Global Markets Research

Economics: Perspective

18 March 2011

The Week Ahead

- The uncertainty and implications over the recent tragic events in Japan are likely to remain a market focus.
- In New Zealand, GDP is likely to have contracted in QIV, pushing the economy into a “technical recession”.
- In the UK, the Bank of England March meeting minutes & the 2011 budget are set to be the focus on Wednesday.

The catastrophic events, which continue to unfold, in Japan have been the driving force behind recent financial market movements. The uncertainty surrounding the fallout from the damaged Fukushima Dai-Ichi nuclear power plant has weighed on market participant sentiment and caused a spike in volatility, particularly in Japan’s equity markets. Moves by the Bank of Japan (BoJ) to boost financial market liquidity and sure up sentiment had, in the early parts of the week, struggled to gain traction. On Monday, at its March policy meeting, the BoJ decided to expand its asset purchase program, which encompasses ETF’s, J-REITs, bills and bonds. Additionally, the BoJ has continued to add unprecedented amounts of short-term liquidity provisions into the financial system. The decline on the TOPIX, on Monday and Tuesday (equal to some 16%), was the largest two day fall since the 1987 stock market crash. The Nikkei 225 Index plunged 10.5% on Tuesday, its largest single day fall since October 2008.

The increased risk aversion and fund repatriation back to Japan has resulted in significant JPY strength. USD/JPY reached an all-time low, as did another “safe-haven” currency, the Swiss franc. In response, the G-7, at the request of the Japanese authorities, decided to undertake a co-ordinated intervention program to weaken the yen. The moves by the G7 represents the first joint intervention since September 2000, when they had entered the market to lift the EUR. The Bank of Japan, the US Federal Reserve, the European Central Bank, the Bank of England and the Bank of Canada all agreed to sell JPY at their respective market opens. In the background to the market volatility, the impact of the recent events on Japan’s economy are still being assessed. Our Chief Economist, Michael Blythe, takes a look at the recovery following the 1995 Kobe earthquake, what lessons were learnt and the implications for financial markets, world economic growth and Australia from the recent events, from page two.

In Australia, there was little in the way of economic data released last week. The Reserve Bank of Australia ‘s (RBA) March policy meeting minutes were the focus, but they revealed no significant surprises. The March minutes reiterated the tone of recent commentary by RBA offical’s and the February statement on Monetary Policy. This week there is little in the way of Australian economic data being released. This week, our Senior Economists, John Peters and Michael Workman, continue on their economic journey around Australia. This week they review the recent performance of the Queensland economy, from page eleven.

In New Zealand, QIV current account estimates and GDP are released on Wednesday and Thrusday, respectively. Our New Zealand Economist, Chris Tennent-Brown, previews the QIV GDP release from page sixteen. It appears likely that New Zealand entered into a “technical recession” in QIV. We are expecting the New Zealand economy to have contracted by 0.1% in QIV, following on from the 0.2% decline in QIII. Looking ahead, the effects of the recent earthquakes are likely to affect retail spending, business services and construction further in QI.

Internationally, the economic focus next week is likely to be in the UK. UK consumer prices for February are released on Tuesday, while retail sales data for February is released on Thursday. However, market attention is likely to be drawn to Wednesday, when the March Bank of England policy meeting minutes are released and UK Chancellor of the Exchequer George Osborne unveils the 2011 budget. It is likely that Chancellor Osborne will present a series of policy measures that begin the process to help reform the UK economy. With respect to the Bank of England, market participants will be eager to see whether the tone of Monetary Policy Committee members has become more “hawkish”, in light of the further acceleration in UK inflation and the recent lift in inflation expectations to a two and a half year high.

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International Economic Perspective

Some thoughts on Japan

- Japanese recovery was quite rapid after the Kobe earthquake in 1995.
- Policy makers have indicated a rapid response will follow. But the ability to act is more limited than in 1995.
- The earthquake, tsunami and nuclear disaster have hit at a time when global financial market sentiment is fragile.

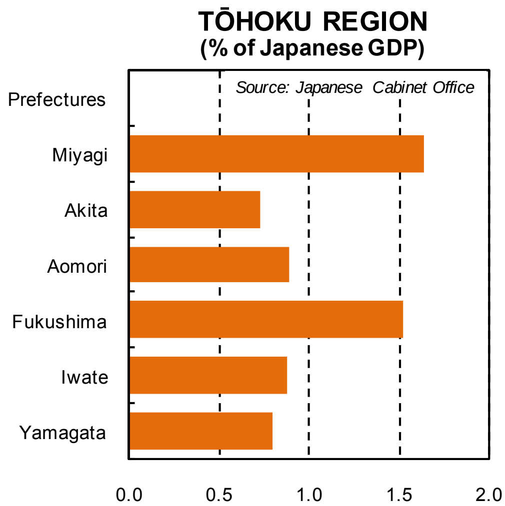
The focus remains on the terrible human toll and the unfolding nuclear disaster. But questions about the economic impact are building. The full scope of the disaster won't be apparent for some time. So it is difficult to be too prescriptive at this stage.

Japan is better prepared than most to deal with the impact of an earthquake.

Japan is better prepared than most to deal with the impact of an earthquake. The physical damage should be relatively small compared with the size of the earthquake. At this stage, the earthquake looks set to be mainly a *disruption* to economic activity. The main economic impact should be from precautionary plant closures and the interruption of key transport and support infrastructure. A number of key car makers and electronic companies, for example, have shut production for safety reasons.

The more serious damage, nuclear considerations aside, will reflect the outright destruction caused by the ensuing tsunami.

The tsunami damage was concentrated in the Tōhoku region of north-east Japan. While the area hit was away from the larger population and more important industry areas, the region is economically significant. Tōhoku is a key agricultural area (especially rice). And there are significant raw materials industries (oil, steel, pulp), electric/electronic parts producers and automobile-related sectors. The region accounts for about 6½% of Japanese GDP. The area that appears hardest hit, the Miyagi prefecture, accounts for 1½% of GDP.



The lessons of history

Japan is particularly susceptible to earthquakes. So previous experience may provide some guide to the economic outcomes this time. The Kobe earthquake of January 1995 is the most recent comparable example. That earthquake was smaller than the current episode. But the region was more important economically. Kobe was a major port and manufacturing centre.

The damage from the 1995 Kobe 'quake was put at 2.5% of GDP.

The damage from the Kobe quake was eventually put at USD102.5bn or 2.5% of Japanese GDP. But the recovery was reasonably quick and certainly faster than expected at the time. Manufacturing production, for example, fell by 2.7% in

January 1995 before rising by 4.4% over the following three months. The essentially v-shaped response was a reflection of the ability to shift economic activity to other areas. Despite the quake, Japanese GDP rose by 1.9% in 1995 and 2.6% in 1996, the strongest period of growth since the early 1990s recession. This outcome also highlights how the rebuilding effect can have a positive impact on growth after the initial output loss.

Recovery was swift.

Later studies on the Kobe economy showed that key economic indicators for the region covering production, trade and retailing were back at or near pre-earthquake trends within twelve-to-eighteen months.

The ability to relocate activity elsewhere will be the key to the ultimate output cost.

The Japanese economy contracted slightly at the end of 2010 but recorded growth of 3.9% for the year as a whole. So a degree of growth momentum should help absorb some of the negative impact from the latest disaster. The ability to relocate Japanese production elsewhere in the Asian region is also greater than in 1995.

A rapid economic policy response is likely. There is broad political agreement on the need for an emergency Budget to fund rescue efforts and economic recovery. The Bank of Japan has acted swiftly to inject liquidity into the financial system.

Policy settings are already at extremes.

The problem for policy makers is that policy settings are already at extreme levels. Interest rates are near zero and general government gross debt already stands at 225% of GDP.

The Bank of Japan has announced unprecedented additional short-term liquidity provisions and extended its quantitative easing policy.

Implications for global growth

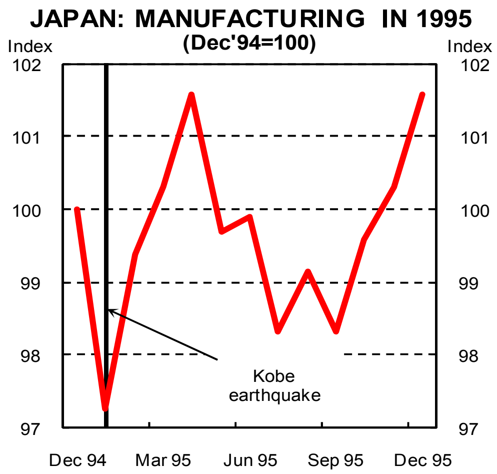
Japan makes little contribution to the expansion of the global economy.

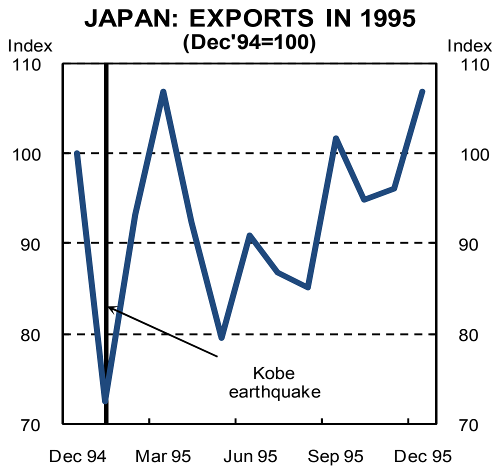
China recently overtook Japan as the world's second largest economy. But Japan still accounts for 6% of global GDP. So a weaker Japanese economy will weigh on global growth. But the impact is likely to be quite small. The essentially sideways trajectory of the Japanese economy over the past five years, for example, means that Japan made little net contribution to the world growth over that period.

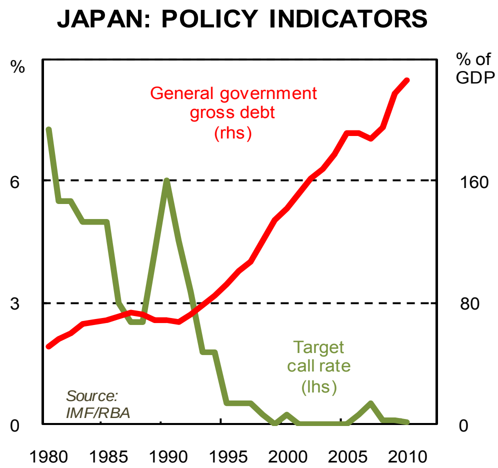
Current projections have the global economy expanding by 4.4% in 2011, significantly above the long-run average of 3¾%pa. Even worst-case outcomes for the Japanese economy would leave the global economy running at no worse than trend.

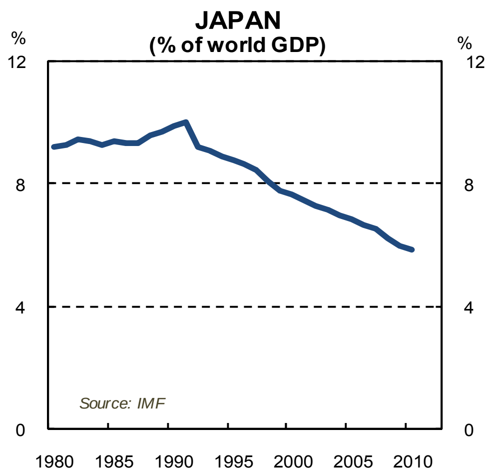
Implications for financial markets

The earthquake and tsunami hit at a time when global financial market sentiment was fragile.









The disaster has refreshed fears about global economic resilience and sovereign debt.

Part of this fragility reflects sovereign debt issues and lingering fears about economic resilience. Both of these fears are being accentuated by the latest disaster. It is reasonable to expect some pull back from perceived "risky" assets as markets assess the impact of the disaster. The uncertainty generated by the current nuclear emergency has overlaid an element of fear onto this risk reassessment.

The dominant emerging theme, however, is a repatriation of capital back to Japan, especially by Japanese insurance companies. This repatriation is already having a significant impact on exchange rates and interest rates.

The JPY should benefit from the repatriation of capital.

The JPY should benefit from the repatriation of capital. Trends in the JPY are strongly correlated with Japanese portfolio investment flows. These repatriation pressures are set to dominate flows during the next six weeks to two months. This period of times straddles the end of the 31 March Japanese financial year, where seasonal repatriation flows are usually at their strongest as well.

The JPY has a long history of strengthening in times of risk aversion. The current episode is likely to be no exception. Japan's net international investment surplus has steadily lifted over the last thirty years and now equals 56% of GDP. The size of this surplus and the income flow it generates underwrites the JPY status as a safe haven.

A high savings rate provides some protection against sovereign concerns.

The earthquake and the cost of rebuilding will focus market attention and commentary on the Japanese government debt position. However, unlike the recent sovereign concerns in peripheral European economies, Japan's high savings rate places them at less risk from a loss of investor confidence. This fiscal risk is unlikely to present a serious issue for global bond markets.

Japanese share markets fell sharply after the Kobe quake. At its 1995 lows, the Nikkei index was about 25% lower than before the quake. These losses were subsequently recouped by the end of the year.

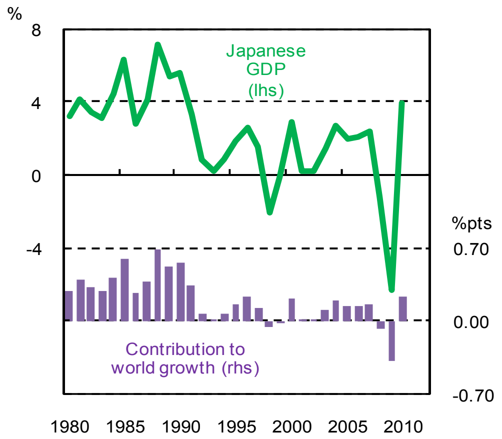
For the economic historians, the collapse in Japanese share prices post the quake was a factor in Nick Leeson's woes and the subsequent demise of Barings.

Implications for Australia

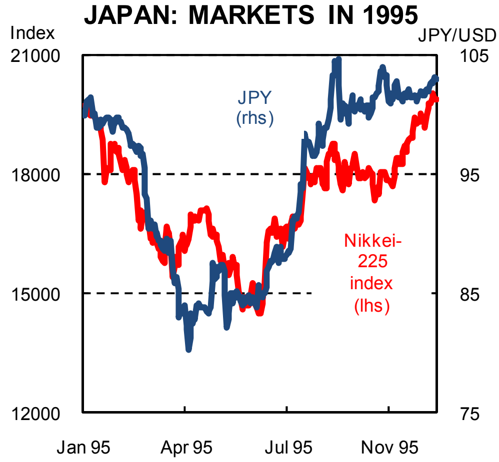
There is little correlation between Australian and Japanese growth over most of the past fifteen years.

Japan is Australia's second largest trading partner, accounting for 11.7% of two-way trade. Despite this important trading relationship, there has been little correlation between Australian and Japanese growth over most of the past fifteen years. The Australian economy has grown strongly over most of this period despite a lacklustre Japanese growth

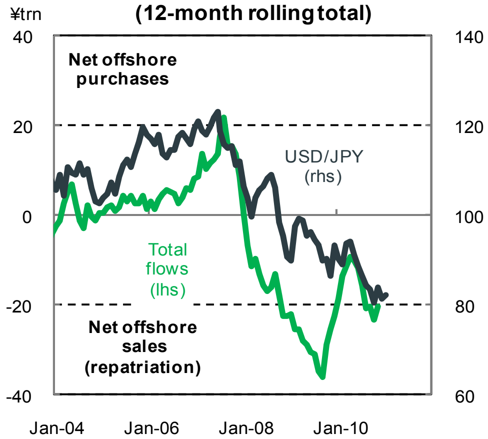
JAPAN & WORLD GROWTH



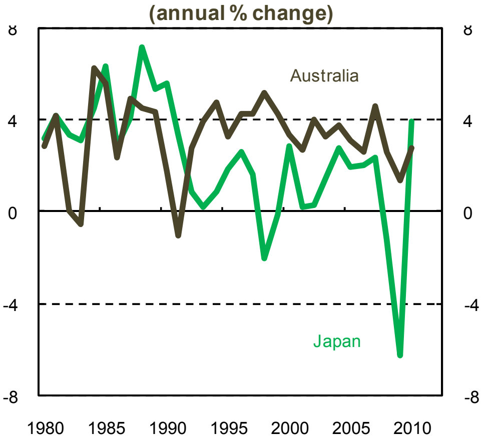
JAPAN: MARKETS IN 1995



JAPAN: NET PORTFOLIO FLOWS
(12-month rolling total)

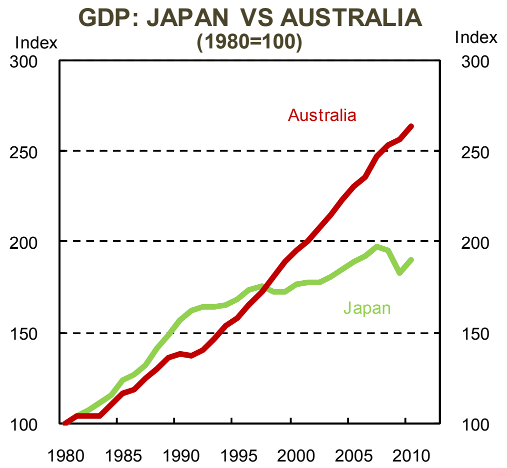


JAPAN & AUSTRALIA: GDP GROWTH
(annual % change)



performance.

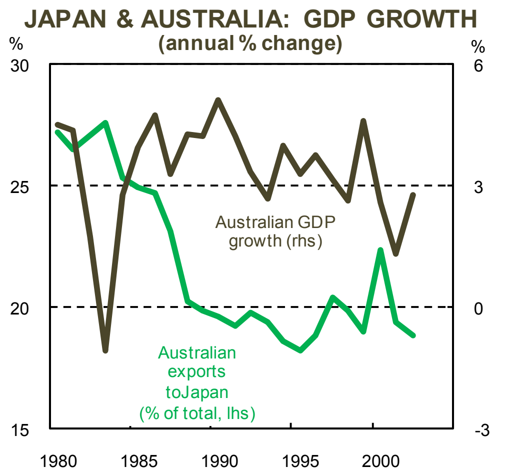
Australia's major exports to Japan are coal and iron ore. Most of this trade is conducted between large corporations through long-term contracts. So trade has been relatively steady. Rising demand from other Asian economies, especially China, plays a greater role in driving Australian growth. Any weakness in Japanese demand is likely to be offset by strength elsewhere.



Implications for Australian financial markets & the RBA

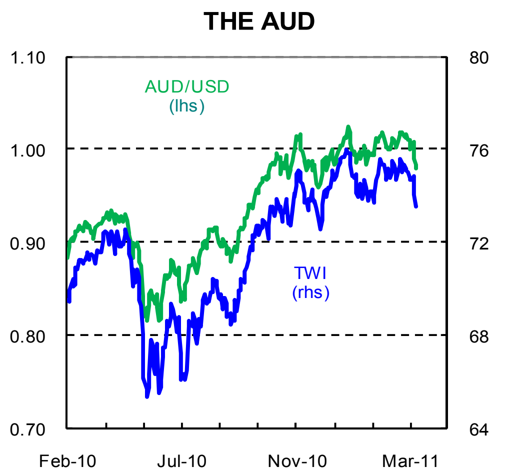
Australian financial markets are susceptible to risk aversion.

The unfolding Japanese disaster is having a significant impact on Australian financial markets. Australian markets traditionally suffer more than most in periods of risk aversion. Above-average volatility in fx, equity and commodity markets is set to continue.



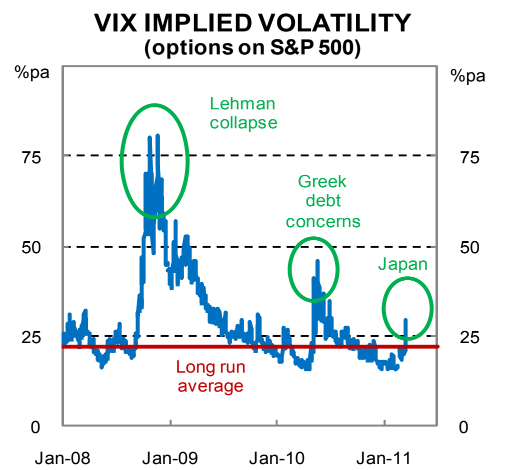
Economists struggle to explain what is going on when markets are moving quickly. Rapid, large moves have more to do with sentiment and risk aversion than changes in the underlying fundamentals. The problem at the moment is that the information flow is patchy, partly sensationalist and sometimes contradictory. It is not an environment where the fundamentals matter and markets will price accordingly.

So what can we say from a fundamental point of view? We have followed a survey by the Fitch ratings agency for some time now as a guide to how market-sentiment may evolve. The survey identifies the factors that major market players see as critical for financial stability and confidence. The bottom line from the survey is that (pre Japan crisis) investors were looking for some reassurance on growth prospects and a resolution of sovereign debt issues.



Market fears have been accentuated by the latest disaster.

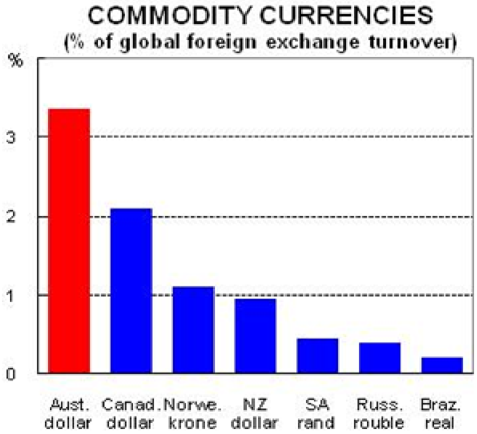
These market fears have been accentuated by the latest disaster. Global growth prospects are under question and the rebuild costs have focussed attention on the already stretched Japanese fiscal position. Risk is being reassessed.



The AUD is most exposed.

Australian assets were always exposed to this risk reassessment. We saw the AUD as most exposed. Anything that challenges global growth prospects is bad for commodity currencies. And the Aussie is the most liquid commodity currency. Anything that challenges Asian growth prospects is bad for Asian currencies. And the Aussie is the most liquid proxy for emerging Asian currencies. Anything that challenges market stability is bad for risk assets. And the Aussie is one of the most sensitive to asset price volatility.

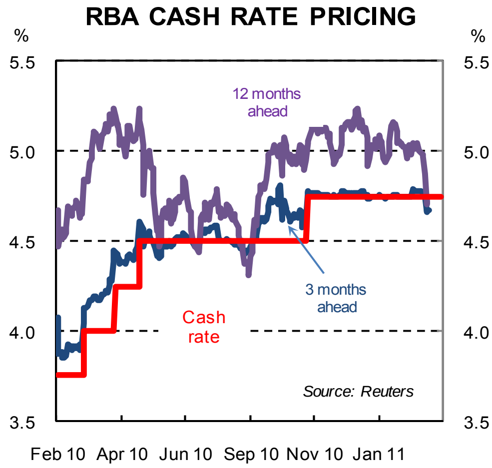
So the *direction* of the move in Australian financial markets is understandable. As is the flight to perceived safe havens. But the *magnitude* of some of the moves isn't. FX market reaction looks reasonable. But other markets that can jump from pricing little chance of any RBA move to an implied 70% chance of an imminent rate cut and then back to 20% chance in the space of a few hours have clearly parted company with the underlying fundamentals.



Will the RBA respond?

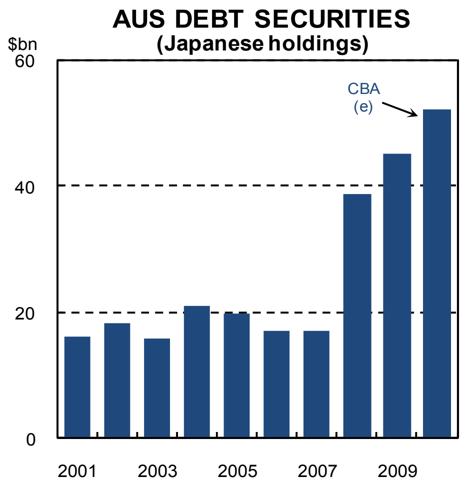
The question of RBA reaction has of course arisen with these market moves. The consensus favouring rate rises has weakened and speculation about rate cuts has emerged.

Any RBA action will depend on the ultimate resolution of Japan's crisis and how long that resolution takes. We don't have enough information to make that sort of call at present. If the crisis ends quickly with limited damage then it will an event, like the Queensland floods, that the RBA "looks through". Policy action will then reflect the economy's (favourable) medium-term trajectory. And that trajectory would favour higher rates. For that reason we are reluctant to shift from our current rate call (although the timing of the next move is open for debate) until the situation is resolved.



The FOMC made no mention of developments in Japan.

The outcome from the recent FOMC meeting is an interesting pointer to how central banks are thinking about the crisis. The Fed, aside from the BoJ, is the only major central bank to have met since the emergency began. The Fed made no mention of developments in Japan. Instead, the Fed upgraded its assessment of US prospects. They note that the US recovery is "*on a firmer footing*". And they have dropped earlier references to factors restraining the recovery. To the extent that central banks have commented on the Japanese situation, the commentary has tended to downplay the negatives for global growth. Nor did the Japanese disaster deter the Reserve Bank of India from raising interest rates this week.



Capital repatriation may have some impact on Australian interest rate markets.

For Australian interest-rate markets more broadly one other potential longer-running risk is that Japanese insurance companies and other investors repatriate funds to assist rebuilding efforts. We estimate that Japanese holdings of Australian debt are just over $50b (about 7% of the total market although Japanese investment is skewed towards the AAA end). At the margin, any selling could place some downward pressure on the market as a whole. Japanese investors tend to favour very high grade instruments like ACGBs, semis and Supras. There might be some underperformance by these asset classes as Japanese fund managers rebalance portfolios.

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Australian Economic Perspective

CBA Viewpoint – Men are from Mars…

The Australian economy performed well again in 2010. Adverse weather events mean 2011 is off to a rocky start. But the income boost from the latest instalment of the commodity story, a mighty capital spending boom and an export response from the earlier part of the mining boom will support activity. There appears to be sufficient momentum to produce a decent growth rate during 2011 and into 2012.

Variations around that broad story will largely reflect the actions of the Australian consumer. A new frugal consumer more interested in saving than spending could mean a very different set of outcomes than would a return of the old party-hard consumer.

The idea of the new consumer has certainly gained some traction in the economic and policy debate. But the evidence is mixed. Households are saving more and borrowing less. And the trend in retail spending growth has ground to a halt. At the same time, lending to buy new cars and pay for overseas holidays is running at elevated levels. Underlying housing lending appears to have bottomed and is trending up. None of these trends sound particularly frugal!

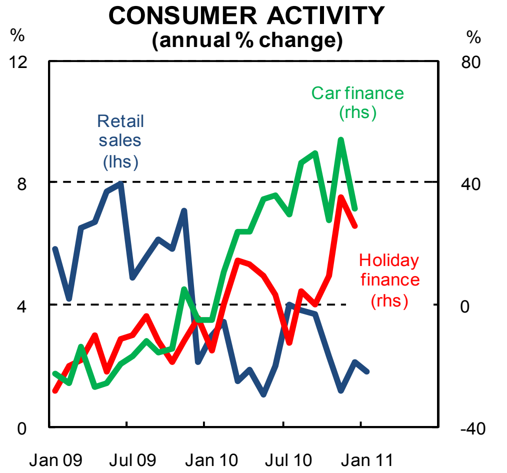
So it appears that if we properly define the issue, it is *retail* caution rather than an overarching consumer caution that is in play. The *non-retail* part of the consumer story is noticeably more robust. Retail spending is running at a well below trend pace at present. But the non-retail part of consumer spending is running around the average rate of the past decade.

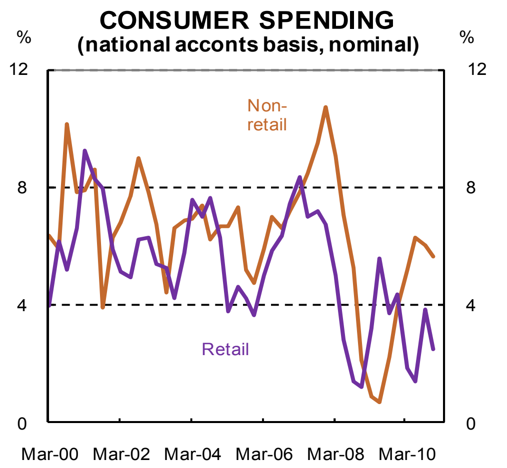
Information from the Commonwealth Bank's *Viewpoint* project provides some valuable insights into the issue of consumer caution.

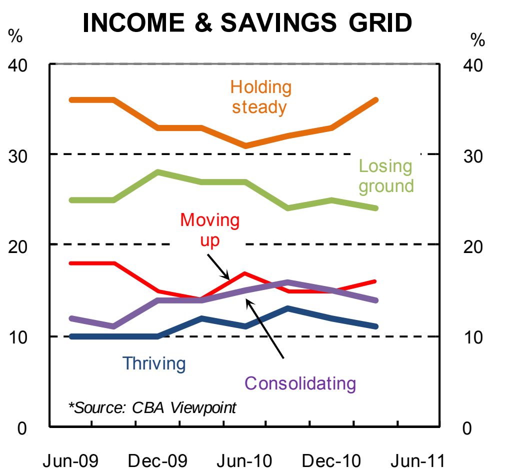
The mixed picture presented by consumer trends looks odd against a backdrop where household *ability* to spend is quite good. The CBA Income & Savings Grid, for example, shows a trend improvement in personal finances over the past year. This trend improvement reflects a lift in household earnings growth and the income tax cut of mid 2010. Household wealth levels have also recovered from the financial-crisis hit.

Household finances are also in better shape than generally thought. Balance sheet repair predates the financial crisis. And this earlier shift is a key differentiator when thinking about the Australian growth outperformance of the past few years:

- The saving ratio started to lift a few years before the onset of the financial crisis. And, at current levels, the saving ratio has fully adjusted to the drop in household wealth that occurred over the 2007-09 period.
- Most of the debt resides with older, higher income households who held their jobs during the financial crisis and who are better placed to deal with any strains.
- Households were relatively conservative in their use of accumulated dwelling wealth and relatively conservative in their financial asset allocation.







- Many households kept home loan repayments unchanged during the period of exceptionally low interest rates in 2008 and 2009. As a result, a sizeable mortgage prepayment buffer will protect against emerging financial strains.

The rationalisation of the gap between a strong ability to spend and a weak appetite to spend, at least at the retail level, is partly provided by the *Viewpoint* survey. The consumer story is not all about the hard-edged economics. Our surveys also highlight the importance of non-economic factors such as satisfaction with personal relationships, social life and health in influencing perceptions about the economy. These factors have driven a significant divide in perceptions about the economic outlook. In particular, female optimism is running well behind that of males and has done so for some time now.

Data collected as part of the *Viewpoint* project reveals that women tend to dominate spending in the retail area. Females, for example, account for 61% of the spending in department stores and 56% of spending on clothing & footwear. So some of the weakness evident in retail spending may reflect the less positive perceptions of female shoppers.

In contrast, males typically account for larger shares of non-retail spending. Males, for example, account for 59% of spending on fuel and 54% of spending on recreation. So some of the greater resilience evident in non-retail spending may reflect the more positive perceptions of male shoppers.

Statistical analysis, called structural equation modelling, was undertaken to investigate aspects of this male-female divide. This analysis identifies the factors most strongly linked to consumer perceptions. And it identifies what drives the differences between male and female perceptions.

The most important perception driver is "personal financial circumstances", for both male and female. Perceptions about the current financial situation dominate. To the extent that there is any gender divide, it reflects salary differences and a greater female sensitivity to unexpected expenses. Nor is there a great deal of difference in "family commitments" as a driver of consumer perceptions.

The main differences stem from the influence of "work-related factors" and "external influences".

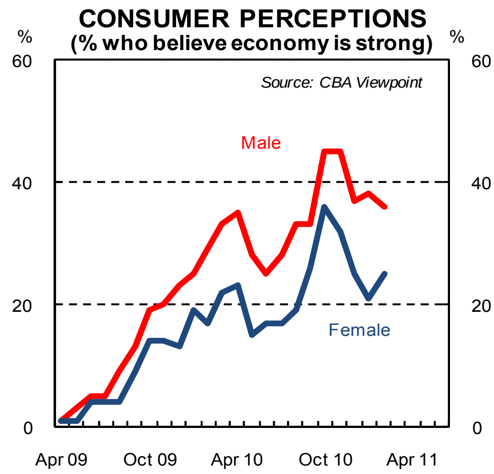
The divergence in work-related factors reflects reduced time at work and fewer perceived opportunities for women as they are often caught up in dual role as wage earners and managers of the household. These factors are long-run structural influences on consumer perceptions. They mean that female consumer perceptions typically diverge from their male counterparts.

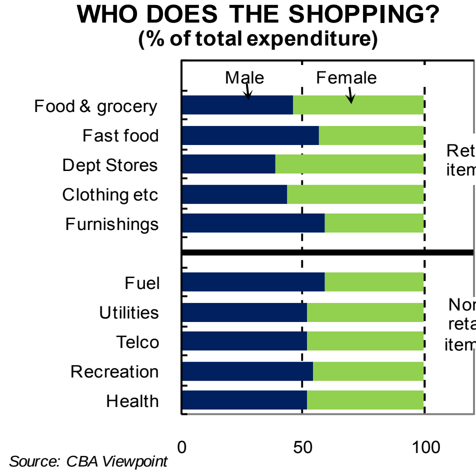
The divergence in "external factors" is more cyclical in nature and seems to reflect a lingering caution following on from the global financial crisis. It appears that the crisis made women "much more careful about spending". But men saw it as an opportunity to "get some great bargains"!

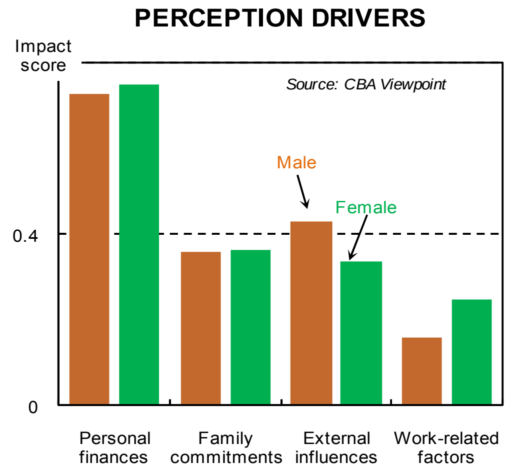
This difference in perceptions comes through quite clearly when respondents to our survey are quizzed on their greatest fears. Females are significantly more concerned about meeting mortgage or rent payments and the ability to provide the necessities for the family.

This caution is also reflected in other readings collected in the *Viewpoint* survey:

- women indicate that they would find it significantly more difficult to deal with an unexpected expense than men;
- women would be more inclined than men to use a cash gift to repay







debt rather than spend or save/invest it.

Spending could recover quickly once the appetite to spend returns. But what is the trigger? Information from the Commonwealth Bank's *Viewpoint* project provides some valuable insights into what could drive such a turnaround.

The majority of respondents to the Commonwealth Bank's survey of consumer perceptions believe the economy is "strong". Shifting the perceptions of those who currently perceive the economy as "weak" in the same direction would improve the backdrop for consumer spending. And, when quizzed on what would push household perceptions in that direction, the standout is a robust labour market.

Labour market readings have been affected by the adverse weather effects in Queensland and elsewhere. But the key job drivers are supportive. "Profit" per employee is running at record highs. So there is a strong financial incentive to expand payrolls. Moderate output growth and falling real labour costs over the past year means that there is a solid fundamental basis for labour demand as well.

Other factors that would drive positive perceptions on the economy include interest rates, the inflation backdrop and government support for the economy. The role of the Aussie dollar as a barometer of economic virility also stands out. The survey also suggests that the importance of property prices and the share market in influencing household perceptions is quite low.

One implication is that higher interest rates may not dominate the consumer story in an environment where job security concerns are low. Our consumer perceptions survey shows that concerns about job prospects fell even as concerns about interest rates lifted. Since most households remain positive about the economic outlook, it appears that "jobs" are outweighing "rates" from a consumer spending perspective at this stage.

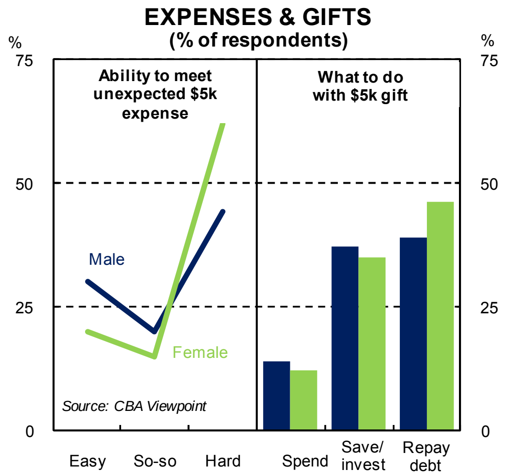
Another implication is that the best thing policy makers can do to support households is to provide an environment where inflation is contained and the Budget remains in good shape.

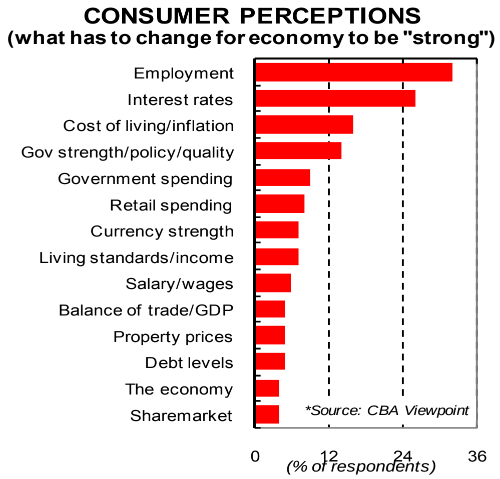
So the risks seem to lie with retail-consumer caution dissipating in 2011. The consumer may not supercharge economic growth rates this year. But nor will the consumer be a large enough drag to change the economy's course.

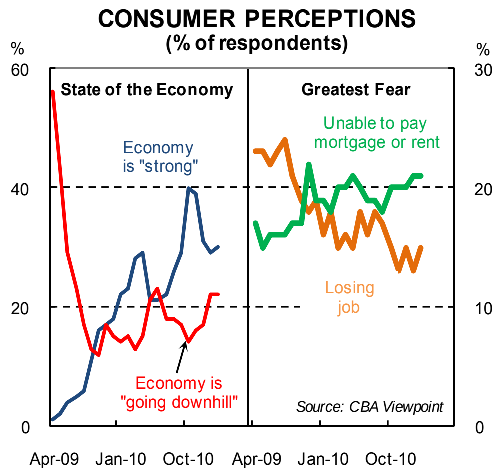
There are some leakages from this story. Rising utility charges, higher petrol prices and greater use of the internet may all weigh on retail activity.

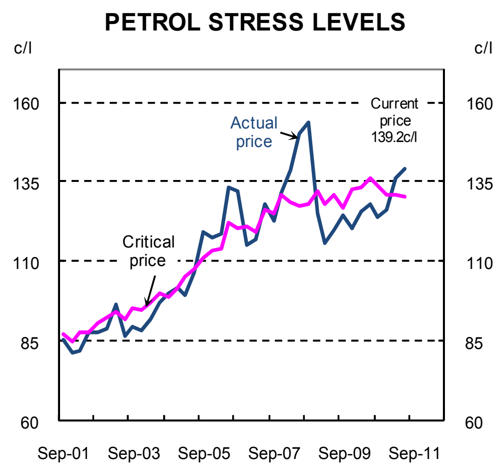
The size and speed of shifts in petrol spending has something in common with other imbalances that emerge from time to time. The imbalances associated with rapid growth in debt and asset prices are a recurring theme in the policy debate. Organisations such as the BIS have attempted to develop indicators of financial stress. We used that analysis and applied it to petrol. The idea is that there is a certain critical level in the accumulation of petrol spending over and above normal where the resultant "stress" has a significant impact on consumer spending. The analysis suggests that the critical value for petrol is currently $1.30/l.

The consumer will also play an important role in determining inflation trends. The CPI numbers in 2010 printed on the low side partly because of extensive retail discounting reflecting consumer reluctance to spend. A return to more normal retail trading conditions if consumer restraint dissipates could see this discounting quickly reversed and faster price growth as a result. Information on retail inflation pressures from the Commonwealth Bank-Ai Group Performance of Services Index shows a





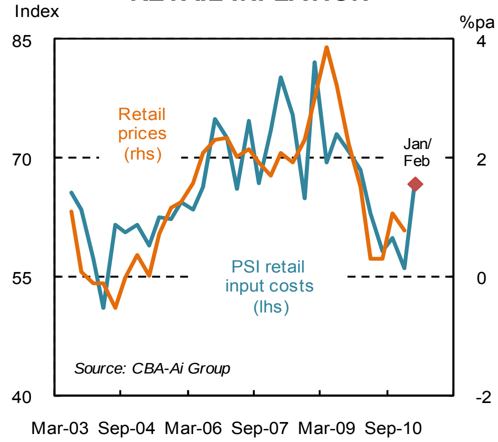




lift in the early part of 2011.

This inflation risk is why the consumer is one of the keys to future interest rate trends. Any lift in consumer activity would be occurring in an economy running close to full capacity and dealing with what looks like an unstoppable mining boom. Both these challenges are acknowledged by policy makers. Both these challenges point to a need for interest rates to eventually move further into restrictive territory.

RETAIL INFLATION



About *Viewpoint*:

The Commonwealth Bank's business generates a vast array of data on financial transactions, savings and spending patterns. From this mass of data a confidential sample of 1.3 million consumers has been selected that closely matches the structure of the Australian population. This sample allows us to investigate topical issues and track trends in incomes, spending, saving.

This hard-edged financial data is overlayed with a survey of consumer perceptions and experiences that we run each month with over 2,000 individuals.

The report is then analysed and commented on by the independent economic research body - the *National Centre for Social and Economic Modelling* (NATSEM) – based in the University of Canberra.

The actual report can be found at:

www.commbank.com.au/viewpoint

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Australian Economic Perspective

Queensland Economic Outlook

- Queensland's economic data will be much weaker in early 2011 because of the devastating floods and cyclone Yasi.
- Then reconstruction works and a recovery in exports should boost jobs and growth in the June quarter and thereafter.
- But its economy was weaker than some of the other States through 2009/10, particularly the construction sector.
- There are reasonable grounds for optimism on Qld's growth outlook in the second half of 2011 and through 2012.

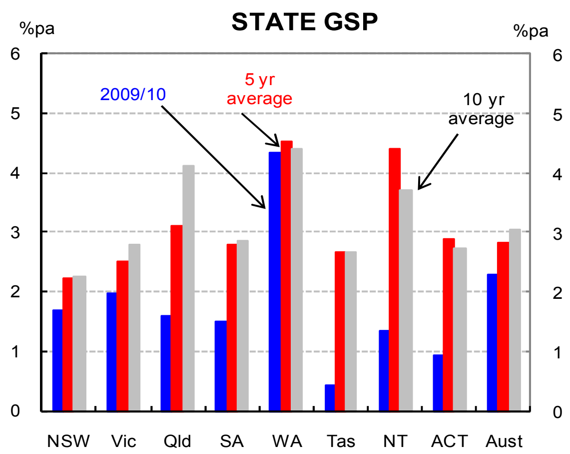
Summary

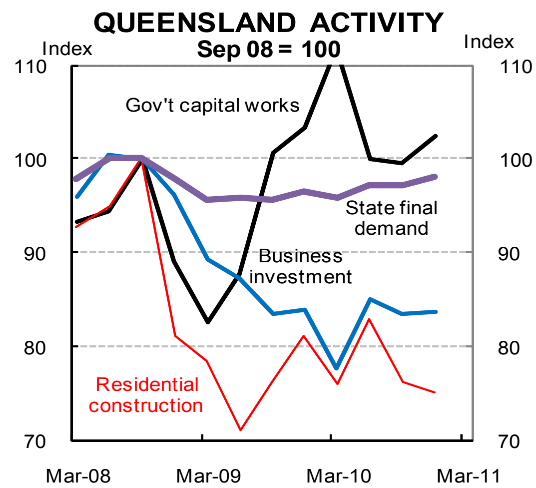
This note concentrates on the economic issues. The challenging social and wealth impacts from the devastating floods throughout Queensland, and then cyclone Yasi, create a larger than usual degree of uncertainty over economic activity indicators in the first half of 2011. But we are confident that most of the economic indicators including retail spending, jobs growth, exports and residential building and other construction will show quite strong rebounds in the second half of the year. There should be strong demand for civil and infrastructure construction groups over the coming year. High levels of reconstruction activity and rising exports should lift the overall measures of growth, ultimately, for 2011 and 2011/12.

Queensland (Qld) recorded Gross State Product (GSP) growth of 1.6% in 2009/10. It was significantly below the previous five year average of 3.1% and the ten year average of 4.1%. But it is indicative of the relatively weak position of the Qld economy following the Global Financial Crisis (GFC) in September 2008. The GFC produced a very swift removal of finance, globally, which undercut world trade and Qld's major exports of coal and metals. It also produced a sudden contraction in finance for property developers which quickly shrank commercial and residential construction activity.

Looking across the broader spending indicators it is clear that, in real terms, State Final Demand, business investment and residential construction spending are still not back to pre-GFC levels. It is also evident that overall activity levels would be much weaker without the significant boosts from Federal Government handouts to households and Qld government capital works spending.

There are reasonable grounds for optimism about Qld's growth outlook in the second half of 2011 and through 2012. We believe that 2011/12 GSP could reach 6%. There will be a massive reconstruction program. Public infrastructure, such as roads, rail and public buildings will be rebuilt, funded by the Qld and Federal Governments. There will also be a large number of new residential dwellings built and repairs to existing ones. The mining groups have already begun to restore production and export facilities. The utilities'groups are committed to restoring damaged networks. Households will need to replace all the durable goods and household equipment damaged in the floods and the cyclone. The rural producers are likely to rebuild their production capabilities, especially when world prices for many rural crops are at such high levels.

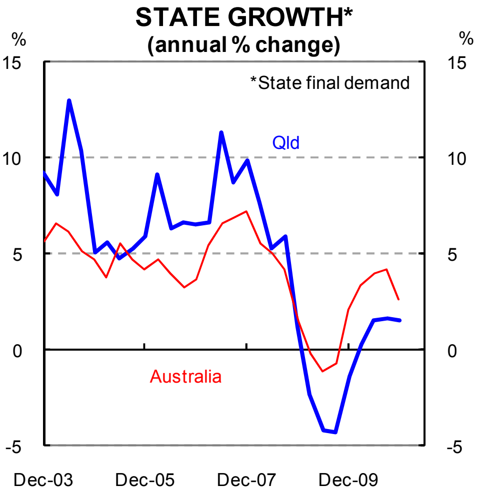




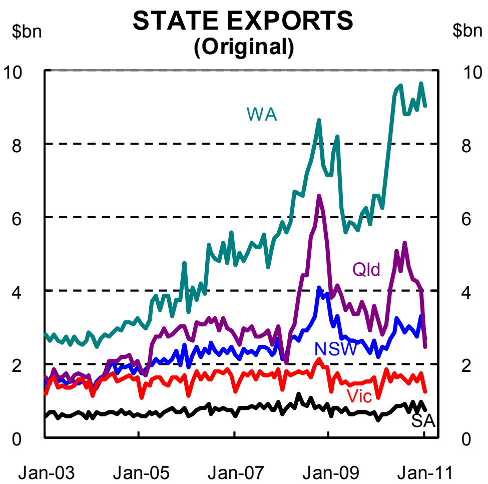
State spending, exports and retail

Business investment trends are forecast to shift appreciably higher.

The SFD trends show the dramatic effect on Qld's growth rates after the GFC. The September and December quarters in 2008 recorded substantial contractions in business investment and residential construction. The graph on page one demonstrates the weakness across the major spending aggregates that produced the poor SFD outcome. The business investment trends are forecast to shift appreciably higher as the LNG projects in Gladstone and some new coal mines begin to influence spending.



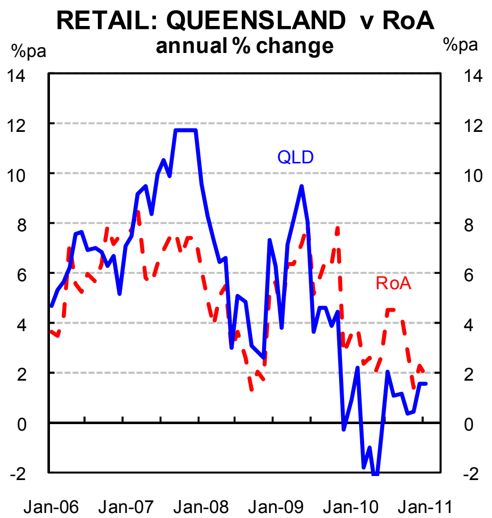
Another effect from the GFC was the large fall in exports from just over $6bn per month in late 2008 to lows of around $3.75bn through 2009 and early 2010. There was a rebound caused by the increases in coal prices, and volumes, in early 2010 that lifted monthly exports to $5bn. But the extensive floods that began in late 2010 and carried through to January 2011 have severely reduced coal and other exports, down to $2.5bn in January 2011.



The timing of a full recovery in Qld's exports is uncertain.

The timing of a full recovery in Qld's exports is uncertain. Rail lines are damaged, as are some mines, and stockpiles at the ports are depleted. Qld's 2010 exports were $50bn, following $43bn in 2009 and $52bn in 2008. Our expectation is that the total exports figure for 2011 could be between $45bn and $50bn.

Retail spending also took an initial hit following the GFC. Federal Government handouts did lift spending into 2009. But recently the traditional retail indicators have moved down to quite weak levels of activity. Higher interest rates and a shift in consumer behaviour towards higher savings has been negative for retail.



Households will need to replace damaged furnishings and fittings, structural items, durable goods and clothing over coming months.

The period around the Federal election in August 2010 appears to have been particularly weak for retailers. But we suspect that there could be a relatively strong rebound in parts of retail spending. Households will need to replace damaged furnishings and fittings, structural items, durable goods and clothing over coming months. Motor vehicle sales, for example, fell 19% in January but rebounded by 22% in February. Insurance payments are flowing to households so expenditures can be maintained at well above income and jobs growth.

Qld's dwelling starts are one of the major sources of uncertainty for 2011 and 2012. Preliminary estimates are that there could be as many as 6,000 to 8,000 dwellings that need to be rebuilt, on top of the 30,000 that were likely to be built. We have forecast an outcome for 2010/11 of around 31,000 new dwellings to be constructed. We then expect a rebound to around 35,000 for 2011/12.

Queensland labour markets

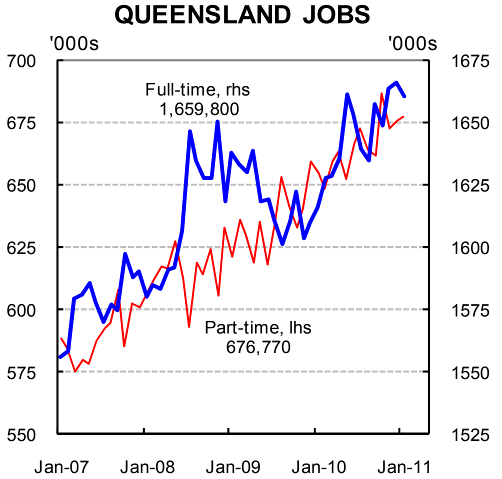
Jobs growth has been "king hit" by floods and cyclone.

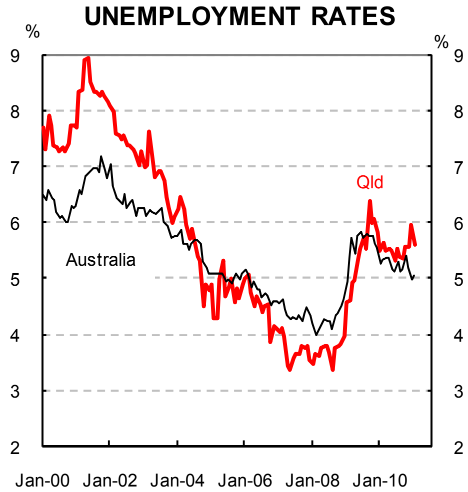
Underscoring the Qld economy's very creditable performance in the wake of the GFC has been resilient labour market conditions. From a cyclical low point of 3.4% in August 2008, the unemployment climbed to 6.1% by November 2009.

By QIII 2010, Qld's unemployment rate had dipped to 5.4%. However, the impact of the Qld floods saw its unemployment jag back up to 5.6% by January 2011. However, the unemployment rate is expected to resume its downward trend over 2011 and 2012 as the national and Qld economies accelerate further, powered by the strongest terms of trade in over a century.

Unemployment rate headed lower.

A Qld unemployment rate under 4% in the next 2-3 years is well on the cards. Further strong employment outcomes should boost consumer confidence and spending in the coming year or two. Over the year to January 2011, jobs growth was a solid 2.9%pa with 66.5k new jobs created (including 44.4k full-time positions). Recovering equity prices and superannuation balances should also help bolster the sunshine state's consumer spending generally later in HII 2011 and 2012. Very strong business investment mainly in mining and ongoing solid Qld public infrastructure spending will help power the state's job markets in the coming years.





Brisbane CPI

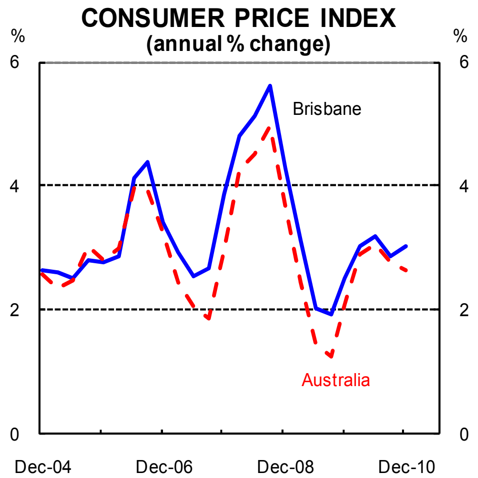
Brisbane CPI running at 3.0%pa in QIV….

….above the national CPI of 2.7%pa.

The national CPI rose a relatively well-behaved 2.7% in the year to QIV 2010. At a state level, the largest positive movement was recorded in Melbourne (+3.1%pa) followed closely by Brisbane (+ 3.0%pa) due to relatively higher increases in housing, alcohol and tobacco and transportation. Canberra (+2.1%pa) recorded the smallest positive movement. Brisbane's CPI peaked at 5.6%pa in September 2008.

The most significant contributors to Brisbane's lift in the CPI in QIV were rises in utilities' prices and residential rents. Falling clothes prices and soft house prices in Brisbane in QIV helped ameliorate these solid increases in prices in other components.

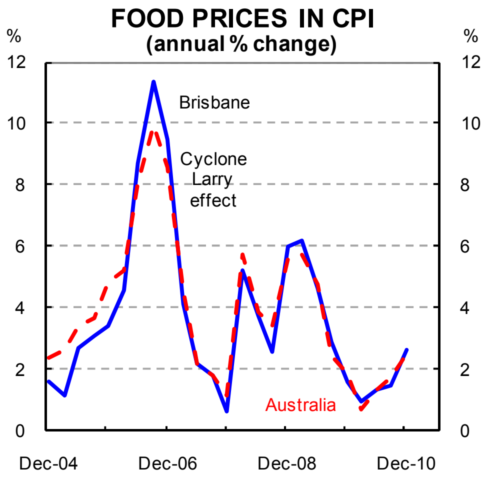
The near term outlook for inflation is mixed. House prices are expected to remain soft, and the high AUD which is presently at post-float highs is likely to continue to bear down on import prices. On the upside, solid wages growth on the back of ever tightening labour markets, and expected hikes in utilities' prices and rents, will exert upward pressure on Qld inflation levels in 2011 and 2012.



Food prices to rise after the floods.

In the short term there is some concern crop damage from the floods and Cyclone Yasi will lift fresh food prices. Following Cyclone Larry in 2006, banana prices rose dramatically, pushing the food price index in the CPI up by 10%pa. Hopefully, the food price rises in coming months could be of a much lower magnitude.

In the next few years, as the mining and investment boom gains momentum in Qld, we expect more wage and general price pressures. Residential rents, health costs and utilities prices are expected to keep rising. We see Qld inflation heading to the top end of a 3-4% range in 2012.

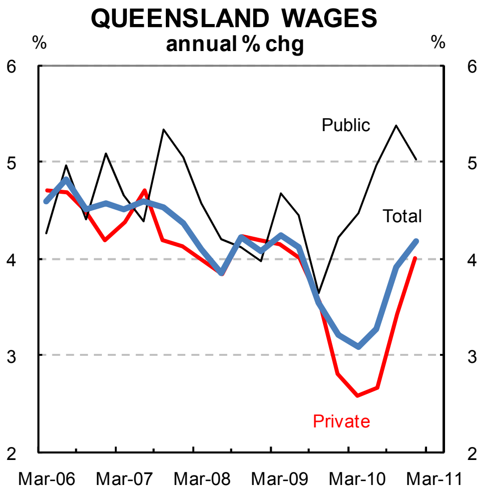


QLD Wages

Private sector wages rising.

The latest wages data shows a quite strong resurgence in private sector wages growth in Qld. But that is in line with the experience of the other States. The QIV 2010 wage cost index (WCI) showed total wage costs running at 4.2%pa. Private sector wages growth is at 4%pa, and rising, while the public sector is at 5%. Nationally, total wage costs were running at 3.9%pa.in QIV. The RBA starts to fret about the inflationary impact of wages when the annual growth rate moves into the 4 to 4.5%pa zone.

Looking ahead, Qld's wage pressures are likely to intensify as the state's economic growth pulse quickens. We expect to see increasing skilled and general labour shortages materialise. We see the Qld WCI rising to 4.5%pa or more in 2011.

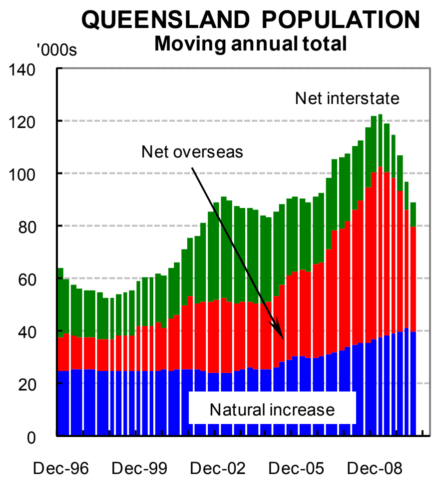


Population growth

Queensland's population growth is slowing.

The latest comprehensive ABS population data (released for QII 2010) showed strong, albeit moderating, population growth across the states and the nation in 2009/10. Qld's population growth was 89k or 2.1% in the year to June 2010. That was the lowest number since December 2004. But this outcome easily outpaced Australia's population growth of 1.7% and NSW growth of 1.5% in 2009/10.

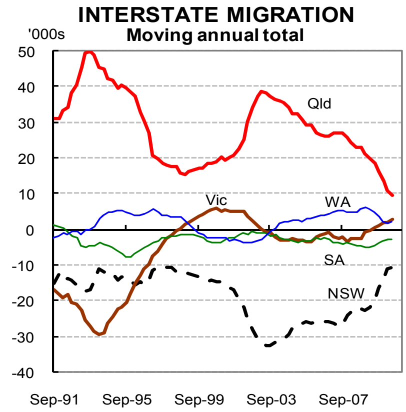
Australia's (& Qld's) relatively high population growth in recent years also demonstrates one of the reasons why Australia avoided the housing market implosions in the advanced G 7 economies.



Australia's strong population growth in recent years and tepid residential construction over 2002 to 2009 has resulted in a significant undersupply of dwellings. It was the reverse in many of the advanced economies. This undersupply in Australia has created pent-up demand pressures that were released as the RBA cut interest rates through 2008 and 2009.

Strong population growth has created pent up demand for housing.

So, while the US and UK witnessed 30% falls in house prices from 2007 to 2009 as their unemployment rates spiked higher and the housing markets were negatively impacted by significant oversupply, Australian house prices recorded, on average, 20% rises. On our estimates, national underlying annual housing demand is around 185-195k, while new construction has been accelerating in the past year, the gap between underlying demand and supply is still significant (around 30k).



Net overseas migration to re-accelerate in coming years.

Net overseas migration was boosted substantially by the Federal Government from 2002 due to fears of widespread labour shortages which could lead to inflationary wages growth. The Global Financial Crisis (GFC) calmed these fears on inflationary wages growth temporarily. But now the re-emergence of the mining boom will most probably require national net overseas migration to be held around the 250k level in coming years. The major impact from this strong population growth will be ongoing upward pressures on housing costs via rising house prices and rents, particularly in Melbourne, Sydney and Brisbane where vacancy rates are already at low levels.

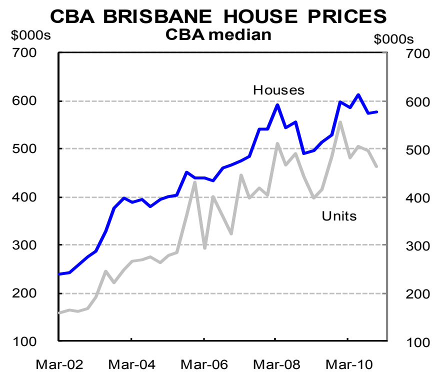


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Table 1: Economic projections

CBA forecasts for Queensland	2009-10 actual	2010-11f	2011-12f	Comment
Real Gross State Product (GSP)%	1.6	1.4	6	Flood & cyclone affected then recovering
Employment Growth %pa June	3.7	3.0	3.0	Jobs growth firm
Unemployment Rate % June	5.3	5.4	4.8	Sliding unemployment rate
CPI (Brisbane) %pa	3.2	4.0	3.5	Moderate inflation
Wages Price Index %pa	4.2	4.5	4.8	Wages growth edging higher
Exports $bn annual	43	47	57	Exports hit by floods, then rising
Dwelling starts, '000s annual	33.2	31	35	Dwelling construction modest
Population growth %pa June	2.01	1.8	2.2	Population growth above national figure
CBA median house price Brisbane $000s	612	625	650	Subdued housing market

Table 1Sources: ABS, CBA

Table 2 Fiscal projections

Qld Fiscal Projections	2008-09 Outcomes	2009-10 Estimates	2010-11 Estimates Mid Year	2011-12 Estimates	2012-13 Estimates
Total Revenue $mn	39,729	41,289	41,796	43,731	44,633
Total Expenses $mn	39,785	43,297	45,755	47,287	46,311
Operating Balance (GFS)$mn	(56)	(l,468)	(3,959)	(3,556)	(1,677)
Fiscal Balance* $mn	(5,3050	(5,660)	(7,406)	(5,665)	(2,656)
Net Debt $mn	(13,342)	(9,790)	(1,576)	4,614	7,502
Net Debt % GSP	8.8	7.9	7.3	5.9	4.8
Capital Works Spending $bn	39,729	41,289	41,796	43,731	44,633

Table 2 Sources: State budgets, CBA

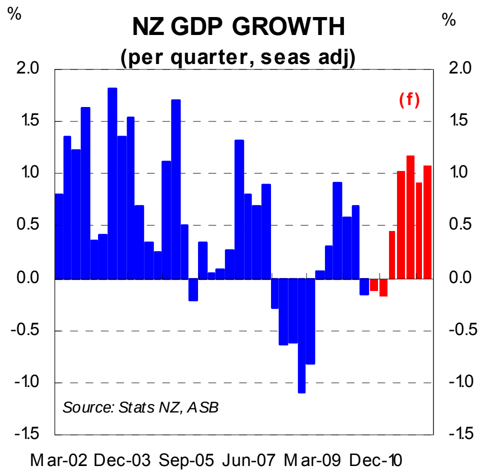
New Zealand Economic Perspective

Economic recovery stalls at takeoff: QIV GDP preview

- We expect QIV GDP contracted 0.1%, although there is more uncertainty than usual with this release.
- Weakness led by household sector; some offset by increased exports, manufacturing production and construction
- RBNZ anticipated weak QIV activity when OCR cut 50bpt, focus on events unfolding during QI.

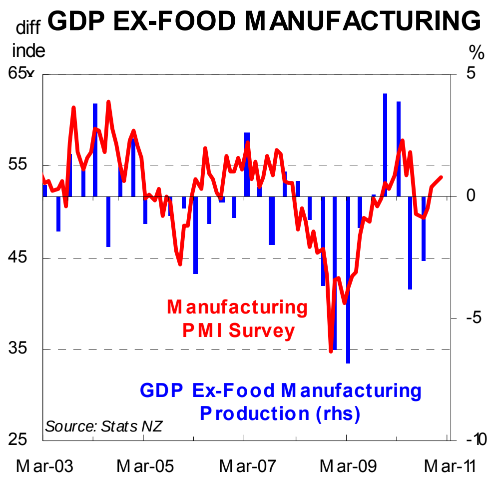
GDP more uncertain than usual. We expect a contraction of 0.1%.

We expect GDP contracted 0.1% over QIV, following on from the 0.2% decline in QIII. This would meet the technical definition of a recession. However, given the small magnitude of decline we would describe the profile as heading sideways rather than backwards. The economic recovery that had been in place in early 2010 stalled over the second half of the year. Business confidence fell as activity underperformed expectations, which in turn affected firms' willingness to hire and invest. The patchy pace of recovery in the labour market weighed on consumer confidence, contributing to low consumer spending and housing demand. On top of lacklustre demand, activity was further weakened by the September earthquake.



Uncertainty greater than usual as key partial data unavailable.

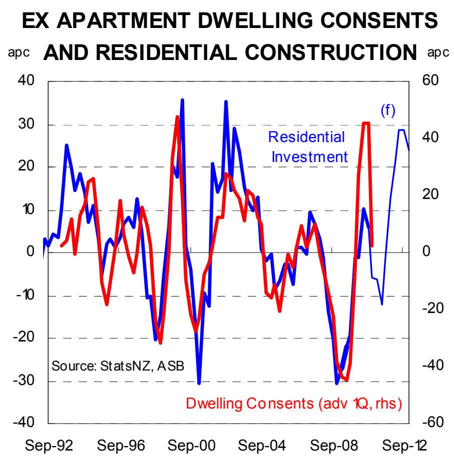
There is more uncertainty that usual around this quarter's GDP release due to February's earthquake. The StatsNZ Christchurch office has been badly affected, and as a result the manufacturing and wholesale trade surveys are unlikely to be released prior to GDP. This leaves forecasters making a rough stab (instead of an educated guess) at what amounts to 20% of GDP.



Manufacturing production likely to bounce back in QIV.

We expect core manufacturing production (excluding food-related industries) to increase in QIV, recovering some of the decline over QII and QIII. The manufacturing survey usually provides a fairly reliable insight into this sector, but is likely to be unavailable prior to the GDP release this quarter.

However, we can gauge trends in the manufacturing sector using alternative indicators such as confidence in the manufacturing sector and employment. These indicators are limited as they are best for describing the underlying momentum, rather than honing in on quarterly volatility. Nonetheless, both suggest improvement is likely following two quarters of decline, although any lift over QIV may be relatively subdued.



Slaughter volumes weak.

Slaughter volumes can provide some insight into meat processing activity, and point to declines over the quarter. Overall, this adds up to an underwhelming 1.2% lift in manufacturing activity. Manufacturing production accounts for 12% of GDP: a surprise could affect the overall GDP result dramatically.

Wholesale trade to be lifted by manufacturing, exports and construction.

The wholesale trade survey is also likely to be unavailable prior to the release of GDP. Wholesale trade is one sector that held up well over QIII. Indeed, we suspect the September earthquake actually increased activity in this sector as damaged stocks had to be replaced. Given our expectation that export volumes, construction activity and manufacturing activity expanded over QIV, we expect positive growth from the wholesale trade sector.

Construction up on public sector building.

The building work put in place survey delivered a pleasing surprise, reporting a 0.9% increase in construction largely due to a 10% increase in non-residential building activity. Along with the anticipated increase in manufacturing and wholesale trade, the lift in construction activity provides support to an otherwise weak quarter for growth. However, much of this increase was government related, with private sector non-residential building remaining weak. In addition, residential building contracted 7% due to weak underlying demand for new housing.

Timing of Christchurch rebuilding pushed back to 2012.

Looking ahead, we had previously expected to see a pick up in construction activity over QI on the back of rebuilding following the September earthquake. However, the February earthquake is likely to put a hold on reconstruction, which is now likely to be delayed until later this year/early next year.

Beyond growth in wholesale trade and the post-earthquake recovery in manufacturing and construction, we expect the remaining sectors in the economy were marred by weakness in underlying demand. Retail trade is likely to lead the weakness with a large decline. In addition, the weak housing market activity will weigh on growth, as well as weak agricultural production due to dry weather conditions.

Retail spending declines post GST increase.

We expect that retail volumes contracted heavily over QIV, with much of the spending on durables brought forward to QIII ahead of the increase in GST. The retail trade survey is now reported under a new classification, which is very different from the classification used by the national accounts. However, using raw data provided by StatsNZ of retail trade under the old classification (that matches the GDP classification), we estimate that retail sales fell 2.3% over QIV.

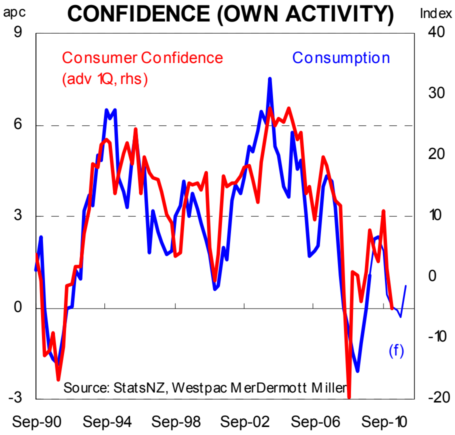
Much of this weakness is due to the lull in retailing following the GST increase in October. However, underlying consumer demand is also very weak, with the recovery in the labour market patchy and households pulling back on discretionary spending due to an increased focus on saving. Looking ahead, spending is also likely to be adversely affected over QI by the Canterbury earthquake, particularly given the disruption to the hospitality industry by the evacuation of tourists and the closure of the Christchurch CBD.

Housing market activity subdued.

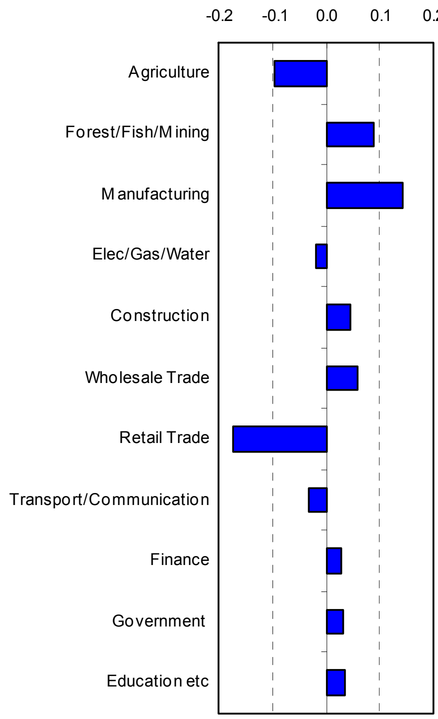
The weakness in the housing market contributes to the flat result in the finance, insurance, property and business services component of GDP.

Transport activity spiked higher in QIII, likely as a result of the earthquake prompting increased movement of goods around the country, particularly into Christchurch. We expect that transport

CONSUMPTION & CONSUMER CONFIDENCE (OWN ACTIVITY)



Q4 2010 PRODUCTION GDP FORECAST
(pp contribution to quarterly % change)



activity did not grow further in QIV, weighed by weakness in overall activity.

Dry conditions to weigh on agricultural production.

Dry conditions prior to Christmas, particularly in the north, are likely to weigh on dairy production over QIV.

The share of hydro and wind generated electricity has fallen over the second half of the year. As these forms of electricity generation have a higher value-add from a national accounts perspective, a fall in production from these sources this tends to detract from electricity generation GDP.

Mining activity lower, but hopefully forestry provides some offset.

Mining production eased according to MED data, largely due to decline in petroleum production. Coal exports remained firm, despite the Pike River disaster. A strong lift in forestry export volumes points to a lift in forestry production, which may offset the weakness in mining.

Looking at GDP from an expenditure perspective, we expect the weakness to be concentrated in a decline in consumer spending and residential investment. A strong export performance is likely to provide some offset. In addition, other investment is expected to grow. However, to the extent much of the new capital equipment is imported (in particular, the Air New Zealand's new Boeing 777 aircraft), this lift does not add directly to GDP growth.

Slow recovery over 2011

Looking ahead, expectations for QI GDP growth have been revised back heavily as a result of the February 22nd earthquake. Retail spending, hospitality, business services and construction are key areas affected, and we are expecting GDP to register another small decline in QI.

Recovery over 2011 likely to be slow, as consumers bunker down.

The economy is likely to be slow to recover over 2011, particularly given the bulk of rebuilding activity in Christchurch is now likely to be put on hold until early 2012. In addition, underlying demand has proved much weaker than expected, particularly the degree of caution displayed by the household sector. The 50 basis point rate cut by the RBNZ should help stimulate some demand, and help provide support to the housing market. Nonetheless, spending growth is likely to remain very subdued. We expect unemployment to increase slightly as a result of the February earthquake. In addition, rising food and energy prices over the first half of 2011 will provide an additional headwind to households that will cut into discretionary spending. The Rugby World Cup later this year will provide a boost to activity, with an increase in tourism spending. This boost to growth should hopefully kick start some momentum, which will be built upon once reconstruction efforts in Christchurch begin.

Market implications

Following February's devastating earthquake in Christchurch, QIV GDP is old news. The RBNZ has since cut the OCR by 50 basis points in order to shore up confidence. At the time of the decision, the RBNZ was aware that activity over the final quarter of the year was likely to be very weak. We do not expect any further rate cuts, and the RBNZ is likely to look through any surprise to QIV GDP, and concentrate on developments over QI. However, in the wake of the Japanese earthquake, tsunami and nuclear crisis the market is currently susceptible to bad news. In Australia, interest rate markets are pricing in possibility of rate cuts, while in NZ the markets have pushed out the timing of eventual rate hikes by the RBNZ until 2012. As a result, the market reaction to GDP is likely to be asymmetric. A negative GDP result could exacerbate the downbeat mood, while a positive result is likely to be ignored.

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The Week Ahead

Calendar - Australasia, Japan and China

Date	Time AEST	Econ	Event	Period	Unit	Last	Forecast Market	Forecast CBA
Mon 21 Mar	08.45	NZ	Net migration	Feb	No.	450.0	~	~
	10.00	AU	Trends in federal enterprise bargaining report	QIII	~	~	~	~
	13.30	NZ	Credit card spending	Feb	m%ch	3.8	~	~
					y%ch	5.6	~	~
Tue 22 Mar	15.30	JP	All industry activity index	Jan	m%ch	-0.2	2.3	~
	16.00	JP	Supermarket sales	Feb	y%ch	-0.1	~	~
	18.00	JP	Convenience store sales	Feb	y%ch	5.1	~	~
Wed 23 Mar	08.45	NZ	Current account balance	QI	$bn	-1.8	~	~
	08.45	NZ	Account deficit-GDP ratio					
Thu 24 Mar	08.45	NZ	GDP	QI	q%ch	-0.2	~	~
					y%ch	1.5	~	~
	10.00	AU	Conference board leading index	Jan	%	0.7	~	~
	10.50	JP	Merchandise trade balance total	Feb	¥bn	471.4	883.4	~
	10.50	JP	Adjusted merchandise trade balance	Feb	¥bn	191.8	709.2	~
	10.50	JP	Merchandise trade exports	Feb	y%ch	1.4	9.1	~
	10.50	JP	Merchandise trade imports	Feb	y%ch	12.4	5.0	~
	11.30	AU	RBA financial stability review	~	~	~	~	~
	13.15	AU	Speech by Malcolm Edey, Assistant Governor (Financial System), to the Basel III Conference in Sydney.					
Fri 25 Mar	10.30	JP	National CPI	Feb	y%ch	0.0	0.0	~
	10.30	JP	National CPI ex-fresh food	Feb	y%ch	-0.2	-0.3	~
	10.30	JP	National CPI ex food, energy	Feb	y%ch	-0.6	-0.7	~
	10.50	JP	Corporate service price index	Feb	y%ch	-1.1	~	~
	11.30	AU	Financial accounts	QIV	~	~	~	~
	12.35	CH	MNI business condition survey	Mar	Index	58.2	~	~

Calendar – North America & Europe

Please note all days and times are UK time, not local release day/times

Date	Time UK	Econ	Event	Period	Unit	Last	Forecast Market	Forecast CBA
Mon 21 Mar	00.01	UK	Rightmove house prices	Mar	m%ch	3.1	~	~
	12.30	US	Chicago Fed National activity index	Feb	Index	-0.2	~	~
	14.00	US	Existing home sales	Feb	mn	5.4	5.2	~
Tue 22 Mar	09.30	UK	CPI	Feb	y%ch	4.0	4.2	~
	09.30	UK	CPI – core	Feb	y%ch	3.0	3.1	~
	09.30	UK	RPI	Feb	y%ch	5.1	5.2	~
	09.30	UK	Public finances (PSNCR)	Feb	£bn	-14.4	~	~
	09.30	UK	Public sector net borrowing	Feb	£bn	-5.3	~	~
	12.30	CA	Leading indicators	Feb	m%ch	0.3	~	~
	12.30	CA	Retail sales	Jan	m%ch	-0.2	1.1	~
	12.30	CA	Retail sales less autos	Jan	m%ch	0.6	0.7	~
	14.00	UK	House price index	Jan	m%ch	-0.3	-0.2	~
	14.00	UK	Richmond Fed manufacturing index	Mar	Index	25.0	22.0	~
Wed 23 Mar	09.30	UK	Bank of England minutes	~	~	~	~	~
	10.00	EZ	Industrial new orders	Jan	m%ch	2.6	1.9	~
	12.30	UK	U.K. Chancellor of the Exchequer Osborne Announces Budget					
	14.00	US	New home sales	Feb	'000	284.0	290.0	~
Thu 24 Mar	09.00	EZ	PMI composite	Mar A	Index	58.2	58.4	~
	09.00	EZ	PMI manufacturing	Mar A	Index	59.0	58.2	~
	09.00	EZ	PMI services	Mar A	Index	56.8	56.3	~
	09.30	UK	Retail sales ex auto fuel	Feb	m%ch	1.6	~	~
	09.30	UK	Retail sales w/auto fuel	Feb	m%ch	1.9	-0.5	~
	12.30	US	Durable goods orders	Feb	%	3.2	1.0	~
	12.30	US	Durables ex transportation	Feb	%	-3.0	2.0	~
	12.30	US	Cap goods orders nondef ex air	Feb	%	-6.9	4.4	~
	12.30	US	Initial jobless claims	19 Mar	'000	385	~	~
	12.30	US	Continuing claims	12 Mar	'000	3706	~	~
Fri 25 Mar	09.00	GE	IFO - business climate	Mar	Index	111.2	110.5	~
	09.00	GE	IFO - current assessment	Mar	Index	114.7	114.7	~
	09.00	GE	IFO - expectations	Mar	Index	107.9	106.8	~
	12.30	US	GDP (annualized)	QIV T	q%ch	2.8	3.0	~
	12.30	US	Core PCE	QIV T	q%ch	0.5	0.5	~
	12.30	US	Personal consumption	QIV T	%	4.1	4.1	~
	12.30	US	University of Michigan confidence	Mar F	Index	68.2	68.0	~

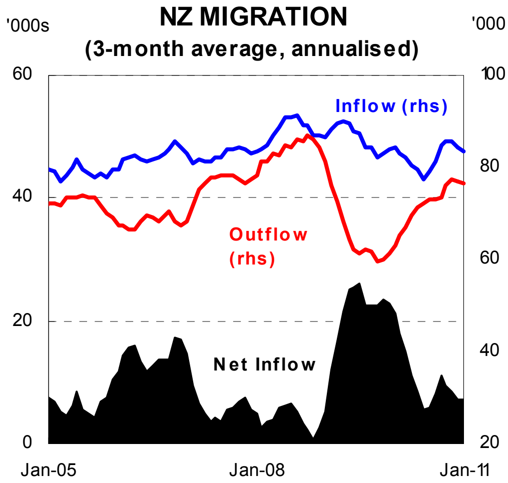
Calendar – Key Events To Watch

Australia and New Zealand

Monday 21 March

NZ Net migration, Feb, (450 prev)

There were just 450 net new migrants over January, with departures continuing to grow strongly and arrivals figures remaining subdued. On an annual basis the pace of migration is continuing to slow. Much of the increase in departures over the past year has reflected New Zealanders heading across the Tasman, attracted by Australia's stronger job market. The recent earthquake is likely to add to this momentum, with fed up Cantabrians likely to find better job prospects abroad than locally. With the housing stock badly damaged in Christchurch, and under-building likely to lead to shortages in places like Auckland, migration out of NZ would alleviate some of the pressure on the housing market in the future.

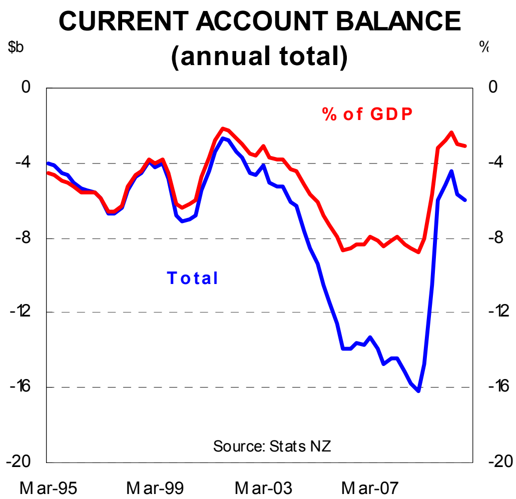


Short-term visitor arrivals were growing strongly prior to the Canterbury Earthquake. We are likely to see some disruption in February statistics as a result of the quake. However, given the quake was relatively late in February, the March figures are likely to give a better perspective on the impact of the quake on tourism.

Wednesday 23 March

NZ Current account, QIV, % of GDP, (f)-2.6 (-3.1 prev)

We expect a current account deficit of $2.4 billion in the December quarter. On an annual basis this will reduce the deficit to $5 billion – or 2.6% of GDP. However, there are likely to be revisions to the previous quarter as StatsNZ fine-tunes its estimate of reinsurance flows following September's quake. At the last release these were estimated at $1.7 billion, but it is likely this estimate will be revised up over time to at least $2 billion. As a result, revisions may contribute to a smaller annual deficit than forecast.



On a seasonally-adjusted basis, we estimate the deficit to be around $1.7 billion, with a strong seasonally-adjusted goods surplus offsetting the investment income deficit. As the economy gradually improves, stronger profits and higher interest rates tend to increase the investment income deficit. With the economy largely tracking sideways over the latter half of 2010, we do not expect to see much increase in the investment income deficit from the previous quarter.

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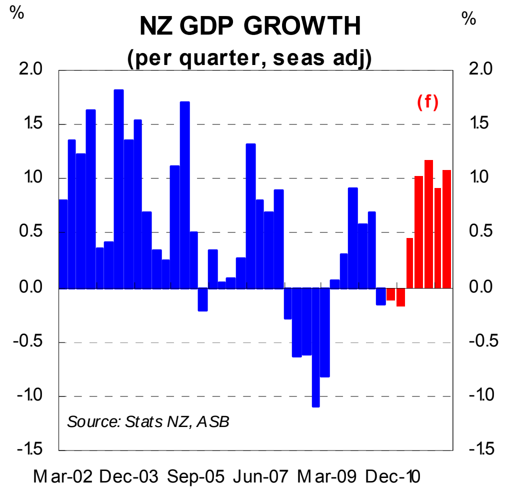
Thursday 24 March

NZ GDP, QIV, q%ch, (f) -0.1 (-0.2 prev)

We expect GDP contracted 0.1% over QIV, following on from the 0.2% decline in QIII. The economic recovery that had been in place in early 2010 stalled over the second half of the year. We expect growth to occur in manufacturing, wholesale trade and construction. However, this will be offset by declines in other sectors due to the underlying weakness in demand. In particular, we expect a sharp contraction in retail volumes. In addition, the weak housing market activity will weigh on growth, as well as weak agricultural production due to dry weather conditions.

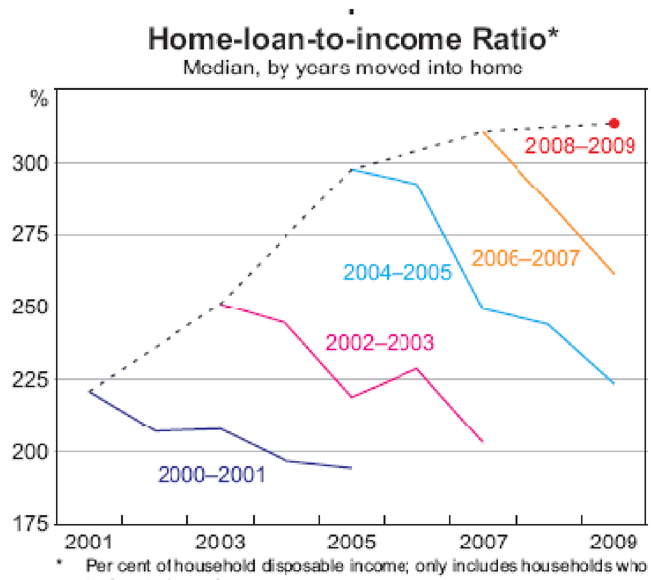
There is more uncertainty that usual around this quarter's GDP release due to February's earthquake. The StatsNZ Christchurch office has been badly affected, and as a result the manufacturing and wholesale trade surveys are unlikely to be released prior to GDP. This leaves forecasters to take a rough stab (instead of an educated guess) at what amounts to 20% of GDP. Along with heightened uncertainty, the market reaction is likely to be asymmetric given recent events in Japan.



Thursday 24 March

AU RBA Financial Stability Review

The RBA will release it's bi-annual Financial Stability review this week. Details of the half-yearly assessment were canvassed in the minutes of the March RBA Boart meeting. The RBA's assessment is that non-performing assets in the Australian financial sector – mainly troubled commercial property exposures – have stabilised over the past year. There is likely to be an impact from flooding and other recent natural disasters in some parts of the financial sector, but the overlal impact is expected to be limited. The household and business sectors do not appear to be under financial stress, though continued caution in borrowing behaviour remains. Recent work by the RBA on household borrowing behaviour noted that the pace of growth in household borrowing has slowed significantly, and there has been a sharp increase in the proportion of households ahead of schedule on loans and paying off credit card balances on a monthly basis.

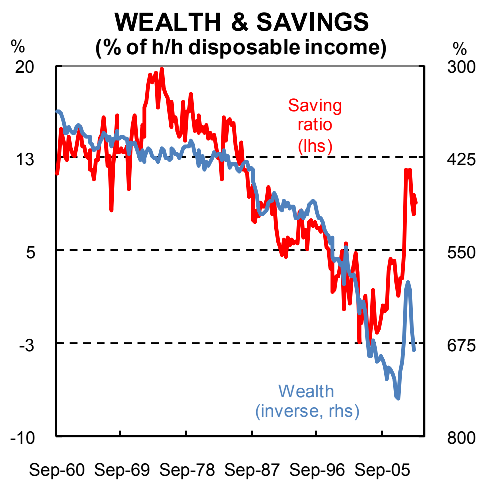


* Per cent of household disposable income; only includes households who took out a home loan
Sources: HILDA Release 9.0; RBA

Friday 25 March

AU Financial accounts, QIV 2010

Household wealth has been recovering strongly in Australia. The QIV finanicial accounts will provide the latest update on the balance sheets of households and businesses. Recent developments in the household savings ratio have brought the household wealth measures into focus. Household wealth has recovered strongly following the GFC. The major driver has been the recovery, and subsequent expansion in house prices through 2009-2010. House price growth has now slowed. Financial wealth appears to have not yet fully recovered. Total wealth is at levels consistent with lower levels of househols savings. The RBA has highlighted the risk of a decline in the households savings ratio. Such a decline would boost consumer spending, and demand in an economy that is already on track to absorb a major boom in business capex spending.



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International

Monday 21 March

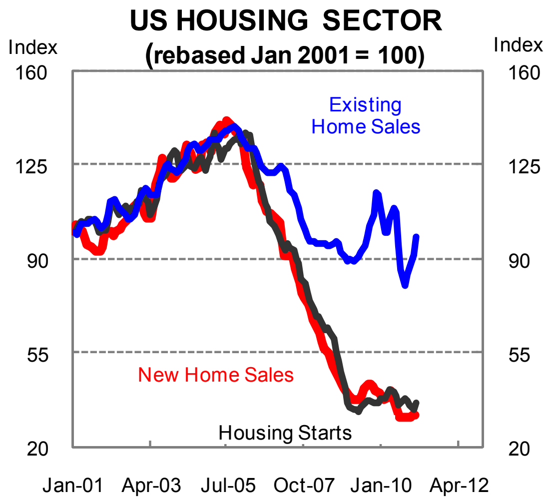
US Existing home sales, Feb, mn, (5.4 prev)

Wednesday 23 March

US New home sales, Feb, '000, (284 prev)

Existing home sales increased 2.7% in January (MoM), to an annual rate of 5.36 million. The recent increase in existing home sales appears to have been driven by the improving US economic outlook and the likely follow through in higher borrowing costs. As mortgages in the US are generally 30-year fixed loans, potential buyers can be induced to bring forward purchases with the prospect of future higher borrowing costs looming.

New home sales fell 13% in January, to a 284,000 annual pace. The influx of foreclosed properties onto the market is depressing home prices. As a consequence, distressed existing homes are appearing more attractive than new homes to potential buyers. With the US unemployment rate tracking around 9% and credit standards remaining relatively tight, home construction is likely to lag other more robust areas of the US economy in 2011.

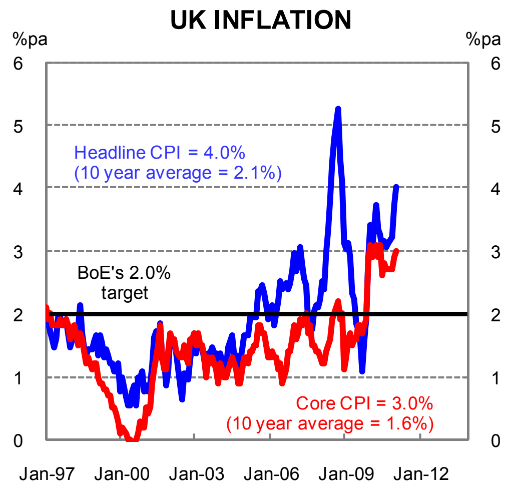


Tuesday 22 March

UK CPI, Feb, m/y%ch, (0.1/4.0 prev)

UK CPI accelerated to 4% (YoY) in January, doubling the Bank of England's (BoE) 2% target. The lift in January pushed consumer price growth to levels not seen since November 2008. The recent increase in prices appears to be a function of the lift in the UK sales-tax, a weaker GBP, and rising commodity prices. Another concern for the BoE may be the rise in inflation expectations, which increased to a two and a half year high in February.

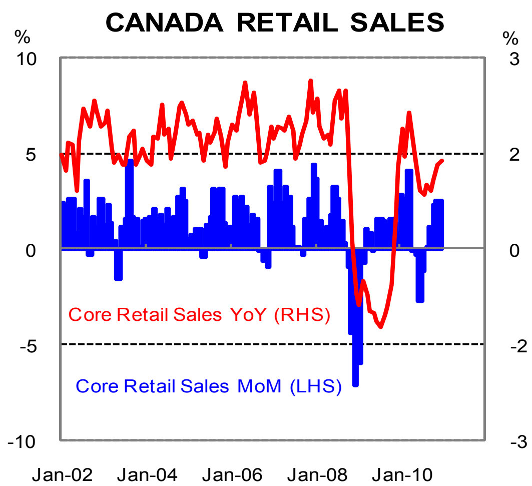
In the letter to the Chancellor explaining January's elevated inflation, BoE Governor King indicated that there was a "*great deal of uncertainty*" surrounding UK inflation. According to King the BoE's central view is that UK inflation is equally "*likely to be above the target as below it two to three years ahead*".



Tuesday 22 March

CA Retail sales, Jan, m%ch, (-0.2 prev)

Somewhat surprisingly, Canada's retail sales declined by 0.2% in December. The December decline was the first fall in seven months and was a function of the drop in new car purchases. Core retail sales, which exclude automobiles and parts, increased by a relatively robust 0.6% in December. Despite the slight pull back in retail sales in December, consumer demand has been a key economic growth driver. In 2010, retail sales increased 4.9% (core sales increased 4.6%). However, the Bank of Canada (BoC) expects consumer spending growth to slow in 2011. According to the BoC, exports and investment will drive Canada's economy in 2011.



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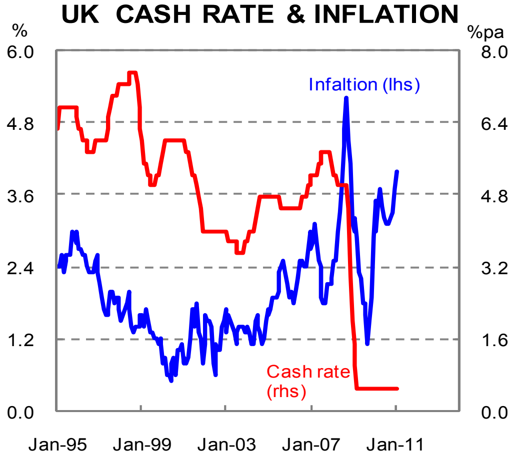
Wednesday 23 March

UK Bank of England minutes, Mar

As expected the Bank of England (BoE) remained on hold at its March policy meeting. The BoE has left its base rate at 0.5% since March 2009. We expect the BoE to commence policy tightening in QII 2011. UK inflation continues to be elevated, rising to 4.0% (YoY) in January. UK inflation has exceeded the BoE's 2% target since December 2009, and there is a growing risk of increased inflation expectations.

The minutes of recent BoE policy meetings have progressively become decidedly more hawkish. In March, a third Monetary Policy Committee (MPC) member pushed for a lift in the Bank rate, with one member wanting to lift rates by 50bpts. Markets will be interested to see whether the tone of the BoE's inflation outlook has again shifted. In March, MPC rate hike dissenters "*thought that the case for an increase had nevertheless grown in strength*".

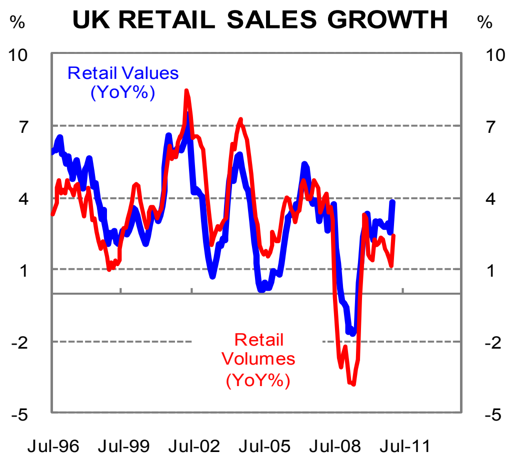


Thursday 24 March

UK Retail sales, Feb, m/y%ch, (1.9/5.3 prev)

In January, UK retail sales were almost four times higher than market expectations. Retail sales, in value terms, increased 2.0% (MoM), or 6.7% (YoY) in January. In volume terms the annual increase was 5.3% in January.

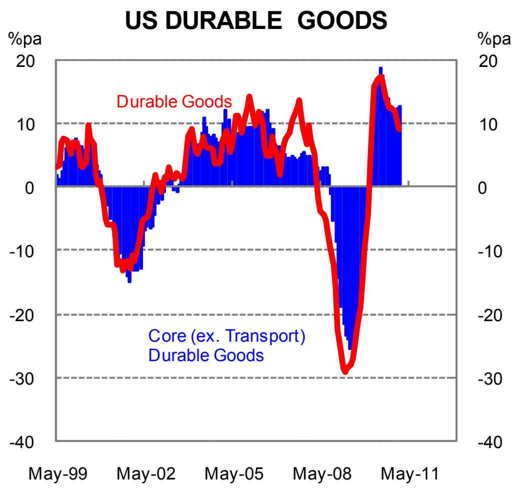
The January increase was the largest monthly gain since February 2010. Significantly, core retail sales have also been trending higher. In January, core retail sales increased 1.6% (5.3% YoY). The January result was a rebound from the weather induced decline of December. The turnaround highlights that the apparent slowdown in the UK economic recovery at the turn of the year was largely adverse weather driven and not a change in underlying momentum.



Thursday 24 March

US Durable goods orders, Feb, %, (3.2 prev)

In January, durable goods orders increased, rising 3.2%. The January result, a rebound from December falls, was the strongest since September. The lift in January was attributed to the volatile demand for aircraft. On an annual basis, core durable goods orders, which exclude transport, have remained robust, despite falling some 3% (MoM) in January. Core durable goods orders have rebounded some 24% from their April 2009 lows. US firms continue to show a desire to invest, in an effort to maintain their economic capacity. Growth in core durable goods orders is likely to continue in the coming months. This bodes well for the slowly improving US labour market. More orders, often prompt manufacturers to add to payrolls.



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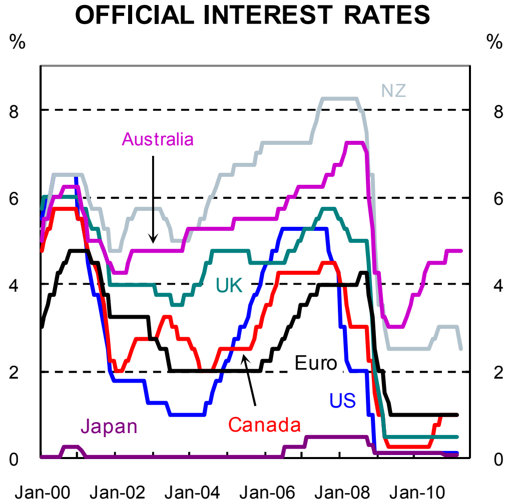
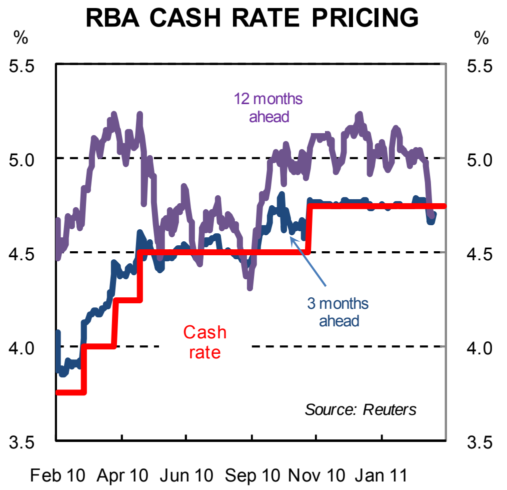
Monetary Policy





Country	Last Move	Next Meeting and Forecast				CBA View
Australia (RBA)	25bpt rise to 4.75% on 7 November 2010.	■ 5 April, 2011				The RBA has normalised monetary policy, and has begun a shift to contractionary rates to head off inflationary pressures. We expect rates to reach 5.50% by QIV 2011.
		Mar '11	Jun '11	Sep '11	Dec '11	
		4.75%	5.00%	5.25%	5.50%	
US (FOMC)	75-100bpt cut to 0 0.25% on 16 December 2008.	■ 28 April, 2011				The Fed has announced a further $600bn QE program in addition to reinvesting maturing funds into Treasury purchases. We do not expect the first Fed Funds hike until QIV 2011.
		Mar '11	Jun '11	Sep '11	Dec '11	
		0-0.25%	0-0.25%	0-0.25%	0.50%	
Eurozone (ECB)	25bpt cut to 1.00% on 7 May 2009.	■ 7 April, 2011				Elevated inflation in the Eurozone is likely to see the ECB commence tightening policy in an effort to pre-empt the onset of second round inflation effects. We expect the first ECB rate hike to be in QII 2011.
		Mar '11	Jun '11	Sep '11	Dec '11	
		1.00%	1.25%	1.25%	1.50%	
UK (MPC)	50bpt cut to 0.5% on 5 March 2009.	■ 7 April, 2011				Members of the BoE are becoming more concerned about UK inflationary pressures. But, most members expect significant spare capacity to dull the near-term pressures. We expect the first move in QII 2011.
		Mar '11	Jun '11	Sep '11	Dec '11	
		0.50%	0.75%	1.00%	1.25%	
NZ (RBNZ)	50bpt cut to 2.5% on 10 March.	■ 28 April, 2011				In response to domestic economic weakness and the Christchruch earthquake, the RBNZ delivered a 50bpt rate cut at the 10 March policy meeting. We expect the RBNZ's tightening cycle to resume in QI 2012.
		Mar '11	Jun '11	Sep '11	Dec '11	
		2.50%	2.50%	2.50%	2.50%	
Canada (BoC)	25bpt rise to 1.00% on 8 September 2010.	■ 12 April, 2011				The Canadian economy is recovering, and the BoC has begun to remove stimulus. We expect a slow and steady removal of policy accommodation to ensue.
		Mar '11	Jun '11	Sep '11	Dec '11	
		1.00%	1.25%	1.50%	1.75%	
Japan (BoJ)	0-10bpt cut to 0-0.1% on 5 October 2010.	■ 7 April, 2011				With the Japanese economy continuing to battle deflation the Bank of Japan is undertaking additional quantitative easing measures. Rates are unlikely to change anytime soon.
		Mar '11	Jun '11	Sep '11	Dec '11	
		0-0.10%	0-0.10%	0-0.10%	0-0.10%	

Forecasts - Economic

	Fiscal Years						Calendar Years						
	2007/08 (a)	2008/09 (a)	2009/10 (a)	2010/11 (f)	2011/12 (f)	2012/11 (f)	2006 (a)	2007 (a)	2008 (a)	2009 (a)	2010 (a)	2011 (f)	2012 (f)
Economic Activity													
Private final demand	**6.4**	**0.1**	**0.8**	**2.9**	**5.6**	**4.4**	**3.7**	**7.1**	**3.1**	**-0.7**	**2.0**	**4.4**	**5.2**
Of which: Household spending	4.7	0.2	2.1	3.0	3.1	3.0	3.4	5.4	1.9	1.0	2.7	3.1	3.0
Dwelling investment	1.2	-1.9	2.1	2.4	4.1	-0.2	-3.0	3.0	2.1	-4.2	4.8	2.3	2.8
Business investment	15.8	1.4	-4.9	4.3	15.1	10.8	8.5	16.1	9.5	-5.3	-0.9	10.9	14.1
Public final demand	**4.2**	**3.6**	**6.7**	**6.0**	**2.7**	**0.4**	**3.7**	**3.4**	**6.3**	**1.6**	**9.1**	**5.1**	**-0.6**
Domestic final demand	**5.9**	**0.9**	**2.1**	**3.7**	**4.9**	**3.4**	**3.7**	**6.3**	**3.8**	**-0.1**	**3.6**	**4.6**	**3.8**
Inventories (contrib to GDP)	0.0	-0.4	0.3	-0.1	0.1	0.1	-0.4	0.6	-0.3	-0.4	0.4	-0.1	0.2
GNE	**5.9**	**0.4**	**2.4**	**3.6**	**5.0**	**3.5**	**3.2**	**6.9**	**3.5**	**-0.5**	**4.1**	**4.5**	**4.0**
Exports	4.0	2.6	5.1	3.4	7.1	8.5	2.3	2.5	4.7	2.8	5.3	3.8	8.4
Imports	14.6	-3.3	4.9	10.1	10.3	8.5	7.0	12.2	11.5	-9.0	13.2	10.5	8.6
Net exports (contrib to GDP)	*-2.1*	*1.4*	*0.1*	*-1.5*	*-0.8*	*-0.1*	*-0.8*	*-1.9*	*-1.5*	*2.8*	*-1.6*	*-1.6*	*0.0*
GDP	**3.8**	**1.4**	**2.3**	**2.4**	**4.1**	**3.4**	**2.6**	**4.6**	**2.6**	**1.3**	**2.7**	**2.9**	**3.8**
Prices & Wages													
CPI	**3.4**	**3.1**	**2.3**	**2.9**	**2.9**	**2.5**	**3.5**	**2.3**	**4.4**	**1.8**	**2.8**	**3.1**	**2.6**
Underlying CPI	3.7	4.3	3.1	2.3	3.0	3.0	2.8	2.9	4.4	3.7	2.6	2.6	3.1
AWOTE	4.9	5.5	5.6	4.0	4.2	4.1	3.4	4.8	4.8	5.7	4.9	4.1	4.1
WPI	**4.1**	**4.1**	**3.0**	**3.9**	**4.0**	**3.9**	**4.2**	**4.0**	**4.2**	**3.6**	**3.3**	**4.1**	**3.9**
Real h/hold disposable income	2.9	8.5	1.0	4.4	2.4	2.7	5.7	6.4	4.7	5.8	2.2	3.4	2.4
Labour Market													
Employment	3.0	1.6	1.4	3.1	2.0	1.9	2.6	3.1	2.8	0.7	2.7	2.6	1.9
Unemployment rate	4.2	4.9	5.5	2.4	4.6	4.5	4.8	4.4	4.3	5.6	2.3	4.8	4.5
External Accounts													
Current Account: $bn	**-74.5**	**-38.5**	**-53.3**	**-28.1**	**-47.1**	**-57.2**	**-55.2**	**-70.2**	**-55.2**	**-52.9**	**-34.5**	**-35.5**	**-54.1**
% of GDP	*-6.3*	*-3.1*	*-4.1*	*-2.0*	*-3.2*	*-3.6*	*-5.3*	*-6.2*	*-4.5*	*-4.2*	*-2.6*	*-2.5*	*-3.5*

Forecasts - Financial

End Period		Interest Rates: Cash Rate	90-day Bank Bill	180-day Bank Bill	3-year Bond	10-year Bond	Exchange Rates (USD versus): AUD	JPY	EUR	GBP	NZD
Jun-07		6.25	6.44	6.59	6.47	6.26	0.85	123.2	1.35	2.01	0.77
Sep-07		6.50	6.89	6.99	6.42	6.15	0.89	114.8	1.43	2.05	0.76
Dec-07		6.75	7.24	7.36	6.80	6.33	0.88	111.7	1.46	1.98	0.77
Mar-08		7.25	7.86	7.96	6.16	6.05	0.91	99.7	1.58	1.98	0.79
Jun-08		7.25	7.84	7.96	6.72	6.45	0.96	106.2	1.58	1.99	0.76
Sep-08		7.00	7.32	7.04	5.07	5.40	0.79	106.1	1.41	1.78	0.67
Dec-08		4.25	4.15	0.00	3.29	3.99	0.70	90.7	1.40	1.46	0.58
Mar-09		3.25	3.14	3.06	3.37	4.42	0.69	99.0	1.33	1.43	0.56
Jun-09		3.00	3.19	3.31	4.75	5.52	0.81	96.4	1.40	1.65	0.65
Sep-09		3.00	3.38	3.78	5.04	5.36	0.88	89.7	1.46	1.60	0.72
Dec-09		3.75	4.28	4.47	5.06	5.64	0.90	93.0	1.43	1.62	0.72
Mar-10		4.00	4.49	4.76	5.39	5.78	0.92	93.4	1.35	1.52	0.71
Jun-10		4.50	4.92	5.00	4.56	5.09	0.84	88.4	1.22	1.49	0.68
Sep-10		4.50	5.01	5.20	4.82	4.96	0.97	83.5	1.36	1.57	0.73
Dec-10		4.75	5.04	5.23	5.30	5.55	1.02	81.1	1.34	1.56	0.78
Mar-11	**Forecast**	4.75	5.00	5.40	5.30	5.60	1.02	85.0	1.40	1.62	0.76
Jun-11	**Forecast**	5.00	5.30	5.60	5.60	5.80	0.99	86.0	1.45	1.70	0.75
Sep-11	**Forecast**	5.25	5.60	5.70	5.80	5.90	0.94	87.0	1.42	1.68	0.72
Dec-11	**Forecast**	5.50	5.80	5.90	5.90	6.00	0.92	88.0	1.40	1.65	0.71

Unless otherwise noted, all data is sourced from Australian Bureau of Statistics material (www.abs.gov.au).

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