

Taking stock of the AUD, curve and semis ahead of budget season

- The high Australian CPI but weaker US data has increased the outlook for the AUD and flattened the curve.
- The 'Budget Season' starts tomorrow with a risk that the states continue to miss their recovery targets.
- We analyse the relative value in the 3Y and 10Y maturity buckets using PCA. EIB looks dear, SG semis cheap.

The US market has rallied strongly over the past two weeks. This appears to be a reaction to the FOMC announcing a very slow and cautious end to QE2. For example, the Fed will continue to reinvest the coupons from its Treasury portfolio and retained the "extended period" of low rates language in the statement. The 2Y US treasury has rallied 7bp since our last Weekly on 18 April while the 10Y has rallied 9bp.

The strong Australian data hasn't been enough to overcome the US rally. The Australian headline CPI rose by 1.6% in the quarter and 3.3% in the year. The underlying CPI rose by 0.85% in the quarter and 2.25% in the year. This lifted money market rates and the AUD but wasn't enough to stop 3Y yields from falling 6bp. With 10Y yields down 16bp, the curve has flattened. Alex Stanley assesses these recent developments in his article on page 3 and finds good reason to expect more flattening.

The RBA will meet tomorrow but is highly unlikely to change the cash rate from its current 4.75%. The main focus will be on the tone the RBA takes when discussing the higher-than-expected CPI print. The RBA has previously said it will "look through" the flood related peak, but the core CPI print was higher than expected, even accounting for the floods.

The March building approvals data and Retail Sales will be released on Thursday. CBA economists are in line with market consensus in expecting a 5% rise in building approvals and a 0.5% rise in Retail Sales (+0.6% in Q1 ex inflation). That could start to change impressions of the 'cautions consumer' and price discounting.

We are approaching the May budget season. TCV will kick off the process tomorrow before the Federal budget is handed down next Tuesday (10 May). There have already been a number of press stories about the budget positions of the various states and the Commonwealth. The information we have seen so far indicates falling revenues from softer economic growth as the main culprit for the lower surpluses and higher deficits forecast. Adam Donaldson discusses the upcoming budgets in detail in his article on page 5.

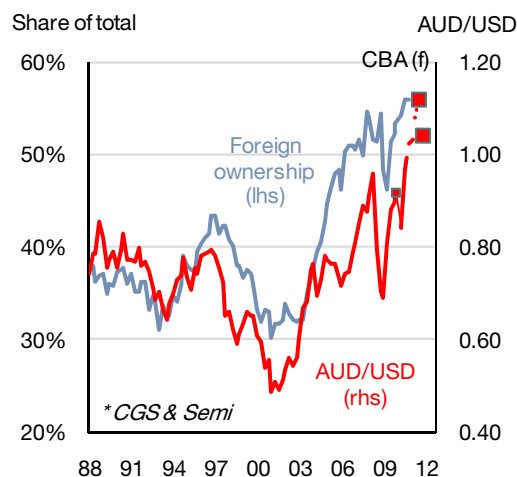
In the US, the recent data has been fairly poor, with Initial Jobless Claims (in particular) surprisingly high (above 400K for each the last three weeks). All that could quickly be forgotten if Friday's Payrolls is strong. The market is currently expecting a fall to 190K jobs created and no change to the 8.8% unemployment rate. The combination of strong Aussie data and weaker US data has changed the outlook for the AUD. Richard Grace updates our FX forecasts on page 14.

Philip Brown tries a new technique for analysing relative value within a maturity bucket in his article on page 10. Initial indications are that the EIB May-14 is slightly dear and that SG 10Y semis have been underperforming.

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Foreign bond ownership strongly correlated with the AUD



Source: ABS, CBA

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Key Positions

The flattening of the curve has made this a good week for our recommended trades. We have reached the target level on one of our RV trades, the ACGB Apr-15 to Feb-17. In fact, the bonds are now 2bp through our target. This spread trade was mostly an RV position, but was also helped by the flattening of the curve.

Key Trades

Trade	Entry	Curent	Profit	Target	Stop	Comment
Buy the NSWTC Jun-20 (Govt G'teed) as an ASW	-12bp (3-Feb-10)	-21bp	+9bp	-35bp	0bp	Hold: A long-term buy-and-hold trade.
Buy the ACGB Jan-18 vs the ACGB Nov-12	54bp (8-Dec-10)	40bp	+14bp	10bp	85bp	Hold. We apologise, this trade was recommended a while ago, but was accidentally excluded from the trade table.
Buy the KfW Dec-19 vs the IBRD Oct-19	33.5bp (31-Jan-11)	22bp	+11.5bp	20bp	40bp	Hold: The Portuguese issues are not affecting KfW.
Buy the Feb-15 IBRD vs the Oct-14 IBRD	9bp (15-Feb-11)	10bp	-1bp	2bp	12bp	Hold: The IBRD curve is too steep compared to the ACGB curve
Pay the AUD 3Y rate vs the NZD 3Y rate (carry 2.9bp per month)	132bp (21-Feb-11)	151bp	+26bp (including +6bp carry)	210bp	140bp	Hold: The spread is relatively stable but should trend wider. There is strong positive carry so we can hold the trade for the medium term.
Buy the QTC 2020 against the IBRD 2020	20.5bp (28-Feb-11)	22.5bp	+2bp	28bp	15bp	Hold: We expect the APRA liquidity announcement will see the spread widen more.
Receive fixed in 1Y ZCS vs paying 5Y ZCS	-38bp (14-Mar-11)	-50bp	-12bp	-15bp	-50bp	Stopped Out: The CPI surprised to the high side.
Buy an NSWTC Nov-20 Linker vs UST 1.25% Jul-20 linker	213bp (14-Mar-11)	222bp	-9bp	150bp	235bp	Hold: The real yield pickup is large. The US linkers are likely to underperform once QE ends.
Buy the ACGB Feb-17 against the Apr-15 (double exposure)	20.5bp (30-Mar-11)	15bp	+11bp	15bp	25bp	Take Profit, Target Reached: An RV trade which also benefits from a flattening curve
Buy the TCV Oct-14 against the ACGB Oct-14	25bp (31-Mar-11)	26.75bp	-1.75bp	20bp	28bp	Hold: An RV trade to take advantage of the wideness of the TCV
Receive the ASW on the NZGB Dec-17 against pay the Apr-15	15bp (4-Apr-11)	9bp	+6bp	5bp	20bp	Hold: The NZGB ASW curve is out of alignment.
Buy the Renten Jul-14s against the Jan-15s	20bp (5-Apr-11)	19bp	-1bp	25bp	17bp	Hold: The Rentenbank curve flattened faster than the ACGB.
Buy a 6M*1Y receiver 20bp below spot yields (4.85%)	7.5bp premium (11-Apr-11)			n/a	n/a	Hold: A deliberate insurance trade if our general optimism proves unfounded.
Receive the 10Y Bills/Libor basis against the 3Y	15bp (11-Apr-11)	10bp	+5bp	7bp	19bp	Hold: We the recent flow has steepened the curve too far.
Buy the ACGB Jun-14 vs EIB May-14 (trial only)	47bp			54bp	44bp	New Trade: We are monitoring this trade as a live test of our new PCA technique.



Maintaining our view for a flatter curve as the AUD rises after the CPI & FOMC meeting

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- The Q1 CPI result was higher than expected and was heavily influenced by recent natural disasters.
- The Fed maintained an accommodative stance on policy.
- The Aussie curve is likely to flatten as the AUD holds up and the market prices earlier tightening by the RBA.

The CPI and FOMC meeting underscore our view for a flatter Aussie bond curve.

The two main events for the market last week were the Australian Q1 CPI and the US FOMC meeting. The headline CPI rose substantially in Q1, mostly reflecting the impact of recent natural disasters, though petrol prices played a part too. In the US, the Fed revised up its headline inflation forecasts and confirmed QE2 would end in June. The Fed also indicated they would initially reinvest coupons and keep the Fed Funds rate low. Overall, the Fed’s policy position remains accommodative.

The CPI and FOMC meeting underscore our expectation for a flatter Aussie bond curve in the medium term. This flattening is already under way. Over the last week, the Australian 3-10y futures slope fell 8bp to touch 29bp at one stage today. In our view, expectations of RBA tightening are likely to drive up short end rates in the medium term.

Australian CPI and short end rates

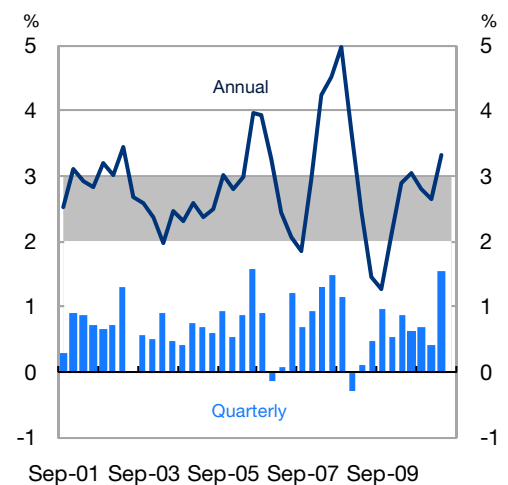
Last week, Q1 CPI data showed headline inflation grew at 3.3% over the last year. Underlying CPI measures were more subdued at 2 ¼% annually (Figure 1). Natural disaster impacts and high commodity prices drove much of the increase, but the magnitude of the pickup in CPI was larger than expected. While the RBA will look through the disaster impacts in the short term, the data is a warning of the likely need for an eventual return to tightening. Indeed, since the release, market pricing has edged toward pricing a more hawkish RBA. The market is still pricing less than one rate hike by year end, though, and less than one further hike in 2012 (see Figure 2).

The high value of the Aussie dollar and ongoing restraint by consumers is helping to contain underlying inflation. This restraint was evident in lower prices across a range of consumer durables in Q1 CPI. Figure 3 shows that the AUD has been especially strong of late, touching a new post-float high of USD 1.10 today. This is no doubt limiting the market’s preparedness to price in much RBA tightening. Our Currency Strategists see the AUD moving even higher to peak around USD 1.12 in Q3, so it could be a struggle to change that market pricing. (See article on page 14)

The high Q1 headline CPI result was mostly driven by natural disaster impacts.

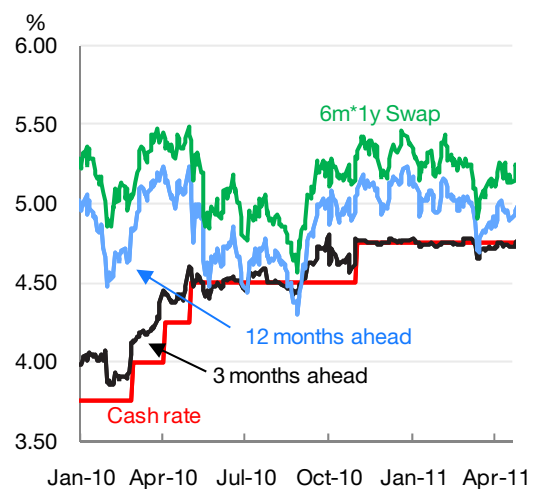
The high Aussie dollar and consumer restraint is helping contain underlying inflation.

Figure 1 – Consumer Prices (% change)



Source: ABS, CBA

Figure 2 – RBA cash rate and market pricing



Source: Bloomberg, CBA



We see these dynamics as starting to change, however. The capacity of consumers to lift spending is being aided by wages growth and a strong labour market. Wages growth, at 3.9% per annum, is back at 2007 levels. The stronger labour market has led to a fall in unemployment expectations, which is pointing to even higher wages (Figure 4). In the face of rising income, consumer restraint may ease, leading to a weakening of the discount pressure and earlier tightening by the RBA than the market expects.

Foreign ownership of AUD bonds is rising and helping flatten the curve

But the upward momentum for the AUD and Australia's very strong fiscal position (see p3) point to ongoing strength in demand for Australia's limited high-grade bond supply. Figure 5 shows that a rising AUD should see foreign buying of the local market step up another notch, holding AUS-US spreads steady (despite upward pressure on the cash rate) and contributing to the flattening of the curve we have been forecasting.

The Fed and the long end of the curve

The FOMC's announcements were largely in line with market expectations (including those made at Bernanke's press conference). Importantly, the QE2 program will expire in June, but coupon proceeds will be re-invested for the time being and the Fed Funds rate will remain low. Even once the Fed stops actively buying securities, US monetary policy will remain very accommodative.

The Fed's will cease buying under the QE2 program in June, as expected by the market.

The Fed lowered their forecasts for growth, especially in 2011. The Fed still considers the recent surge in commodity prices to exert only a "transitory" impact on inflation. On Friday, the Fed's favoured measure of inflation, core PCE, was released. At just 0.9%, underlying inflation in the US isn't yet at threatening levels. The FOMC did slightly raise their forecasts for PCE last week (though the 2012 and 2013 forecasts are still below what the Fed considers desirable). Bernanke stressed that medium and long term inflation expectations remained stable. The Fed still expects unemployment to fall at a very slow pace.

The US economy is slowly improving and conditions are starting to be tightened very slowly. Normally, a US recovery would be associated with higher US rates and a steeper Australian curve as the 10Y underperforms. However, this time, we think the US policy reaction will be slow enough that the RBA pressure at the front end will exert a greater impact on the slope of the Australian curve. This is reinforced by the advanced nature of the bond sell-off in Australia versus the US. We assess the terminal BBSW rate being priced in the futures market (5.8%) as being broadly appropriate, whereas US Eurodollar rates look too low in the years ahead.

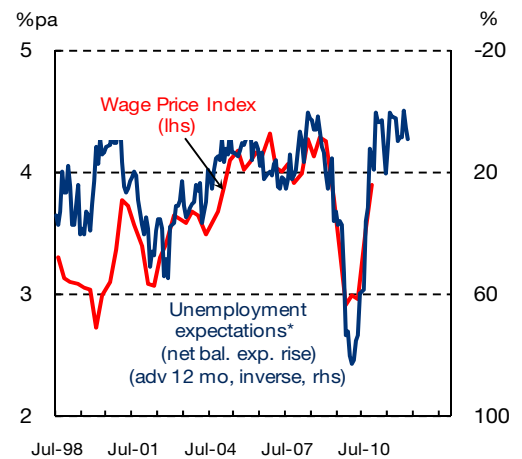
We expect slow rises in US long end yields to help flatten the Aussie curve.

Figure 3 – Aussie dollar at new record highs



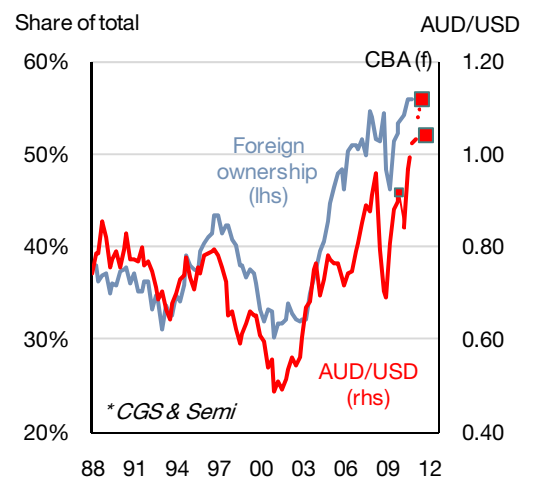
Source: Bloomberg, CBA

Figure 4 – Wages growth and Unemployment Expectations



Source: ABS, Melbourne Institute, CBA

Figure 5 – AUD versus foreign bond ownership



Source: Bloomberg, ABS, CBA



Budget Black Holes – Much Ado About Nothing for Debt Markets

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- Commonwealth revenue is behind the budget forecasts, but the slippage is small in context.
- State Governments have announced ‘black holes’. States have a history of forecast, but unrealised recoveries.
- Victorian Government revenues will remain under pressure from the reduction in GST distributions.

Budget season kicks off this week in Australia. As detailed last week, we generally view state and federal fiscal management as sound, fiscal positions to be strong and the high-grade debt market outlook as favourable. But talk of ‘black holes’ and fiscal deterioration continues to circulate, so it’s worth taking a closer look at the debt market implications ahead of tomorrow’s Victorian Budget.

Commonwealth

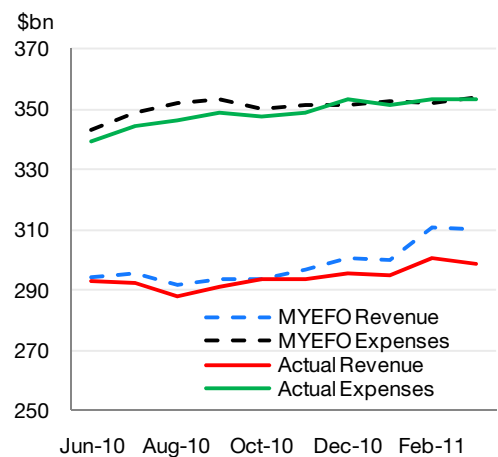
Evidence continues to mount that Commonwealth finances are under pressure. March fiscal results released over the weekend show that revenue is starting to fall well short of Commonwealth forecasts (Figure 1). The underlying cash deficit was \$47.9bn for 2010-11 YTD compared to a \$43.3bn profile mapped out in the November MYEFO (which forecast a total 2010-11 deficit of \$41.5bn relative to a \$40.8bn deficit in the May Budget). This leaves the 2010-11 result \$4.5bn behind plan compared to \$2.5bn in February (as released on the prior weekend). Treasurer Wayne Swan has indicated the tax take is \$6.5bn behind Budget and it now seems clear the deficit will be wider than previously forecast.

These numbers are small in the scheme of things. The Government is indicating next week’s 2011-12 Budget will be tight (particularly with respect to middle-income welfare and return to work incentives) and that it remains on track to deliver a small surplus the next year (2012-13). This suggests slippage of \$5-10bn in 2010-11 and 2011-12, which is small in the context of \$350bn annual spending or \$185bn debt securities outstanding.

The March Financial Statements show debt issuance had increased from \$157.4bn to \$193.0bn as at March, slightly above the \$191.1bn MYEFO estimate for June 30. More up-to-date AOFM data shows that Commonwealth securities outstanding have increased by \$38.4bn to \$185.5bn over the year to April 29, consisting of

- Treasury Bonds - \$161,492m
- Treasury Indexed Bonds - \$13,529m
- Treasury Notes - \$10,500m

Figure 1 – Commonwealth general government monthly revenue and expenses (accrual)

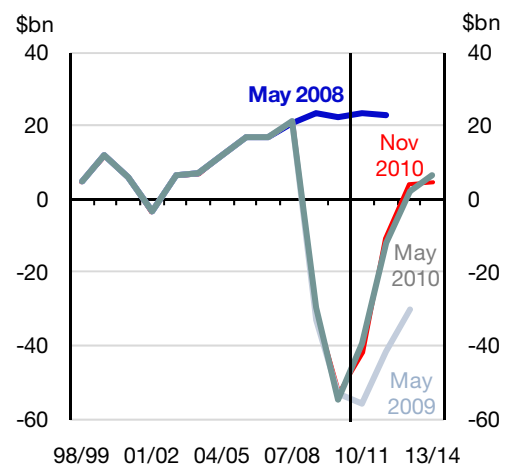


Source: C’wealth Monthly Financial Statements, CBA

Commonwealth revenue is behind budget in 2010/11.

In context, the short term fiscal slippage is small.

Figure 2 – Commonwealth general government fiscal balance



Source: Commonwealth Budgets & MYEFO, CBA



The AOFM is on track to meet its November issuance guidance.

- Other Securities - \$20m

The \$38.4bn increase in outstandings reflects \$47.2bn of net new issuance offset by maturities of \$8.8bn. With 10 months of the year gone, that issuance run-rate would suggest AOFM is well on track to meet its November guidance that total issuance will be \$50-55bn this financial year. There is obvious room within the T-note category for any last minute adjustments. Our sense is that the large step-down in total issuance from \$55bn to around \$25bn in 2011-12 (as previously projected) is the main game to focus on, not whether the soft patch in the economy means that figure is now slightly higher (Figure 4). Relative to most advanced AAA economies, the Australian position is obviously very strong.

The Government's assets portfolio provides an important offset.

From a debt management perspective, it's also worth highlighting that the extra call on funds from the deterioration in the Budget has thus far been met by running down the Government's assets portfolio. *Investment, loans and placements* have declined by \$16.3bn YTD to \$86.6bn, relative to the MYEFO forecast for \$94.5bn at June 30. We tend to think further variance in the numbers for 2010-11 would impact this side of the ledger as opposed to borrowing. For example, a \$20bn cut to the investments estimate for June 30 2011 saw the Government revise its estimate for securities outstanding down by \$19bn in the MYEFO, despite a small upward revision to its net debt estimate (Figure 5).

The magnitude of these possible changes show that it is almost pointless to try and guesstimate the possible debt profile for 2011-12 or coming years. This will depend much more on the government's actual debt management policy. The key question here is whether it will maintain the existing, politically attractive, policy of taking gross debt back down to \$75bn? Or will it seek to maintain liquidity in the market and some relevance in global fixed income benchmarks by opting to keep issuance above \$150bn in the years ahead? Any news on this front would be much more important for the CGS market (particularly linkers) than relatively small tweaks to deficit estimates. However, with debt still yet to peak, policy-makers have time up their sleeve before needing to worry about that.

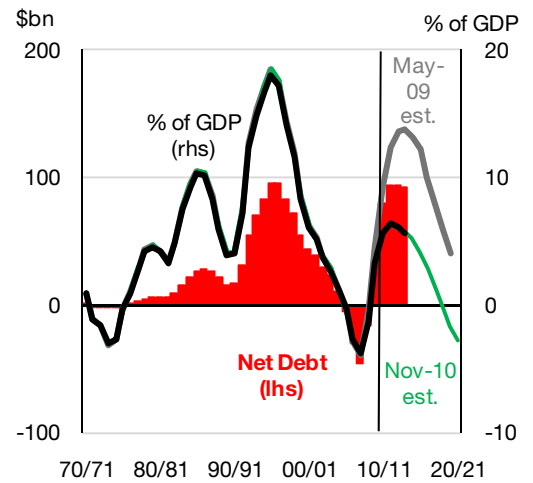
The Government's debt management policy will be the key factor in determining the future debt profile.

The Research team's more comprehensive Commonwealth Budget preview will be released in the next few days.

States

There is (or at least should be) a slightly greater focus than usual on state government finances following a change of government in NSW and Victoria within the past six months. The new

Figure 3 – Commonwealth general government net debt near its peak



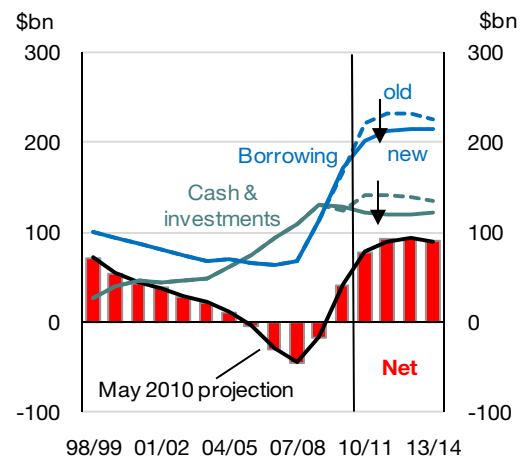
Source: Commonwealth Budgets & MYEFO, CBA

Figure 4 – High-grade AUD bond outstandings



Source: AOFM, MYEFO, CBA

Figure 5 – MYEFO revisions to components of Commonwealth net debt



Source: Budget Reports, KangaNews, CBA



New State Governments have commented on budget “black holes”.

coalition governments in both states have pointed to Budget ‘black holes’ and indicated that worse than expected fiscal positions mean they must tighten fiscal policy and jettison election promises.

It is clear that government revenue has been weaker than expected due to the soft-patch in the economy. This has impacted company profits, housing stamp duties and GST receipts (with Victoria also suffering from an additional change to the distribution of federal grants). Expenses are also under pressure due to rising capex costs and the spate of natural disasters. But the on-going economic expansion and strength in national income growth mean fiscal strategies remain broadly on track.

As stated last week, we see much of the ‘guidance’ as reflecting the usual softening up that new governments undertake ahead of their first Budgets. We shed some detail on that process below. However, it is true that semi-government debt remains on a firm upward trajectory (Figure 6). Deterioration in that picture is unlikely to threaten credit ratings, but we are at the stage of the cycle where we need to see some corrective action being taken.

State Government debt remains on an upward trajectory.

Figure 6 shows forecasts for net debt have improved a little since the 2009-10 Budgets were framed two years ago. This reflected two key developments; asset sales in Queensland and a much better than expected economic performance in 2009-10. But the end level of debt remained much the same (just a year later) and the trend slipped back a bit between the 2010-11 Budget season and the various mid-year reviews.

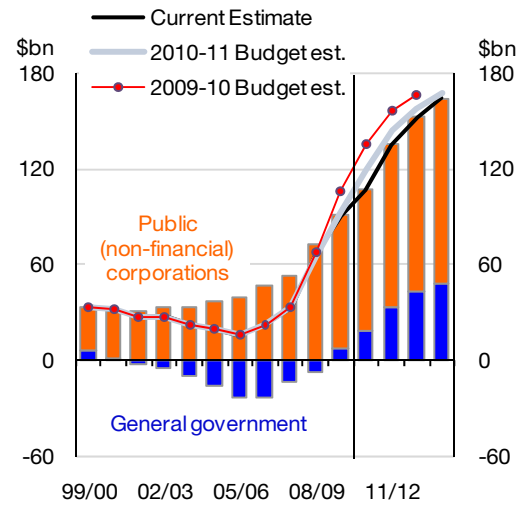
Figure 7 shows how this latter deterioration is actually more in line with the performance over the past five years. With the exception of 2009-10, we can now say that State Governments as a group have repeatedly forecast improvement in their fiscal position and failed to deliver. The soft spot in the economy means there is a clear risk that wider 2010-11 and 2011-12 deficits extend this trend. But the time has probably come where Governments should ensure this does not flow through to further deterioration in the estimates for future years by actually taking some corrective fiscal repair measures. In that context, the new Governments in Victoria and NSW are making the right, if perhaps misleading, noises.

State Governments have a history of missing forecasted improvements in their fiscal position.

Victoria

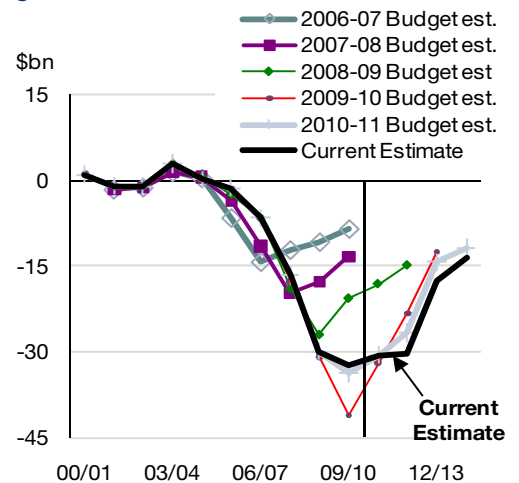
Victoria’s new coalition government announced an independent review of the State’s finances, debt management, governance and service delivery in January. It followed in April with a short *Economic and Financial Statement* that unveiled cost and revenue pressures it said

Figure 6 – Total 6 States Net Debt



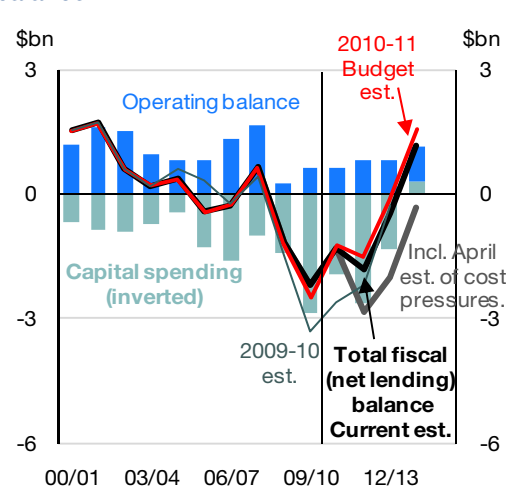
Source: Budget Reports, ABS, CBA

Figure 7 – Total 6 States Fiscal Balance



Source: Budget Reports, ABS, CBA

Figure 8 – Victorian general government fiscal balance



Source: Budget Reports, ABS, CBA



exposed the state to 'financial vulnerabilities'. These developments indicate some fiscal repair is likely as the government attempts to fund some of its election promises in tomorrow's 2011-12 Budget. However, it's important that political posturing designed to pave the way for fiscal consolidation in a government's first term not cloud perceptions of the State's fiscal health.

The *Independent Review of State Finances* has found that reported measures of General Government net operating balance overstate the underlying position of the sector's finances. This reflects inclusion of grants revenue from the Commonwealth as operating revenue, whereas the infrastructure spending tied to the *Nation Building-Economic Stimulus Plan* is recorded as an acquisition of non-financial assets and therefore captured within the total fiscal balance (or net lending) bottom line. The *Interim Report* says that the 'underlying' net operating balance has actually been a deficit of around \$1bn in 2009-10 and 2010-11.

While this may be technically true, Figure 9 shows that the issue is of little relevance after 2010-11 (and that at least some of the expense has been captured within grants expense). The forward estimates capture the flattening out of grants revenue and expenses and belie the claim that there is a structural operating deficit (which the Review argued exists based on projecting forward the 0.8% p.a. gap between 'underlying' revenue and expenses over the past 10 years). The reality is that these numbers have been knocked around substantially by the GFC and coordinated state and federal efforts to protect the economy. Some fiscal repair is required following such an episode, but is already captured in the forecasts.

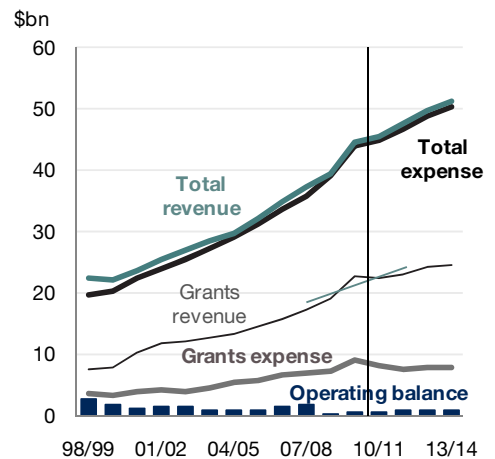
The real problem is that revenues are under some pressure due to the Commonwealth changes in GST distribution and cyclical weakness in the economy. Victoria was a major loser when the Commonwealth Grants Commission provided its recommendation for distribution of the GST pie back in February (Figure 10). That accounts for \$2.5bn of the \$5.05bn in Budget 'pressure' announced in April (over a four-year period). The rest of the figure related to Commonwealth funding delays and capital project cost overruns (in addition to an unspecified floods cost).

Figure 8 shows the potential impact of these pressures on the fiscal balance – hardly a game breaker in our view and one that is likely to be offset by consolidation measures. Figure 11 shows the impact on the 2010-11 Mid-year estimates of incorporating the full impact of these pressures in to both higher debt and lower revenue (though half is a cost story).

An independent review found some overestimation of State Government's underlying fiscal position, but it is of little relevance after this financial year.

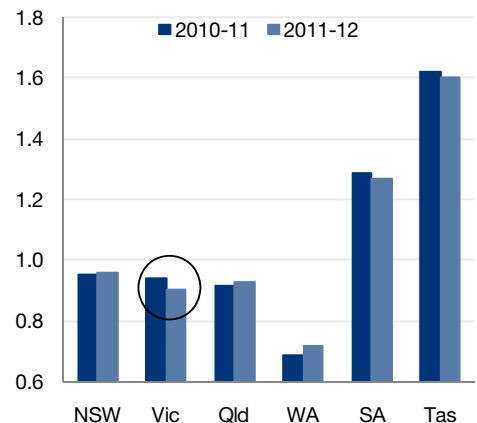
Victorian revenues are under more pressure following Commonwealth changes to GST distribution.

Figure 9 – Victorian revenue and expenses



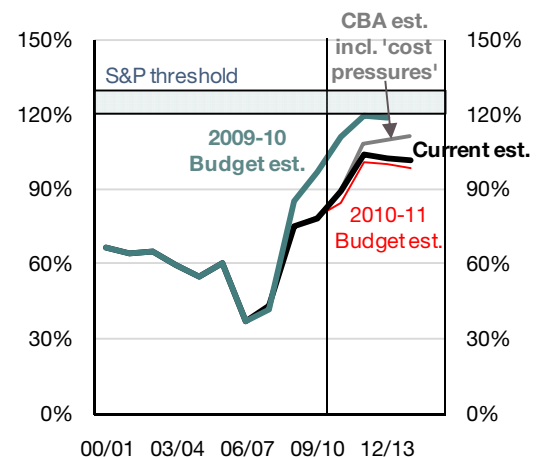
Source: Victorian Mid-year Review, CBA

Figure 10 – GST distribution relativities recommended for 2011-12



Source: Commonwealth Grants Commission, CBA

Figure 11 – Victorian revenue and expenses



Source: Victorian Mid-year Review, S&P, CBA



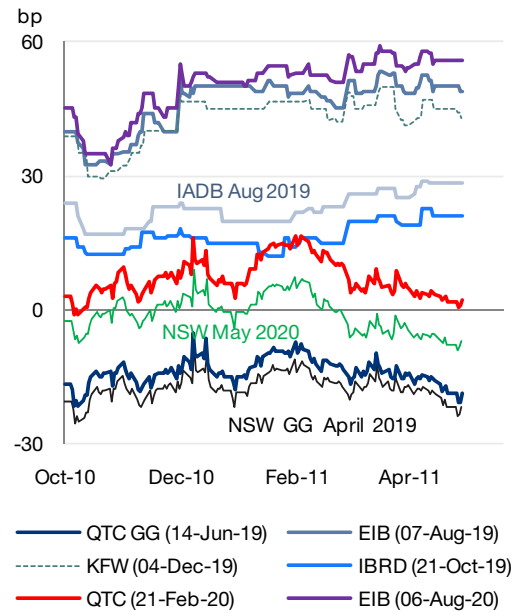
The outlook for Victorian debt is very secure.

We continue to think semi-government spreads will tighten to CGS.

Victoria’s net financial liability/operating revenue measure will remain well below S&P’s key AAA ‘trigger’ level for some time yet.

Our sense is that this very strong ratings position, combined with fiscal tightening (and perhaps embracement of the *Independent Review’s* outlandish call for a zero net debt target) means that the outlook for Victorian debt is very secure. We will reassess following the Budget on Tuesday and ahead of the various other state Budgets to be presented in coming months, but for the time being are happy to stick with our call for semi-government spreads to tighten against bond and move more decisively through swap. As discussed in the next article, our sense is that non GG semi government spreads have room to tighten even more following the very strong performance since the APRA liquidity announcement in February.

Figure 12 – High-grade spreads to swap



Source: CBA

Figure 13 – Government spreads to swap

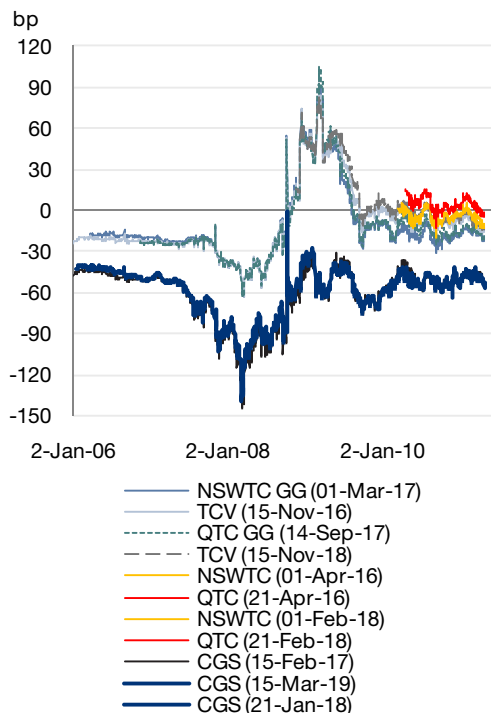
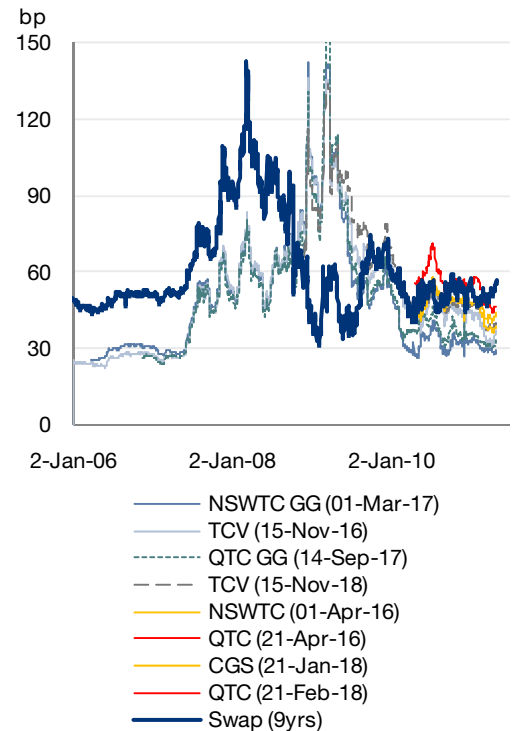


Figure 14 – Semi-govt spreads to bond





Using PCA to examine high-grade maturity buckets shows significant promise

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- We apply PCA in a new way to analyse the relative value in maturity buckets of the high-grade bond sector.
- In the 3Y maturity bucket, the semis are seen as comparatively cheap, but not overly so.
- The EIB May-14 looks dear compared to the ACGB Jun-14. We intend to follow this trade as a test run.
- In the 10Y, the SG semis are cheap, but the WATC Jul-21 is an exception.

We want to assess relative value within a particular maturity bucket

We are often asked which bonds in a particular maturity bucket are the most attractive. For example, “Of the semis, which is the cheapest 3Y bond?” From a statistical perspective this is a hard question to answer, because there is a measure of credit risk in semi bonds and there is no easy way to price the credit fan. Most models of interest rates are based on modelling the change in rates over a curve of different maturities, not for different credit levels at a single maturity.

It occurred to us that we could modify our Principal Components Analysis approach to cheap/dear curves to model a particular section of the yield curve. We have, previously, used PCA to identify which bonds from a particular issuer are cheap or dear compared to that issuer’s curve. The process works for analysing similar bonds of the same maturity too. Our preliminary results suggest the 10Y semis are slightly cheap, as a rule, with the exception of the WATC Jul-21, which has been richening in recent weeks.

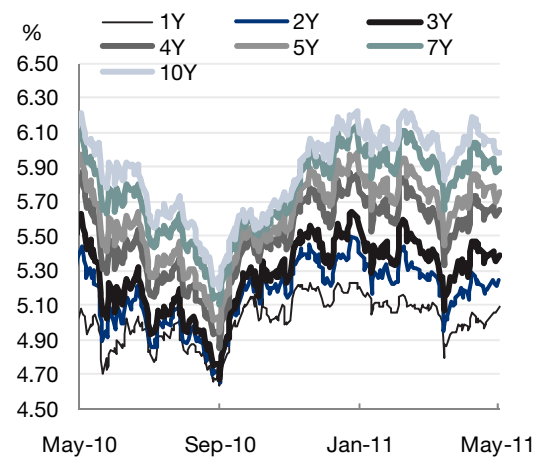
How PCA works and why it should work for analysing high-quality credits

PCA should work because a maturity bucket has excess and redundant information

PCA was not, originally, a financial markets technique. It works by summarising a large set of information into its most common moves, known as the principal components, or PCs. The purpose of the PCA is to remove redundant information and to express a very large data set in a much smaller number of observations. Removing the redundant and repetitive data makes unexpected changes easier to see.

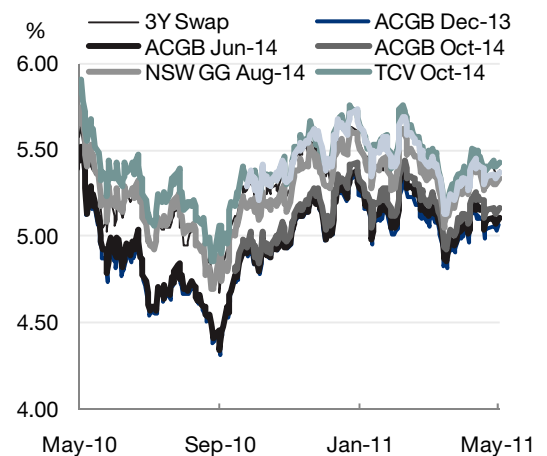
In a fixed income setting, a yield curve is a common forum for PCA. The PCA process allows a large set of information (all rates for the entire yield curve) to be summarised using fewer, simpler concepts (like the level and slope of the curve). PCA works in the case of a yield curve because there is a lot of redundant information. Once I know the 2Y, 3Y, 4Y, 5Y, 7Y and 10Y rates, knowing the 6Y provides very little extra information. The 6Y will be highly predictable. In fact, the 4Y was probably almost entirely redundant, too...

Figure 1: There are significant redundancies when analysing the whole yield curve



Source: Bloomberg, CBA

Figure 2: Similar redundancies can be seen in the 3Y high-quality bond space



Source: Bloomberg, CBA



Similarly, the set of all high-quality 3Y bonds will have a lot of redundant information. Once you know the movement of the 3Y ACGB, the 3Y swap, the 3Y NSWTC and the 3Y WATC, predicting the moves in the yield of the 3Y TCV should be relatively simple. The redundancy in the information makes high-grade maturity buckets a candidate for PCA. (See Figures 1 and 2.)

At least, that's the theory. We have used PCA to analyse the high-quality 3Y and 10Y bond buckets, covering ACGB, swap, semis and some supras. Our initial results are promising and are presented below. We will keep using this technique over coming weeks and see how it goes, but the initial results look good.

Initial results: Semis on the cheap side, EIB May-14 and WATC Jul-21 the exception

3Y semis show as slightly cheap

The EIB is dear compared to the ACGB

In the 3Y bucket, the ACGBs and semis show as marginally cheap, while the supras are a little dear. However, these results are only in the order of 1 to 2bp. Only the EIB May-14 is statistically significantly dear. To capture the dearness of the EIB it's best to pair it with a cheap bond of a similar maturity. The best way we can see to do that is to buy the EIB May-14 against the ACGB Jun-14 at a spread of 47bp. We are still testing the PCA technique in this setting, so will follow the trade as a sort of live test.

10Y semis are statistically significantly cheap

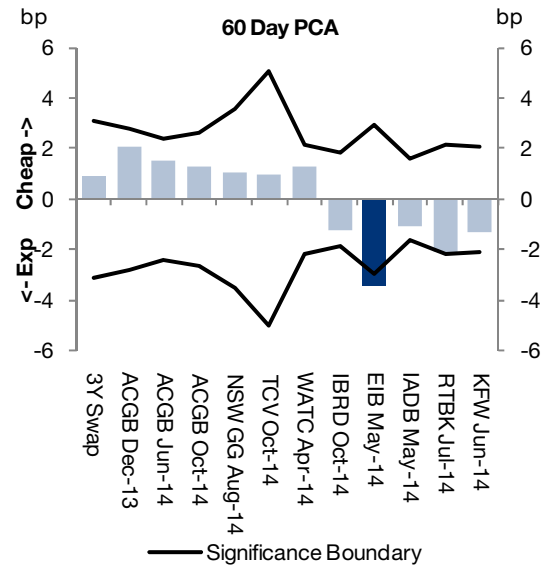
In the 10Y bucket there is a slightly odd result. The WATC Jul-21 shows as dear. The two Government Guaranteed semi bonds are also on the dear side. The two state-guaranteed semi bonds are shown as cheap. This is somewhat of a surprise, because our traders have been suggesting that the semis have been looking slightly dear. For example, most semis have been tightening compared to swap. But more on this later, first let's examine the dearness of the WATC, since the dearness of the WATC goes a long way to explaining the relative cheapness of the other semis.

The WATC Jul-21 is different – it's in the process of moving back to the curve

In the Fixed Income Daily of 13 April we noted that the WATC Jul-21 was cheap and was likely to outperform the market. Though, at the time, we declined to make an "official" trade recommendation because the WATC Jul-21 can be difficult to source.

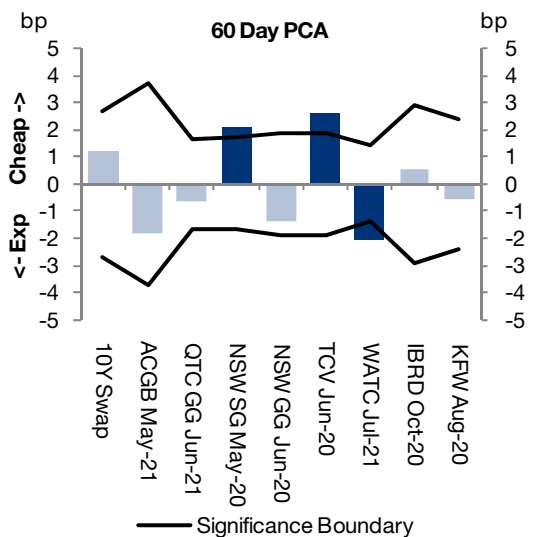
The touted outperformance of the WATC appears to have have come to pass. The slope between the WATC Oct-19 and WATC Oct-21 has flattened from 16bp to 13bp since then. Also, on 13 April, a Nelson-Siegel fit of the WATC curve showed the Jul-21 as 4bp cheap. Today, the same process shows the bond is now only 1bp cheap (see Figure 5).

Figure 3: In the 3Y bucket the semis look a little cheap, but are not statistically significant



Source: Bloomberg, CBA

Figure 4: In the 10Y bucket the semis also look cheap, except the WATC Jul-21



Source: Bloomberg, CBA



How come the PCA says “dear” while the Nelson-Siegel says “cheap”? A PCA analysis compares a bond’s current position to its historical average position. The Nelson-Siegel curve compares a bond’s current position to a theoretically smooth curve. A bond which used to be very cheap, but has now richened slightly, can show as dear compared to recent history (PCA) but cheap compared to theory (NS).

The WATC bond is a perfect example of the cheap-yet-dear behaviour we described. The bond used to be very cheap because it was longer than 10Y and had only a very small amount on issue. As we highlighted in the original article in the daily, the bond is now approaching the 10Y bucket and WATC have slowly increased the volume on issue. Both of these factors should cause the bond to move from being exceptionally cheap, to less cheap and so show as dear on the PCA but cheap on the Nelson-Siegel.

We suspect the WATC Jul-21 will actually continue to richen slightly if WATC continues to increase the volume on issue. This close to the state budget announcement on 19 May we think it is unlikely the WATC will make a significant offering of new bonds. However, once we move past the budget, there is likely to be continued issuance into this line which will continue the richening process.

The other way to measure the movement of the WATC Jul-21 is by comparing it to the TCV Jun-20. Figure 6 shows that the TCV has been underperforming the WATC for the last couple of months. Over the same period, though in a slightly less obvious way, the NSWTC SG bond has been underperforming the GG.

Figure 6 goes a long way to explaining why the two SG semis are shown as cheap. A PCA shows the relative position of bonds compared to their historical averages. Although the SG semis have been tightening compared to swap, they have been tightening at a slower pace than the WATC and the GG bonds. As such, the PCA identifies them as having moved “less far” than we would expect. Hence, they are shown as cheap.

We tend to think that the GG bonds will continue to outperform and that the WATC bonds will continue to tighten (slowly). As such, we don’t think these SG semis are likely to mean revert in the near future. Their recent underperformance was structural, not random, and those same structural effects are likely to continue.

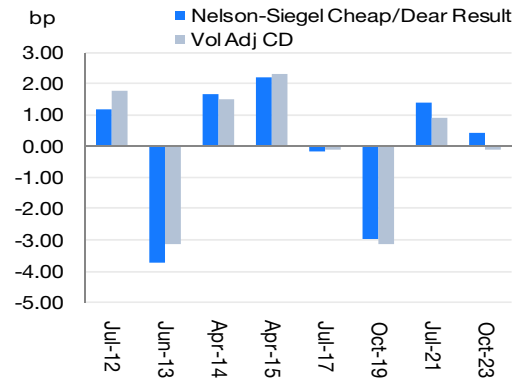
TCV underperforming WATC and NSW SG underperforming GG

The main driver of maturity buckets is a parallel shift

Interpreting the PCs

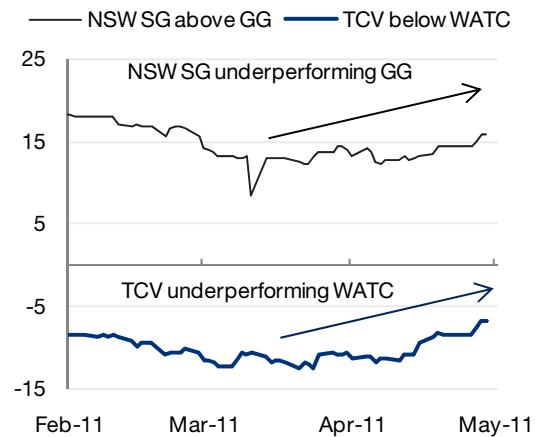
A PCA analysis also provides a breakdown of the most common movements in a given

Figure 5: In the 10Y bucket the semis also look cheap, except the WATC Jul-21



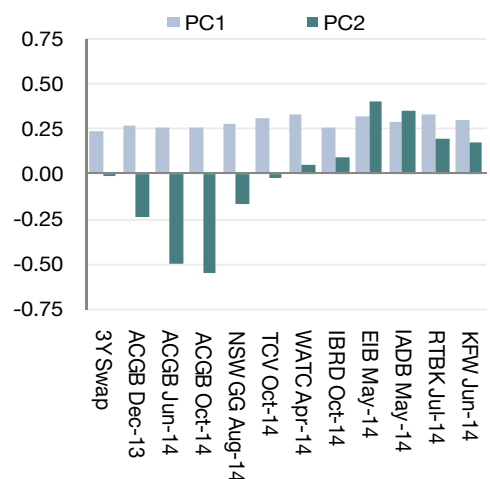
Source: Bloomberg, CBA

Figure 6: Relative performance of SG bonds to other bonds in the bucket



Source: Bloomberg, CBA

Figure 7: PCs of the 3Y bucket



Source: Bloomberg, CBA



Secondary drivers tend to be outperformance by categories, like semis or supras

dataset. We were not surprised to find that the most common movements of bonds in the 3Y bucket was a general parallel shift, which accounted for 95% of the movement. The second most common movement was for the supras to move in the opposite direction to the ACGBs. This movement accounted for 3% of the total movement of the dataset. These two PCS are shown in Figure 7.

For the 10Y, the story is fairly similar. The most common move was, once again, a move in the level of all rates. This move explained 93% of the variation in the dataset. However, unlike the 3Y bucket, the second most common movement was for the semis to move in the opposite direction from the other bonds (both ACGBs and Supras). The second PC explains 6% of the movement of the long basket. (See Figure 8.)

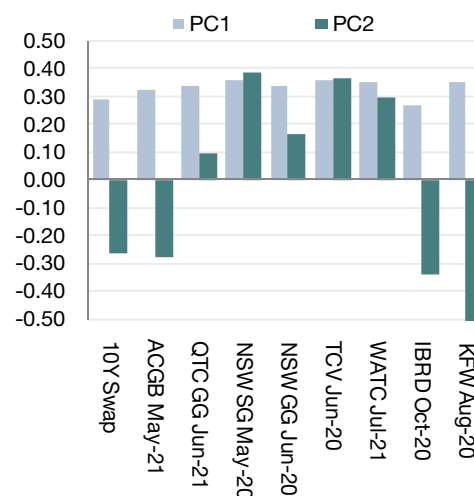
Conclusions

We believe a PCA approach, similar to the one we use for modelling yield curves, can be used to model the bonds inside an individual maturity bucket too. Currently, in both the 3Y and the 10Y buckets, the SG semi-government bonds are relatively cheap compared to recent history. In the 3Y bucket, the effect is small. The supras are generally dear and the EIB May-14 is particularly dear. We will monitor the EIB May-14 vs ACGB Jun-14 spread as a live test of the technique.

In the 10Y bucket, the SG semis are statistically significant cheap. However, in our view, they are unlikely to mean revert, because the driver is structural rather than random. The WATC bond has richened as it entered 10Y had more issuance added. The WATC may continue to richen slightly. Also, the 10Y Government Guaranteed semi bonds are relatively dear, but are likely to continue drifting tighter as the lack of supply builds a scarcity value.

The 10Y Supras did not show a particular pattern in this analysis, though might at a future time.

Figure 8: PCs of the 10Y bucket



Source: Bloomberg, CBA



Upward revision to AUD forecasts

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We have revised up our AUD forecasts and now believe the AUD will be at 1.1200 by end-September 2011.

An extended period of USD weakness and a greater volume of capital invested in the AUD are the main reasons.

We have also revised up our long-term AUD forecasts consistent with structural adjustments in the AUD & USD.

Introduction

It is more than seven months since we changed our AUD, NZD, CAD and JPY forecasts. Please see *FX Strategy – Adjustments to the Forecasts*, published 23 September, 2010. It is almost three months since we revised up our EUR, GBP and CHF forecasts. Please see *FX Strategy – Upward Revision to the European Currencies*, published 28 January, 2011. The changes to the currency forecasts represent little change to broad currency direction; rather the changes generally represent an extended period of USD weakness and the greater volume of capital being invested in the AUD.

Downward revision to USD forecasts

Seven months ago we forecast the USD would recover in the month before the Fed concluded their quantitative easing policy at the end of June. We now believe the USD won't recover until the Fed formally changes their monetary policy guidance from an easing bias to a tightening bias. At this point, the weighted US two-year swap spread to the US's major trading partners will turn higher, guiding the USD to firmer levels (chart 1). Until the swap spread turns the USD will remain soft and continue to weaken. We have subsequently pushed out the timing of our USD recovery by one-quarter, which allows further upside in most currencies vis-à-vis the USD.

We have also lowered our long-term USD forecasts consistent with our view that the USD is undergoing a long-run structural depreciation. Please see *FX Strategy – The long-run structural decline in the USD*, published 23 March, 2011. The decision by international credit rating agency Standard & Poor's (S&P) to affirm the long-term US AAA credit rating, but revise down the outlook from stable to negative, supports our view the USD is in a longer-run structural decline. We still believe that the USD will experience a temporary period of cyclical strength beginning in the final quarter of 2011, but the USD rally will fade and reverse by H11 2012.

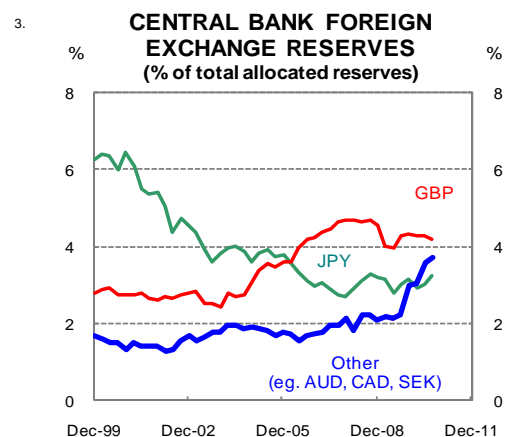
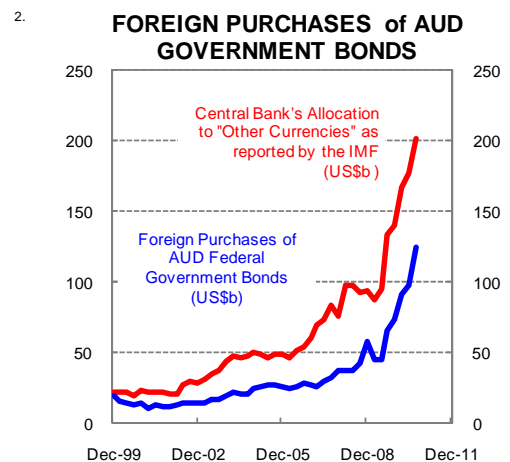
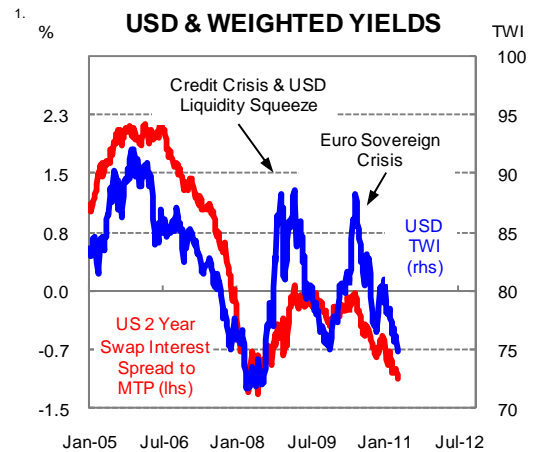
Upward Revision to AUD forecasts

We have revised up our short-term and long-term AUD forecasts. The old and new short-term forecasts are presented in the table below.

	Current	End Period			
	29-Apr-11	Jun-11	Sep-11	Dec-11	Mar-12
AUD	1.0926	1.0800	1.1200	1.0400	0.9800
	<i>Old</i>	<i>0.9900</i>	<i>0.9400</i>	<i>0.9200</i>	<i>0.9000</i>

There are five main reasons why we are revising up our short-term AUD forecasts to a new post-float high –

(1) *An extended period of USD weakness.* Please see above.





(2) A greater volume of international capital looking to invest in the AUD. The official data very clearly illustrates that foreign central banks, with US\$9.2 trillion in foreign exchange reserves under management, are lifting their allocation of AUD within their portfolios (charts 2 and 3). In many cases, some central banks are adding AUD to their portfolios for the first time.

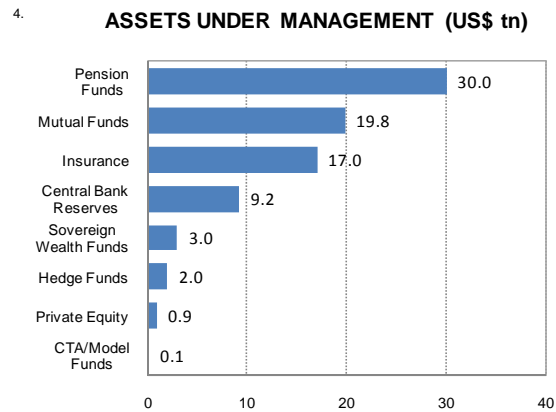
Compared to the series of marketing trips to London, New York and Asia over the last five years, anecdotal evidence from last month's trip suggests to us that major private sector (and public sector) funds now better understand the Australian terms of trade story. The greater weight of private sector international capital now being invested in Australia and its appreciation effect on the AUD should not be underestimated. The collective size of global private sector funds (pension, insurance and mutual funds) is very large at around US\$67 trillion; more than 7 times the size of central banks' foreign exchange reserves (chart 4).

As at the end of 2010, the stock of foreign purchases of Australian Federal government bonds totalled \$136 billion (equivalent to 10% of Australian GDP) compared to \$35 billion at the end of 2005. Total foreign ownership of the \$350 billion Australian Federal and Semi-Government bond market is around 60%.

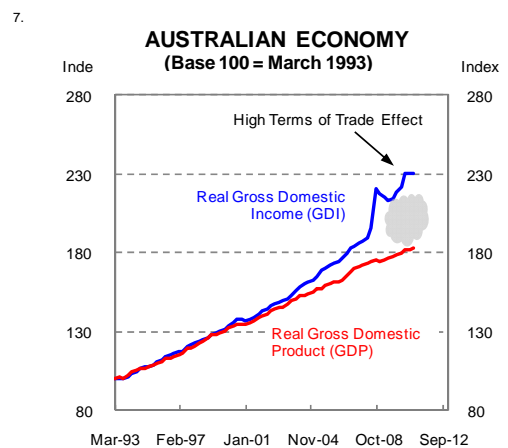
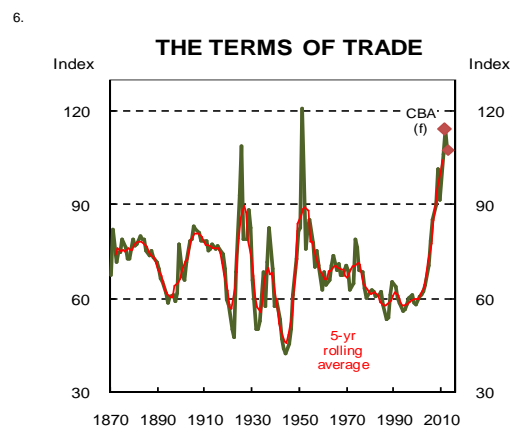
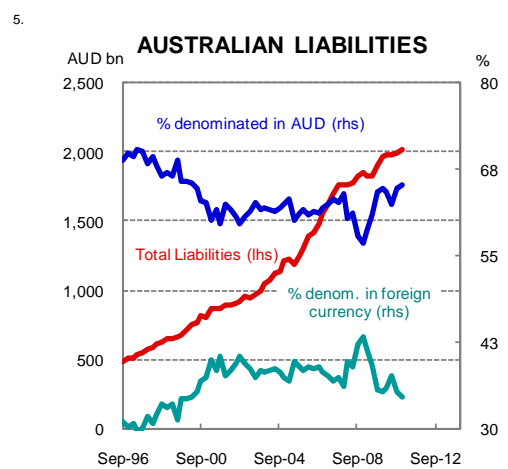
The increase in foreign purchases of Australian bonds (as well as the appreciation in the AUD) has lowered the proportion of Australia's debt denominated in foreign currency (chart 5). Australian banks are responsible for raising the vast majority of Australia's foreign capital requirements. Australian banks are having less trouble funding balance sheets in AUD and the proportion of AUD funding has increased in recent times. At AA, the four major Australian banks have got close to the highest bank ratings available. One of the key criteria for international rating agencies like Moody's and S&P, is the health of the commercial banking system. The Reserve Bank of Australia's (RBA's) semi-annual Financial Stability Report noted "the Australian banking system has continued to perform better than those in many other countries, consistent with the relative strength of the domestic economy over recent years". The relative health of "sovereign Australia" is attracting international capital into AUD investments, and this process is likely to push the AUD higher over coming months.

(3) A further lift in Australia's terms of trade. Australia terms of trade rose another 3.8% in Q1 2011 to be 20.8% higher than a year ago. The five-year moving average in Australia's terms of trade has lifted to its highest level in 140 years (chart 6). Australia's terms of trade represent the net income inflow from the rest of the world into the Australian economy. Reflecting the terms of trade effect on the Australian economy, real gross domestic income (GDI) continues to expand at a rate much greater rate than real gross domestic product (GDP); please see chart 7. The income growth is stimulating economic activity, and generating an investment boom. The net effect is putting downward pressure on Australia's unemployment rate and upward pressure on inflation. Australian interest rates and the AUD will remain under upward pressure. Commodity prices are expected to remain firm driven by strong global demand and a slow supply response.

(4) Confirmation of the IMF's firm global growth forecasts. In the April 2011 IMF World Economic Outlook, the IMF maintained their 2011 and 2012 global GDP growth forecast at 4.4% and 4.5% respectively. These global growth rates are well-above the long-run average of 3.8%. The 22.2% lift in the IMF's forecast for the average 2011 oil price since the January update, as well as the risk of higher future oil prices, has not, to date, dampened the IMF's global growth forecasts. We have also not altered our global growth forecasts; but we, like the IMF, acknowledge the risks. Sustained higher oil prices represent a risk to



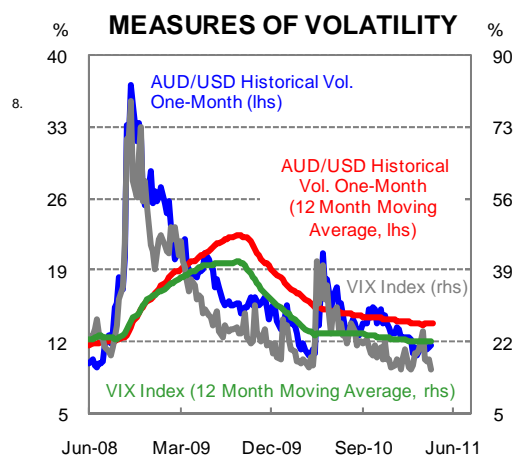
Source: Mckinsey, Bluegold Capital, IFSL Research, IMF





the global growth outlook and hence the strength of the AUD. But as the IMF notes; in advanced economies, the declining share of oil, the disappearance of wage indexation, as well as the anchoring of inflation expectations, “all combine to suggest there will only be small effects on growth and inflation.” Developing economies, which account for the lion’s share of global growth, will face greater challenges, but “we do not expect a major adverse impact on growth.”

(5) *A continued low vol. environment.* The impact of the Basel III phase in-arrangements suggest market volatility (vol.) will continue to trend lower, largely because the changes to the regulatory requirements discourage excessive risk taking. Vol. has declined in most asset classes; particularly in the equity and currency markets as represented by the VIX and one-month currency options vols. (chart 8). When market vol. is low, relative economic health tends to drive exchange rates (rather than risk aversion). Australia’s sovereign health remains excellent, with the highest interest rates in the AAA spectrum. Low vol. tends to encourage participants to search for yield, and Australia and the AUD is increasingly coming onto their radar.



Higher long-term AUD forecasts

We have been publishing material on the long-run structural appreciation of the AUD since mid 2007 (Please see *FX Strategy – A Structural Break for the AUD ?* published 26 July 2007). We have raised our long-term AUD forecasts to be consistent with the view that the AUD is undergoing a structural appreciation, and to be consistent with our view that the USD is undergoing a long-run structural depreciation, as detailed on page two. The new long-run average AUD forecasts are detailed below.

	Current	Financial Year Averages			
	29-Apr-11	2010/11	2011/12	2012/13	2013/14
AUD	1.0926	0.9926	1.0175	0.9825	0.9400
	<i>Old</i>	0.9726	0.9150	0.8500	0.8500

	Current	Calendar Year Averages		
	29-Apr-11	2011	2012	2013
AUD	1.0926	1.0540	0.9650	0.9825
	<i>Old</i>	0.9690	0.8700	0.8500

Upward revision to other non-USD forecasts

We have made upward revisions to virtually all other currency forecasts as a result of downward revision to our USD forecasts. Rather than detail all the additional reasons for adjustments to the EUR, GBP, NZD, CHF, CAD, JPY and non-Japan currency forecasts, details of these changes will be forthcoming in separate publications. Details of the old and new forecasts are nevertheless given in the table below.

	Current	End Period			
	29-Apr-11	Jun-11	Sep-11	Dec-11	Mar-12
Industrialised Countries					
AUD	1.0926	1.0800	1.1200	1.0400	0.9800
	<i>Old</i>	0.9900	0.9400	0.9200	0.9000
EUR	1.4824	1.4700	1.5000	1.4300	1.4000
	<i>Old</i>	1.4500	1.4200	1.4000	1.3600
JPY	81.55	83.00	82.00	85.00	88.00
	<i>Old</i>	86.00	87.00	88.00	88.00
GBP	1.6631	1.6500	1.7000	1.6500	1.6000
	<i>Old</i>	1.7000	1.6800	1.6500	1.6000
CAD	0.9509	0.9400	0.9000	0.9800	1.0000
	<i>Old</i>	1.0200	1.0300	1.0400	1.0500
NZD	0.8024	0.8200	0.8500	0.7900	0.7600
	<i>Old</i>	0.7500	0.7200	0.7100	0.7000
CHF	0.8735	0.8800	0.8500	0.9300	0.9800
	<i>Old</i>	0.9100	0.9500	0.9700	0.9800



Key Views

United States		Tactical (<1 mth)	Strategic (>3 mths)
<p>The improvement in the US data has temporarily stalled. Uncertainty about the stability of the Middle East & high oil prices are buffeting data, confidence and markets, but aren't a recovery deal-breaker. US politicians have agreed a budget deal to avoid shutdown. The next step will be to pass an increase in the debt ceiling, with pressure for a longer-term fiscal deal intensifying following an S&P revision to the AAA rating outlook. We think a deal will come to pass and do not expect the US to be downgraded in the next 1-2 years, reinforcing our view that the US bond sell-off will be moderate.</p> <p>We expect a stronger economic recovery to take hold in mid or late 2011 and for bond yields to head higher as the situation becomes clearer. The Fed remains concerned about the slow recovery in the labour market (though even this is now starting to show signs of life) and the very low level of (underlying) inflation, though Bernanke has been softening his tone on this a little in the face of high commodity prices. Chairman Bernanke confirmed that the Fed would cease buying new bonds at the end of June, but would continue to reinvest coupons. Later, once the Fed starts raising the Fed Funds rate, we see room for the curve to flatten markedly.</p> <p>The USD is likely to stay heavy while the Fed maintains QE and indicates no tightening is likely in the near term. Rising 2-year bond yields in Europe and elsewhere are in stark contrast to falls in US yields and this bond spread is putting downward pressure on the USD. S&P's downward revision to the US sovereign outlook will continue to weigh on the USD. In addition, low volatility, solid US company profit reporting and US debt issues are likely to keep the USD soft in the near term and US residents continue to invest offshore.</p>	Policy rate	0.1%	0.1%
	10yr bond	3.60%	3.80%
	2/10 curve	280bp	270bp
	USD/JPY	82.00	83.00
	EUR/USD	1.50	1.50
Australia		Tactical (<1 mth)	Strategic (>3 mths)
<p>Australia's economic health and lack of spare capacity continues to stand in stark contrast to the rest of the advanced world. The recent consumer caution is unlikely to continue if wages continue to rise and unemployment continues to fall. RBA tightening in 2010 put substantial flattening pressure on the domestic curve and saw spreads to the US widen noticeably.</p> <p>An important dynamic in the domestic markets is tension between a comparatively weak current picture of the economy and a very strong medium term outlook. The RBA has been highlighting the medium-term outlook repeatedly in recent communications. We see the fundamental strength exerted by high commodity prices and booming investment as dominating over the year and pushing the RBA to continue to tighten rates over the course of 2011-12. However, with no "smoking gun" likely in the near term, a new flood levy on the way and some further fiscal tightening in prospect, timing on rate rises is harder to predict. Australian spreads to US should tighten quickly when the Fed starts to raise rates.</p> <p>The recent surge in the AUD reflects a weak USD. But local factors are also lifting the AUD. The market has removed its pricing for rate cuts by the RBA. We expect AUD to lift further as the money market prices in further rate hikes. In a low volatility environment, the recent good US economic data raises the risk of a further lift in equities that would support a higher AUD.</p>	Policy rate	4.75%	5.00%
	10yr bond	5.70%	5.80%
	3/10 curve	40bp	30bp
	10yr EFP	52bp	55bp
	10yr v US	210	200
	AUD/USD	1.1000	1.1200
New Zealand		Tactical (<1 mth)	Strategic (>3 mths)
<p>The Christchurch earthquake has completely changed the direction of the NZ economy. The RBNZ cut rates by 50bp at the meeting on March 10. We do not expect the RBNZ to raise rates until March 2012. The destruction in Christchurch is considerable and the recovery will be a very long, slow one.</p> <p>The New Zealand economy was already weakening before the quake and the rest of the year is likely to be a slow grind. Economic activity appears to have stalled over the second half of 2010. Data continues to suggest that inflation is not a concern. This bodes well for NZ bond and swap rates to outperform as the US and AUD markets come under pressure.</p> <p>Even though New Zealand is close to recession, the weak USD, firm global agricultural prices and low volatility in asset prices are very supportive for the NZD. We expect the USD to remain weak in the near term and push the NZD to a post-float record of 0.85. Confidence amongst New Zealand consumers and businesses is now recovering in response to the RBNZ's 'insurance' rate cuts in March. We expect the RBNZ to start the tightening cycle in early 2012 but the risks are growing for an earlier interest rate increase.</p>	Policy rate	2.50%	2.50%
	10yr bond	5.60%	5.80%
	2/10 swap curve	210bp	200bp
	10yr v US	200	200
	10yr v AUS	-10bp	0bp
	NZD/USD	0.82	0.85
	AUD/NZD	1.34	1.33



CBA Forecasts:

Cash rate	2-May	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12
US	0.25	0.25	0.25	0.50	0.75	1.00	1.25	1.50
Australia	4.75	4.75	5.00	5.25	5.50	5.75	5.75	5.75
New Zealand	2.50	2.50	2.50	2.50	2.75	3.25	3.75	4.25
United Kingdom	0.50	0.75	1.00	1.25	1.50	1.75	2.00	2.25
Eurozone	1.25	1.25	1.25	1.50	1.75	2.00	2.25	2.50
Japan	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
2-yr bond yield	2-May	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12
US	0.62	1.10	1.40	1.70	2.00	2.30	2.60	2.80
Australia	4.98	5.20	5.40	5.70	5.90	5.90	5.80	5.70
New Zealand	3.80	3.50	3.80	4.00	4.20	4.40	4.50	4.60
United Kingdom	1.13	1.70	2.00	2.20	2.40	2.50	2.60	2.60
Eurozone	1.80	2.00	2.20	2.40	2.60	2.80	3.00	3.00
Japan	0.20	0.20	0.25	0.25	0.30	0.35	0.40	0.40
10-yr bond yield	2-May	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12
US	3.30	3.70	3.90	4.00	4.10	4.20	4.30	4.30
Australia	5.44	5.70	5.80	5.90	6.00	6.00	5.90	5.90
New Zealand	5.43	5.80	5.90	5.90	6.00	6.00	5.90	5.80
United Kingdom	3.47	4.00	4.20	4.30	4.30	4.40	4.40	4.40
Eurozone	3.25	3.60	3.70	3.80	3.90	4.00	4.00	4.00
Japan	1.21	1.30	1.30	1.40	1.40	1.40	1.50	1.50
Currencies	2-May	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12
AUD/USD	1.10	1.08	1.12	1.04	0.98	0.95	0.95	0.98
AUD/JPY	89.15	89.64	91.84	88.40	86.24	85.50	86.45	86.24
AUD/EUR	0.74	0.73	0.75	0.73	0.70	0.69	0.69	0.70
AUD/GBP	0.66	0.65	0.66	0.63	0.61	0.60	0.60	0.60
AUD/CAD	1.04	1.02	1.01	1.02	0.98	1.00	1.00	0.98
AUD/NZD	1.36	1.32	1.32	1.32	1.29	1.27	1.27	1.26
USD/JPY	81.46	83.00	82.00	85.00	88.00	90.00	91.00	88.00
EUR/USD	1.48	1.47	1.50	1.43	1.40	1.38	1.38	1.40
GBP/USD	1.67	1.65	1.70	1.65	1.60	1.58	1.58	1.62
USD/CAD	0.95	0.94	0.90	0.98	1.00	1.05	1.05	1.00
NZD/USD	0.81	0.82	0.85	0.79	0.76	0.75	0.75	0.78



Calendar – May 2011

Monday	Tuesday	Wednesday	Thursday	Friday
2 CH PMI Manufacturing, Apr, Index, (53.4) (1 May) AU CBA-ACCI Business Exp. Survey, QI AU AI-Group PMI, Apr, Index, (47.9) AU TD inflat gauge Apr, m/y%ch, (0.6/3.8) AU ABS House price indexes, QI, q%ch, (0.7) JP Vehicle sales, Apr, y%ch, (-37.0) EU/GE PMI manufacturing, Apr, Index, (57.7/61.7/57.1) US Construction spending, Mar, m%ch, (-1.4) US ISM manufacturing, Apr, Index, (61.2)	3 AU RBA cash rate, %, 4.75, (4.75) AU Vic, ACT, NT State Budgets NZ Avg Hourly Earnings, QI, q%ch, (0.6) NZ Labour Cost - Priv Sect, QI, q%ch, (0.6) CH Non-Manuf PMI Apr, Index, (60.2) EU PPI, Mar, m/y%ch, (0.8/6.6) UK PMI manufacturing, Apr, Index, (57.1) US Factory orders, Mar, m%ch, (-0.1) US Total vehicle sales, Apr, mn, (13.06)	4 AU CBA/AI-Group PSI, Apr, (46.5) AU HIA new home sales Mar, m%ch, (0.6) NZ Building permits, Mar, m%ch, (-9.7) EU PMI services/composite, Apr, Index, (56.9/575.8) EU Retail sales, Mar, m/y%ch, (-0.1/0.1) GE PMI services, Apr, Index, (57.7) UK PMI construction, Apr, Index, (56.4) UK Net consumer credit, Mar, Ebn, (0.8) US ISM non-manufacturing, Apr, Index, (57.3)	5 AU Build approv, Mar, m%ch, 5 (-7.4) AU Retail trade, Mar, m%ch, 0.5, (0.5) AU Retail volumes, QI, q%ch, 0.6 (-0.3) NZ Emp Growth/Unemp Rate, QI, (-0.5/6.8) EU ECB announces int. rate, %, 1.25, (1.25) UK PMI services, Apr, Index, (57.1) UK BoE announces rates, %, 0.50, (0.50) CA Building permits, Mar, m%ch, (9.9) CA Ivey purchasing manager index, Apr, (73.2)	6 AU RBA Statement on Monetary Policy AU Ai-Group PCI, Apr, Index, (39.4) GE Industrial production, Mar, m/y%ch, (1.6/14.8) US Non-farm payrolls, Apr, '000, (216) US Avg hrly earnings, Apr, m/y%ch, (0.0/1.7) US Unemployment rate, Apr, %, (8.8) US Consumer credit, Mar, \$bn, (7.62) CA Net change in employment, Apr, '000, (-1.5) CA Unemployment rate, Apr, %, (7.7)
9 AU ANZ Job ads, Apr, m%ch, (1.3) GE Trade bal, Mar, Ebn, (12.1) CA Housing starts, Apr, '000, (188.8)	10 AU 2011-12 Federal Budget AU Trade balance Mar, \$bn, 1.0, (-0.2) AU NAB Bus conf/cond, Apr, Index, (9/9) CH Trade balance Apr, US\$bn, (0.14) UK RICS house price balance, Apr, %, (-23.0) US Import price index, Apr, m/y%ch, (2.7/9.7) US Wholesale inventories, Mar, m%ch, (1.0)	11 CH PPI/CPI, Apr, y%ch, (7.3/5.4) CH Industrial production, Apr, y%ch, (14.8) CH Retail sales, Apr, y%ch, (17.4) JP Leading / Coincident index CI, Mar, (104.2/106.8) GE CPI, Apr UK Total trade balance, Mar, Ebn, (-2.4) UK Bank of England Inflation Report US Trade balance, Mar, \$bn, (-45.8) CA Trade balance Mar, C\$, (0.0)	12 AU Labour Force, April employment, '000, 25, (37.8) participation rate, %, 65.8, (65.8) unemployment rate, %, 4.8, (4.9) NZ Business PMI, Apr, Index, (50.1) JP Machine tool orders, Apr, y%ch, (49.6) EU ECB monthly report EU Industrial production Mar, m/y%ch, (0.4/7.3) UK Industrial production, Mar, m/y%ch, (-1.2/2.4) US Producer price index Apr, m/y%ch, (0.7/5.8) US Retail sales, Apr, m%ch, (0.4) US Business inventories, Mar, m%ch, (0.5)	13 NZ Retail sales ex inflation, QI, q%ch, (-0.4) EU GDP, QI, q/y%ch, (0.3/2.0) GE GDP, QI, q/y%ch, (0.4/4.0) US CPI, Apr, m/y%ch, (0.5/2.7); core, m/y%ch, (0.1/1.2) US Uni. Of Michigan confidence, May, Index
16 AU Housing finance, Mar No. of own-occupiers, %, 3.0, (-5.6) Value of all loans, %, 2.0, (-4.8) AU Motor veh. sales, Apr, m/y%ch, (3.4/1.9) NZ PSI, May, Index, (50.8) JP Machine orders, Mar, m/y%ch, (-2.3/7.6) EU CPI, Apr, m/y%ch, (1.4/2.7); core, y%ch, (1.3) EU Trade balance Mar, Ebn, (-2.4) US Empire manufacturing, May, Index, (21.7) US NAHB housing market index, May, (16)	17 AU RBA Board minutes AU Tsy Sec Martin Parkinson speech in Sydney JP Machine tool orders, Apr EU New car registrations Apr, y%ch, (-5.0) EU/GE ZEW survey (econ. sentiment), May, (19.7/7.6) UK CPI, Apr, m/y%ch, (0.3/4.0); core, y%ch, (3.2) US Building permits, Apr, '000, (594) US Housing starts, Apr, '000, (549) US Capacity utilisation, Apr, %, (77.4) US Industrial production, Apr, m%ch, (0.8)	18 AU MI/WBC Consumer Sent, May, Index, (105.3) AU DEWR skilled vacancies, May, m%ch, (1.7) AU WPI QI, q/y%ch, 1.1/4.0, (1.0/3.9) NZ Producer prices, in/outputs, QI, q%ch, (0.9/0.2) EU Construction output, Mar, m/y%ch, (-0.7/3.5) UK Bank of England minutes UK ILO unemployment rate (3mths), Mar, %, (7.8) US FOMC Minutes CA Leading indicators, Apr, m%ch, (0.8) CA Wholesale sales, Mar, m%ch, (-0.6)	19 AU MI Consumer Inflation Exp., May, %, (3.5) AU MI Unemp. Expt., May, Index, (109.3) AU AWE Feb, q/y%ch, 1.1/3.8 (1.1/3.9) AU WA State Budget NZ New Zealand Budget JP GDP, QI, q%ch, (-0.3) JP Industrial production, Mar UK Retail sales, Apr, m/y%ch, (0.2/1.3) US Existing home sales, Apr, mn/m%ch, (5.1/3.7) US Leading indicators, Apr, m%ch, (0.4)	20 NZ Credit card spending, Apr, m/y%ch, (-1.6/1.5) JP BoJ target rate, %, 0-0.10, (0-0.10) EU Current account, Mar, Ebn, (-7.2) GE Producer prices, Apr, m/y%ch, (0.4/6.2) CA CPI, Apr, m/y%ch, (1.1/3.3) CA Retail sales, Mar, m%ch, (0.4)
23 JP Leading / Coincident index CI, Mar,	24 EU Industrial new orders, Mar, GE GDP, QI, GE IFO - Business climate, May, Index, (110.4) US New home sales, Apr, m%ch, (11.1) US Richmond Fed, May, Index, (10)	25 AU Prelim. Const. work done, QI, q%ch, (0.8) JP Trade bal total/adj, Apr, \$bn, (196.5/96.3) UK Total bus investment, QI, q/y%ch, (0.0/12.2) UK GDP, QI, y/y%ch EC OECD Economic Outlook released US Durable goods orders, Apr, CA Teranet House Prices, Mar,	26 AU Capex, QI, q/y%ch, 4.0 (1.3) AU RBA Dep Gov Ric Battelino speaks in Sydney AU CBA-HIA Affordability Index, QI, (53.5) US GDP, QI,	27 JP CPI, Apr, JP Retail sales, Apr, m/y%ch, (-7.8/-8.5) GE Retail sales, Apr, UK GfK consumer confidence survey, May, Index US Personal income/spending, Apr, m%ch US Uni. Of Michigan confidence, May, Index US Pending home sales, Apr,
30 AU Company profits, QI, q%ch, -1.0, (-2.8) AU Inventories, QI, q%ch, -0.5, (0.7) NZ Trade balance, Apr, JP Construction orders, Apr, JP Housing starts, Apr, CA Current account, QI, \$Cbn, (-11.0) CA GDP, QI, q%chsaa, (3.3)	31 AU RP Data house prices, Apr, AU Build approv, Apr, AU Current acc deficit, QI, \$bn, -7.0, (-7.3) AU Net export contrib, QI, ppt, -1.0, (0.0) AU Govt Finance Statistics, QI AU Private sector credit, Apr, NZ Building permits, Apr, NZ NBNZ Business confidence, May, Index, (14.2) JP Industrial production/vehicle production, Apr, US S&P/Case-Shiller home price ind., Mar, m%ch, (-0.2) CA Bank of Canada, %, 1.00, (1.00)	Budget dates AU VIC Budget (3 May) AU ACT Budget (3 May) AU NT Budget (3 May) AU 2010-11 Federal Budget (10 May) NZ Budget (19 May) AU WA Budget (19 May) AU SA Budget (9 June) AU QLD Budget (14 June) AU Tas Budget (16 June) AU NSW Budget (6 September)	Early June AU GDP, QI (1 June) AU Retail trade, Apr (2 June) AU Trade in Goods & Services, Apr (2 June) AU Housing Finance (8 June) AU Labour Force (9 June)	Central Bank Meetings AU RBA (3 May) EU ECB (5 May) UK BOE (5 May) JP BoJ (19-20 May) CA Bank of Canada (31 May) NZ RBNZ (9 June) US FOMC (22 Jun)

Note: Figures in brackets represent previous result (if available). All information is preliminary and subject to revision. Chief Economist: Michael Blythe ph: 9118-1101 Economist: James McIntyre: 9118-1100



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