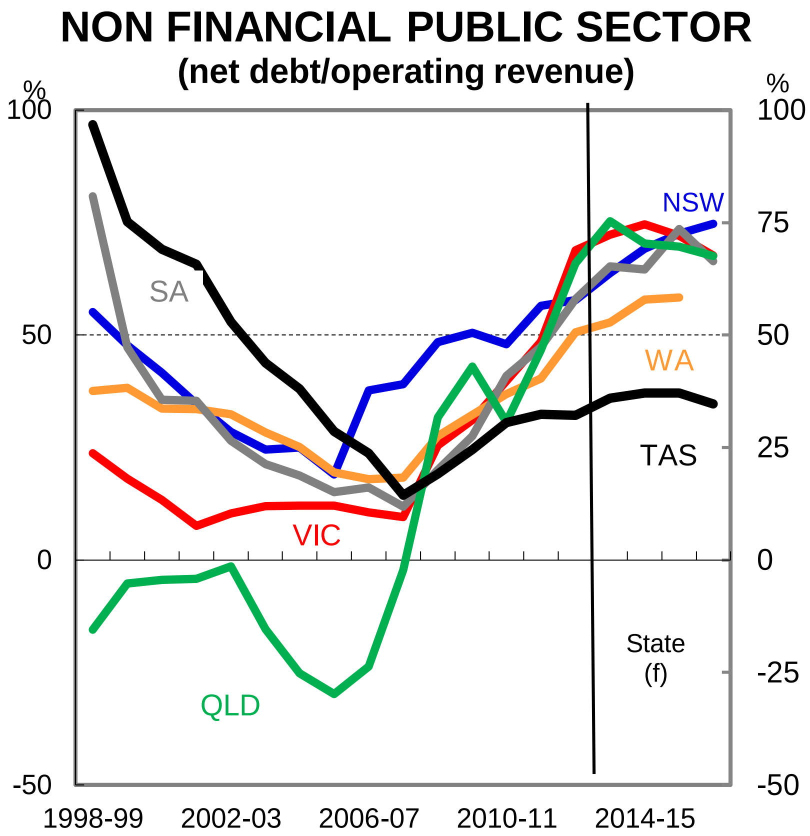


- **Growth in the State tax base that comes from payroll tax has been impacted by a soft labour market characterised by weak employment growth and soft wage increases.**
- **Weak growth in royalties and the GST pool has also slowed through weakness in the nominal economy.**
- **Stamp duty revenue is likely to come in higher than forecast courtesy of strong house price growth and turnover.**

State Fiscal Outlook

State Credit Ratings

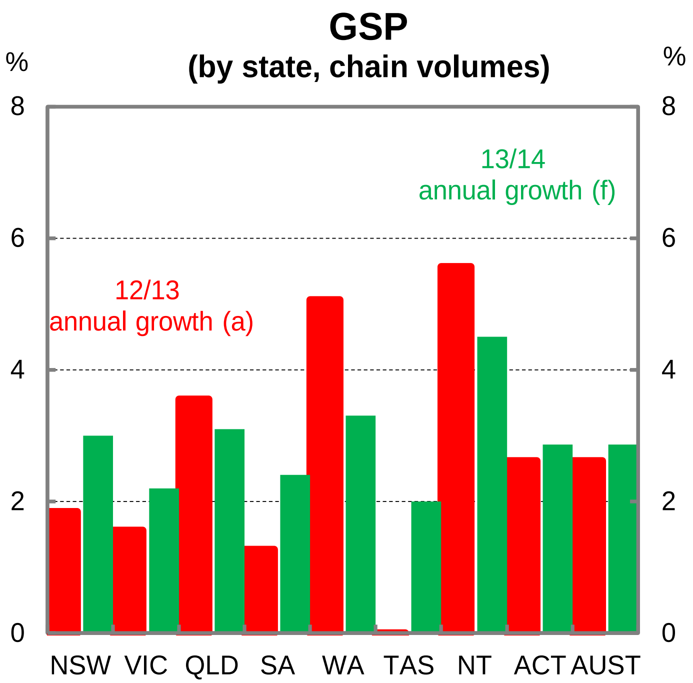
	Moodys	S&P
NSW	Aaa	AAA
VIC	Aaa	AAA
QLD	Aa1	AA+
SA	Aa1	AA
WA	Aaa	AA+
TAS	Aa1	AA+
NT	Aa1	NA
ACT	NA	AAA
AUST	AAA	AAA

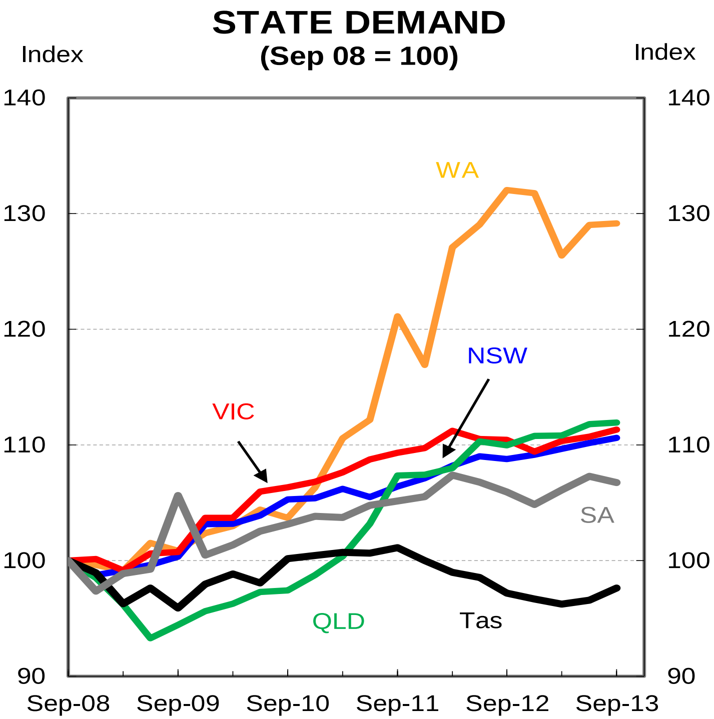


- **Most States are expecting balance sheet improvement over the forecast period as the economy and revenue grow faster than the increase in net debt. Though NSW is expected to continue to ramp up debt as a share of revenue to fund infrastructure.**
- **Credit ratings look largely secure across the States. Though the room for slippage is minimal in NSW. WA's Aaa rating from Moody's looks a close call.**

State Growth

Mining State growth plateauing, non-mining State growth lifting slowly





- **Growth in WA is stabilising at a high level as business investment slows. Our expectation for a *plateau* in mining investment means that the decline in WA's growth should be gradual. The peak impact of lower business investment will occur in FY14. Once the production phase of the mining boom ramps up, lifting exports, WA growth will find support.**

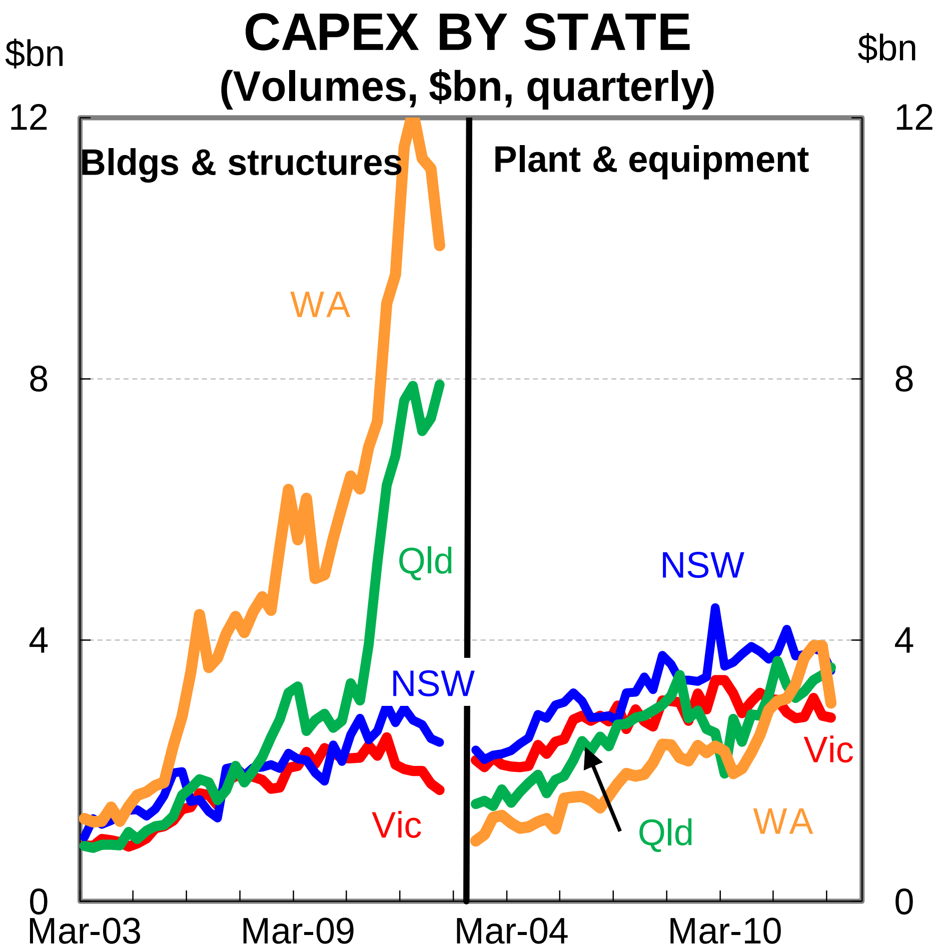
- **QLD growth will also slow in FY14, in-line lower levels of LNG investment. LNG projects tend to be very large with a long construction timeframe. So the initial slowing should be quite mild and LNG exports will provide a growth offset.**

- **There are early signs of a growth transition from the mining to the non-mining States. The QIII State spending data indicated that the large non-mining States of NSW and VIC had the largest rise in spending across the States. But the increase in growth is soft. Stronger growth rates will be needed from the non-mining States to offset the deceleration in growth rates in the mining States over FY14**

- **Growth in the small non-mining States of SA and TAS remains soft, although it appears that growth in TAS has bottomed out is now turning up slowly.**

Capital Expenditure

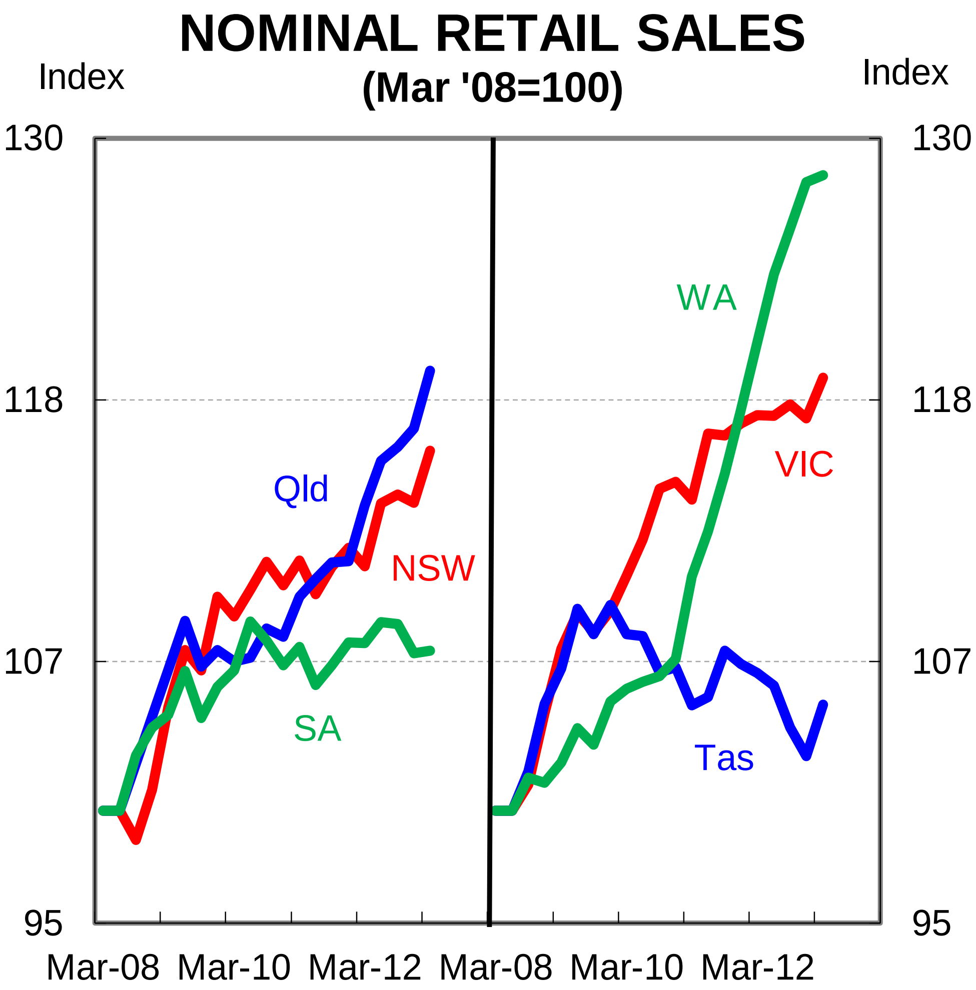
Mining investment weighing on capex growth in WA and QLD



- ***The mining construction boom has been an important driver of buildings and structures capital expenditure in WA and QLD.***
- **Capex in WA is beginning to decline (especially buildings and structures) as mining investment slows down. WA capex will continue to decline over the year.**
- ***QLD capex will be more resilient due to the long scale and large LNG projects under construction*.**
- **Capex growth in the non-mining states is also low. CBA expects non-mining capex growth to turn up in HII 2013. The fall in the AUD will assist non-mining businesses in the large non-mining states (NSW and VIC).**

Retail Trade

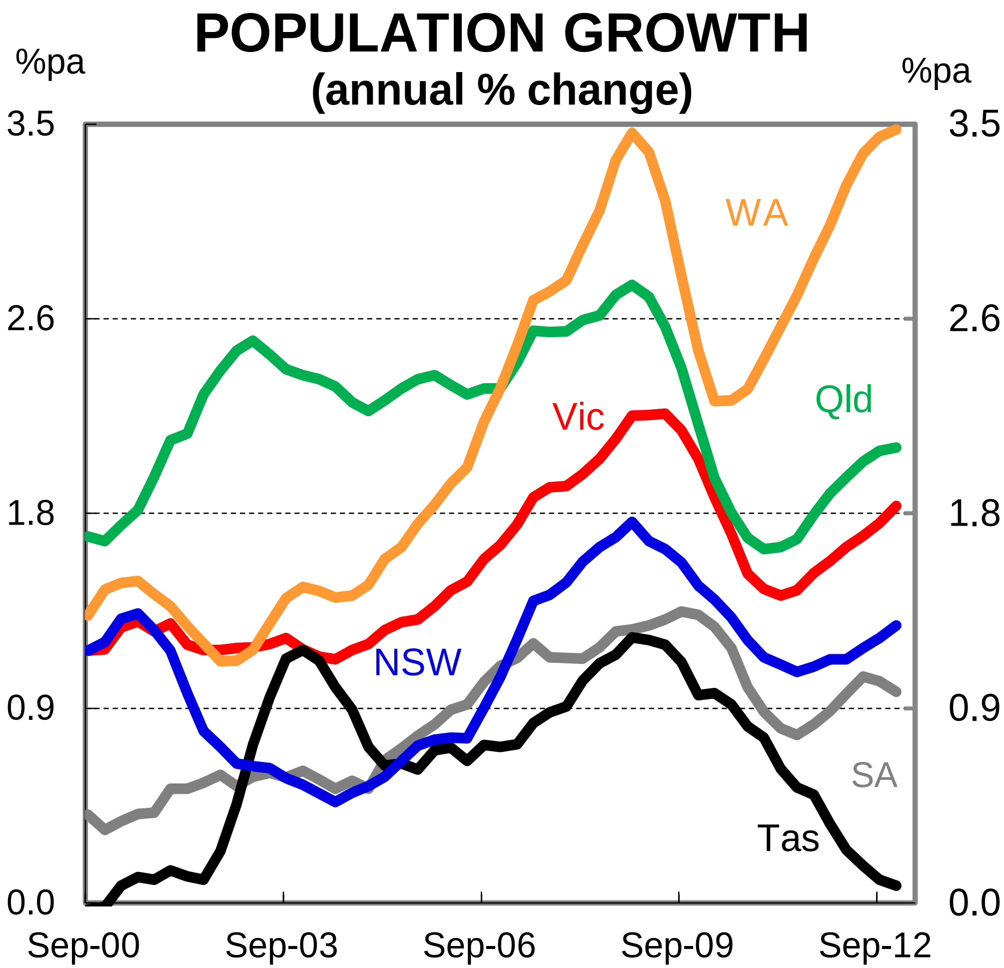
Growth in the big non-mining states is picking up



- **Retail trade in the mining states outperformed the rest of Australia over 2012. But, the increase in retail sales growth over 2013 has been concentrated in the big non-mining States (NSW and VIC). This suggests that lower interest rates are boosting economic activity and that consumers do respond to price and other economic signals.**
- ***Growth in QLD retail trade remains strong while WA growth has flattened*.**
- **We see a pick up in retail trade growth in the big non-mining states over 2013.**
- **The outlook for retail sales growth in the small non-mining states (SA and TAS) is poor given the weak labour markets in these states.**
- **Consumers are spending, but they are selective in where that spending is occurring. Retail spending is running at the lower end of the range.**

Demographics

Demographics are a key driver of economic activity

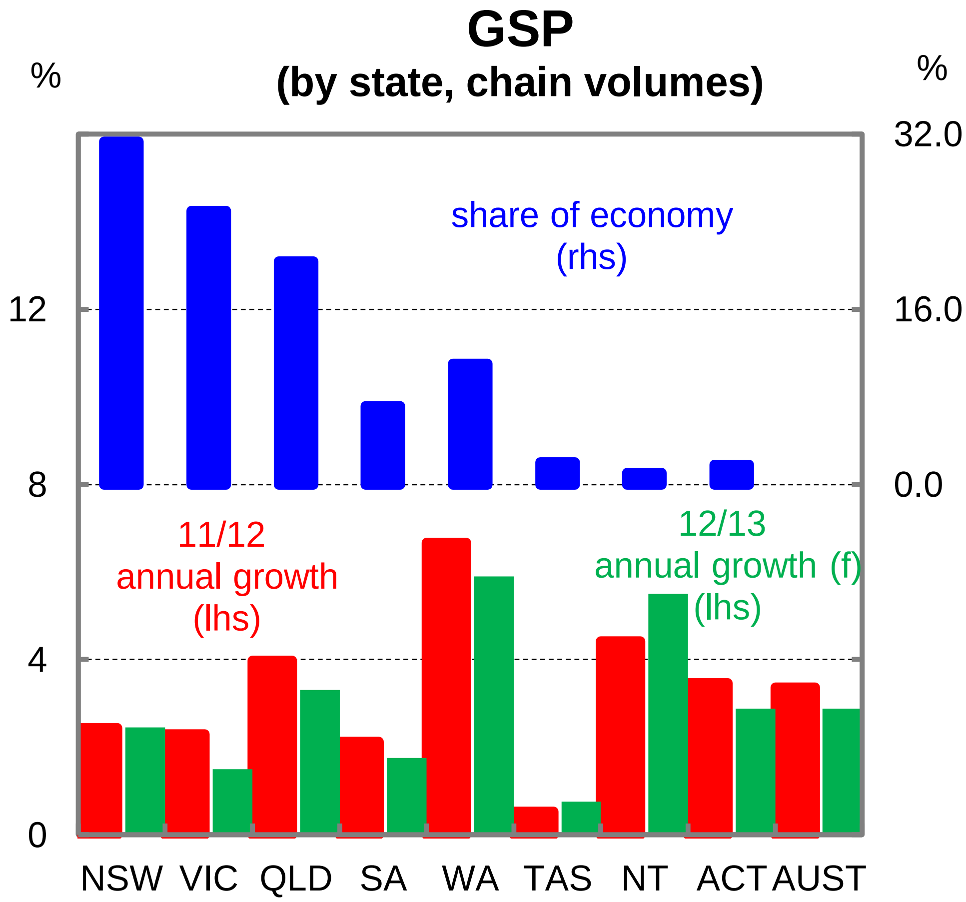


- **Population growth is an important driver of economic activity and the divergence in State growth rates.**
- **The Australian population growth rate is rising again, due to higher births and (more significantly) higher migration levels.**
- **WA's population has been surging (+3.5%pa) compared to the national average (+1.8%pa). Strong population growth in WA has been one of the factors influencing higher growth outcomes. A slowdown in WA's population growth rate is likely.**
- **Population growth will continue to trend up across the States, apart from TAS.**

Forecasts – Gross State Product

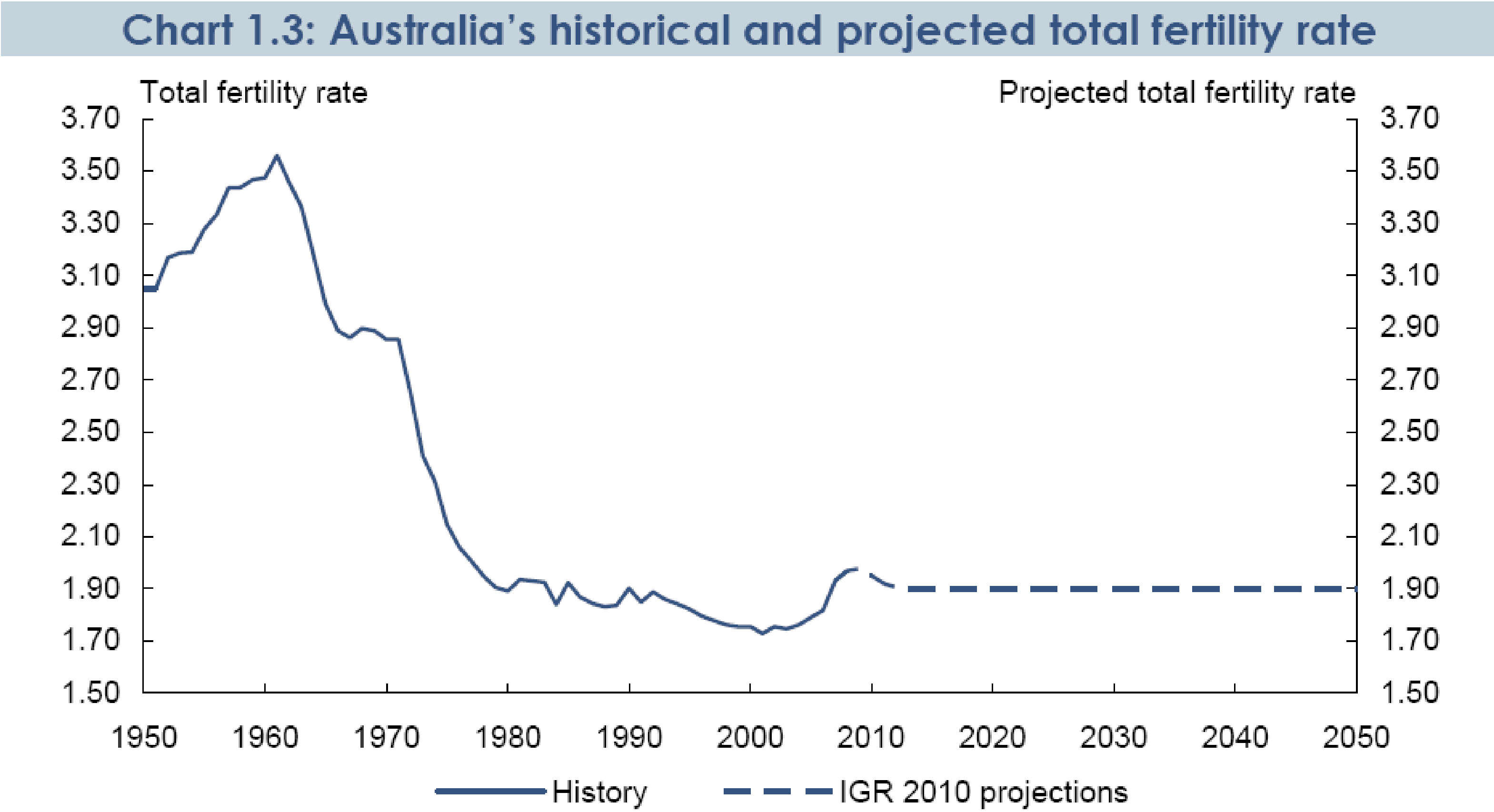
Gross State Product Forecasts

%	2011/12 (a)	2012/13 (f)	2013/14 (f)	2014/15 (f)
NSW	2.4	2.5	2.5	2.7
VIC	**2.3**	**1.5**	**2.3**	**2.5**
QLD	4.0	3.3	3.0	3.5
SA	2.1	1.8	2.0	2.2
WA	6.7	5.9	4.4	4.3
TAS	0.5	0.8	1.2	1.3
NT	4.4	5.5	3.8	3.8
ACT	3.5	2.9	2.8	3.1
AUST	3.4	2.9	2.8	3.1



AGED CARE CHARTS

Ageing: Low fertility rate here to stay!



Source: ABS cat. no. 3105.0.65.001 and cat. no. 3301.0 (various), and Treasury projections.

Ageing: Proportion of older Australian as % of total lifting

Table 1.4: Australian population history and projections

Age range	1970	2010	2020	2030	2040	2050
Population as at 30 June (millions of people)						
0-14	3.6	4.2	4.9	5.4	5.7	6.2
15-64	7.9	15.0	16.6	18.2	20.0	21.6
65-84	1.0	2.6	3.7	4.8	5.6	6.3
85 and over	0.1	0.4	0.5	0.8	1.3	1.8
Total	**12.5**	**22.2**	**25.7**	**29.2**	**32.6**	**35.9**
Percentage of total population						
0-14	28.8	19.1	19.0	18.3	17.4	17.2
15-64	62.8	67.4	64.7	62.4	61.3	60.2
65-84	7.8	11.7	14.3	16.6	17.2	17.6
85 and over	0.5	1.8	2.1	2.7	4.0	5.1

Source: ABS cat. no. 3105.0.65.001 (2008) and Treasury projections.

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