



Economic Prospects

March Quarter 2010

International Economy

Australian Economy

Australian Interest Rate Outlook

Australian Dollar Outlook

Wages and Inflation Outlook

Retail Spending Outlook

Services Sector Activity – Ai Group CBA PSI

Construction Outlook

Resource Commodities

Agricultural Commodities

State Comparisons

Equity Markets

Economic and Financial Forecasts



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Based on information and data available at 4 January 2010.

Unless otherwise noted Australian data is sourced from ABS publications.
See www.abs.gov.au

ABS Numbers for data used are:

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5206.0

5609.0

6202.0

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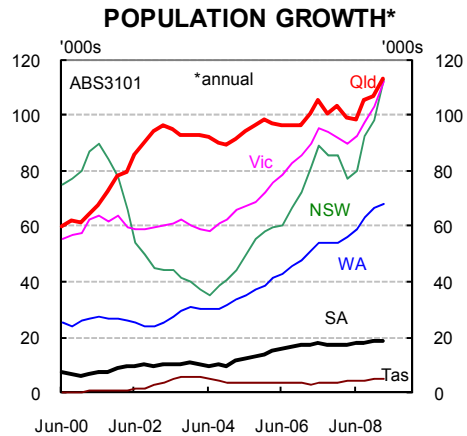
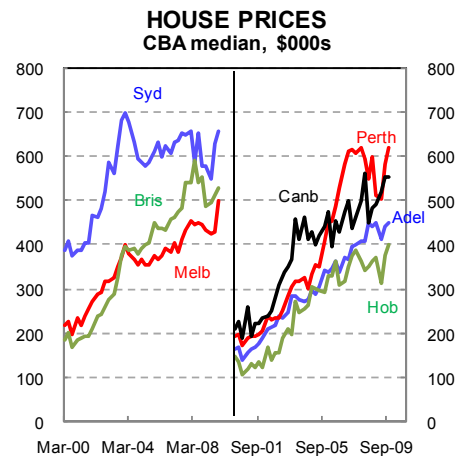
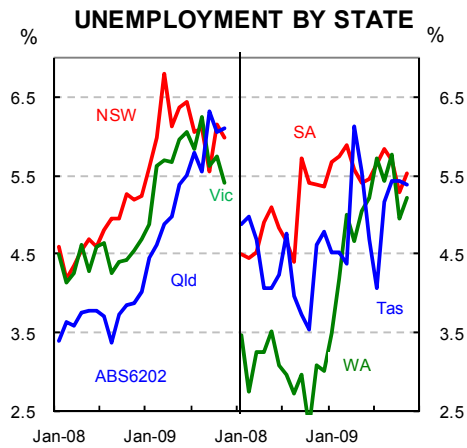
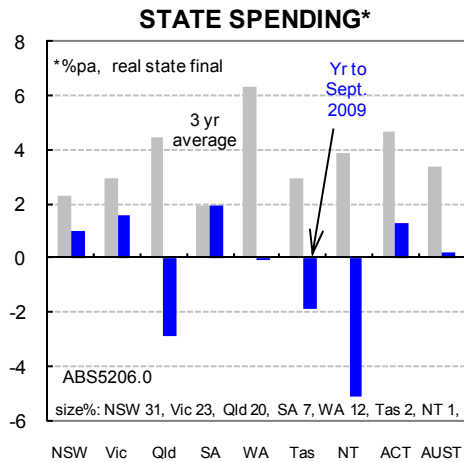
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The States to Bounce Back in 2010

The States have survived 2009 in reasonably good condition and are well placed to return to average growth rates in 2010. While there will still be problems in commercial, industrial and leisure property construction, along with manufacturing, most sectors will experience expansionary activity. The business and consumer sentiment surveys have rebounded strongly, returning to 2007 levels. It is very positive for business investment and consumer spending in 2010. Areas of strongest activity are likely to be in infrastructure investment (utilities and transport), health, education and defence. New residential construction should be buoyant following large rises in lending. The mining regions of Western Australia, Queensland, Northern Territory and South Australia are likely to record higher growth rates than NSW, Victoria, Tasmania and the ACT over the next three years and generally outperform in economic measures.



*Growth rates are expressed as annual percent changes.

Source: ABS catalogues 3101, 5206, 6202 and 6416



Table of Contents

▶ International Economy	Global economy to rebound in 2010	5
<i>The credit crisis aftermath will dampen growth rebounds in the advanced economies in 2010. World economy to expand by just 2.9% in 2010 after contracting by 2.2% in 2009. Emerging economies will outperform.</i>		
▶ Australian Economy	GDP should bounce back above 3% in 2010	6
<i>QIII GDP rose 0.2% in quarterly terms, with annual growth at just 0.5%. Substantial fiscal and monetary stimulus along with firmer residential construction and a rebounding China should lift 2010 GDP to to 3.25%pa.</i>		
▶ Australian Interest Rate Outlook	More RBA rate rises likely through 2010	7
<i>The RBA looks set to lift the cash rate to 4.25% in QI and to 5.0% by the end of 2010 as activity lifts. The world economy is improving as interest rates stay low and financial markets are starting to function properly again.</i>		
▶ AUD Outlook	AUD peak expected before mid 2010	8
<i>We expect the AUD to rise against a weak USD until mid 2010 until higher US interest rates strengthen the USD.</i>		
▶ Wages and Inflation Outlook	Tame wages but rising inflation in 2010	9
<i>The higher unemployment rate should moderate wages outcomes well into 2010. Headline inflation hit the low point in late 2009 and is set to rise to 2.5% in 2010. Underlying inflation measures are falling gradually but will rise in late 2010.</i>		
▶ Retail Spending Outlook	More consistent growth coming in H1 2010	10
<i>Retail sales growth should return to the 6%pa level in 2010 as consumers react favourably to better news on the jobs outlook and rising house and share prices.</i>		
▶ Services Sector Activity, Weak But Improving	AIG-CBA Performance of Services Index recovering	11
<i>Services sector recovery is relatively subdued according to the Ai Group business survey. Survey suggests the depth of contraction is abating, with improvements in leading components.</i>		
▶ Residential Construction Outlook	Low rates and stimulus positive for construction	12
<i>Residential construction turns on low mortgage rates, high demand and First Home Owners Boost. Population growth of 2.1%, or 443k, in the year June 2009 continues to lift housing demand.</i>		
▶ Resource Commodities	Stronger medium term outlook	13
<i>Anticipation of international economic recovery has contributed to the recovery in base metal and oil prices since early 2009. We believe that base metal prices may pull back in the near term but will strengthen over the period from late 2010 to 2012.</i>		
▶ Agricultural Commodities	It's been a wild ride!	14
<i>Global agricultural commodity prices have been on the rebound in 2009 after slumping during the GFC. The softs have led the charge, with sugar up 150% and cotton up 100% from their late 2008 lows. World wheat prices have proven resilient despite a weak fundamental backdrop.</i>		
▶ State Comparisons	2010 should see return to trend growth	15
<i>State growth rates should return to trend by the end of 2010 despite higher interest rates. Consumer spending and business investment to rise through 2010. Unemployment rates to peak at 6%.</i>		
▶ Equity Markets	Rebound, then consolidation	16
<i>Global share-markets have posted solid gains since reaching lows in early March. A period of consolidation has been in place since mid October. The Australian share-market is expected to record gains of 10-12 per cent over 2010.</i>		
▶ Economic and Financial Forecasts		17
▶ Contacts List		



International Economy

Global economy to rebound in 2010

- The credit crisis will dampen growth rebounds in the advanced economies in 2010.
- World economy to expand by just 2.9% in 2010 after contracting by 2.2% in 2009.
- Emerging economies will outperform.

Forecasts Source	US		Japan		Euroland		China	
Consensus Forecasts	2009 (f)	2010 (f)	2009 (f)	2010 (f)	2009 (f)	2010 (f)	2009 (f)	2010 (f)
GDP %pa	-0.4	2.9	-5.3	1.5	-3.9	1.3	10.4	9.2
CPI %pa	1.4	1.8	-1.3	-1.0	0.3	1.2	0.7	2.8

World growth prospects have improved but 2009 recessions will take big toll.

World growth prospects have improved dramatically in the past few months. A combination of very low interest rates, bank bail-outs and targeted fiscal expansion will lift the advanced economies into weak recoveries in 2010. We expect that central banks may lift interest rates after mid 2010. World economic growth looks set to be around 2.9% after contracting 2.2% in 2009.

US economy still fragile but signs that worst is over.

The US, which accounts for around 25% of world output, still has some negatives with bad debt problems in its financial and commercial property sectors. On the positive side there are clear signs that residential house prices and new construction are turning after recording 30% falls to mid 2009.

The US unemployment rate looks to have peaked at 10% in the past few months. Industrial production is slowly reviving as producers and retailers re-stock in preparation for higher US and world growth in 2010.

Euroland and Japan outlooks are for weak recoveries.

Euroland, the UK and Japan could have relatively weak recoveries in 2010. All are struggling with weak commercial property and finance sectors and high unemployment rates. Budget deficits have ballooned. It means there is limited fiscal flexibility to stimulate their economies further. It also places pressure on world bond yields as the supply of government bonds increases over the next five years. Higher than expected world growth in the next few years may offset some of these supply concerns.

China is the most important influence on Australia's export growth outlook.

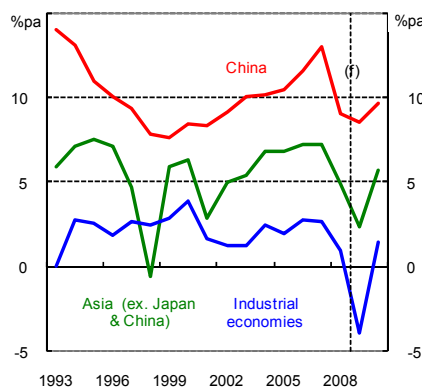
For Australia the major favourable development in the world economy is China's relatively buoyant growth outlook. It should have GDP growth of 10.4% in 2009 and at least 9.2% in 2010.

Chinese policy makers have boosted commodity-intensive infrastructure spending and bank lending. Domestic growth drivers are helping offset some of the contraction in Chinese export markets. These latter developments are particularly significant given the importance of China for Australia's trade and commodity prices. Growth in India and other emerging nations should also accelerate in 2010. Eighty per cent of Australia's export dollars come from Asia and Middle East.

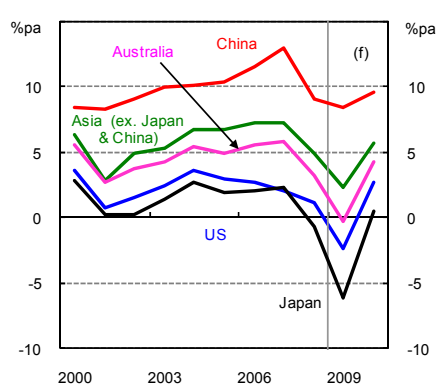
Financial markets are pricing in interest rate rises from the major central banks after mid 2010. The rapid upwards shift in world growth expectations has been welcomed by the international share markets which have regained about half of the falls recorded in 2008 and 2009.

World growth outlook has improved.

WORLD ECONOMIC GROWTH



WORLD ECONOMIC GROWTH





Australian Economy

GDP should bounce back above 3% in 2010

- QIII GDP rose 0.2% in quarterly terms, with annual growth at just 0.5%.
- Substantial fiscal & monetary stimulus, the lower AUD, and a rebounding China will buoy local growth.
- Ever widening demand/output (ie supply) gap points to ongoing downside inflation bias in HII 2009.

Forecasts	GDP %pa	CPI %pa	Unempl. Rate %	CAD \$bn (% GDP)	Business Investment %pa	Wages Price Index %pa
2009(f)	2.4	2.3	5.7	-52 (-5.1)	-4.9	3.1
2010(f)	3.3	2.5	6.1	-62 (-5.0)	5.2	3.7
2011(f)	3.5	2.7	5.5	-72 (-4.8)	6.0	4.0

GDP running at weak 0.5%pa in QIII 2009.

Australia's favourable outcomes flowed from good management....

...and good luck.

2010 growth should be near trend....

...as consumer confidence and jobs lift.

Business investment should also recover helped by a lift in energy projects.

GDP growth is headed back to its trend rate of 3.25% in 2010.

Real GDP rose by 0.2% in QIII 2009, putting annual growth at 0.5%. Growth is weak. But Australia has outperformed the very gloomy expectations of earlier in the year.

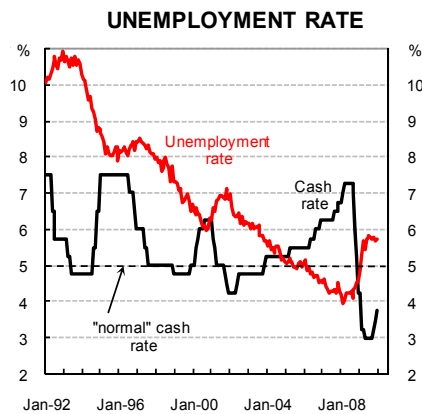
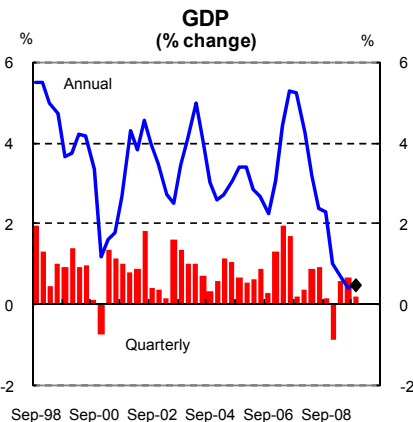
Australia's favourable growth and employment outcomes are, in our view, due to a combination of good luck and good management. The good management came from large RBA interest rate cuts and the rapid distribution of \$20bn in cash and first home buyers' grants to low and middle income households in late 2008 and early 2009. The handouts acted as a significant cushion to households expecting a re-run of the early 1990s recession.

The rebound in the business and consumer sentiment surveys reflects the relatively strong balance sheet position of households and businesses because of the handouts and the 50 year low in mortgage rates. Confidence bounced back when the flow of data indicated that Australia had escaped with only a slowdown and not a recession.

The good luck in economic terms came from the strong population growth of the past 5 years which helped keep housing demand relatively buoyant. Housing sales and new construction have lifted through 2009 as variable mortgage rates fell to the 5.8% level, a 50 year low. Export volumes held up particularly well as China kept buying after commodity prices fell in 2008. In contrast Australia's imports dropped as buyers anticipated a major recession and cut inventories accordingly.

The peak in the unemployment rate at 5.8% is a welcome development for the 2010 growth outlook. It is part of the reason for the strong lift in consumer confidence over the past few months. Employers have retained their workforces by reducing hours worked rather than outright shedding. As jobs lift in 2010 we expect consumer spending to move back to normal growth rates. Higher residential construction across the nation should also feed into firmer jobs and spending outcomes. The RBA's move to "normalise" interest rate settings should not be a barrier to the lift in residential construction.

Non-residential construction activity should lift significantly through 2010. Spending on mining and infrastructure should help offset the expected weakness in new commercial and industrial construction. The Federal Government's infrastructure funds will add about 2 percentage points to GDP over the next few years. Recent announcements on the LNG projects in WA and Queensland have the potential to lift annual LNG investment from about 0.5% of GDP (or \$6bn) currently to, possibly, 2.5% (or \$36bn) in 2015.





Australian Interest Rate Outlook

RBA rate rises likely through 2010

- The RBA looks set to lift the cash rate to 4.25% in Q1 and to 5.0% by the end of 2010 as activity lifts.
- The world economy is improving as interest rates stay low and financial markets are starting to work properly again.
- Australia's unemployment rate has peaked earlier and at a much lower level than expected.

Forecasts (%)	Cash	90 Day Bill	3 Yr Swap	5 Yr Swap	10 Yr Swap	10 Yr Bond
4 January 2010 actual	3.75	4.14	5.41	5.84	6.25	5.70
Mar 10f	4.25	4.50	5.95	6.10	6.50	5.80
Jun 10f	4.50	5.30	6.25	6.30	6.60	5.90
Sep 10f	4.75	5.55	6.40	6.40	6.70	6.00
Dec 10f	5.0	5.70	6.50	6.50	6.75	6.10

RBA move to lift rates in October was earlier than expected.

The RBA surprised financial markets when it lifted the cash rate from 3.0% to 3.25% in October. The RBA Board had decided to remove the “emergency” level of interest rates because domestic economic conditions had not deteriorated to the extent thought likely in early 2009.

Low rates and big spending helped us avoid a recession.

Since then the RBA has lifted the cash rate twice to 3.75%. Its comments indicate that Australia's GDP growth rate is forecast to return to trend, i.e. about 3.25%pa, by the end of 2010. It also believes that the low point in the headline and underlying measures of inflation will occur through 2010, with both rising by year end.

More rate rises coming in 2010.

The low level of domestic interest rates through late 2008 and most of 2009 gave borrowers a significant lift in cash flow if required. Along with the \$20bn in cash handouts to households there was a hefty stimulus applied to the domestic economy. It helped Australia avoid the deep recessions evident in the US, Euroland, the UK and Japan of the past year.

Activity levels will rise and jobs market will improve.

Borrowers should expect more increases in the RBA's cash rate and other interest rates through 2010. Most interest rates are likely to move back towards their average, or “normal”, levels of the past 17 years.

Terms of trade headed back to 2007 or pre-crisis level.

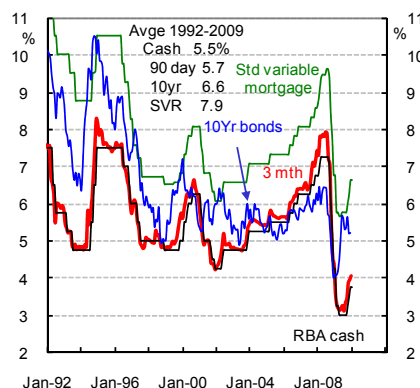
In our view local economic growth will be driven by firmer consumer spending as the jobs market improves, higher government and infrastructure spending and a strong rise in residential construction activity across the cities and regions. It means that the jobs market will firm and most probably exert some upward pressure on wages in late 2010 and into 2011.

There are also clear signs that our major export markets will lift demand for, and prices of, mineral and energy exports over 2010 and 2011. The rise in export prices should lift Australia's terms of trade back to its 2007 or pre-financial crisis levels.

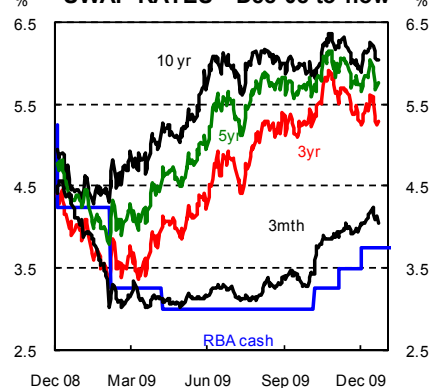
From the RBA's viewpoint it all adds up to an outlook that has some pleasing lifts in activity. But it also requires interest rates to move into more neutral territory over 2010.

Interest rates are moving back to “normal” levels.

INTEREST RATES 1992 - 2009



SWAP RATES - Dec 08 to now



AUD Outlook

AUD peak expected before mid 2010

- The AUD has risen aggressively against the USD through 2009 as the US recession undermines the USD.
- We expect the USD to reach its low, and the AUD to peak, around mid 2010.
- Rising commodity prices and still high local interest rates should keep the AUD above USD0.80 in 2010.

Forecasts (end qtr)	AUD/USD	AUD/JPY	AUD/EUR	AUD/GBP	AUD/NZD	AUD/CHF
4 January 2010 actual	0.8980	83.4	0.6280	0.5578	1.2415	0.9317
Mar 10f	0.95	85	0.62	0.55	1.20	0.94
Jun 10f	0.98	93	0.63	0.54	1.19	0.96
Sep 10f	0.95	91	0.63	0.51	1.19	0.98
Dec 10f	0.90	88	0.61	0.50	1.18	0.97

The USD should weaken further until its interest rates rise

The AUD low point over the past year was USD0.6009 in late October 2008. But that was against a swing to global de-leveraging and a much stronger USD. Since then the AUD has risen as the US recession worsened and US Fed cut short term interest rates to near zero. The US economy is now showing clear signs of recovery with the housing market turning upwards in terms of sales, prices and new construction. Industrial output and forward looking indicators such as the ISM index are also pointing to a sustained recovery in output through the first half of 2010.

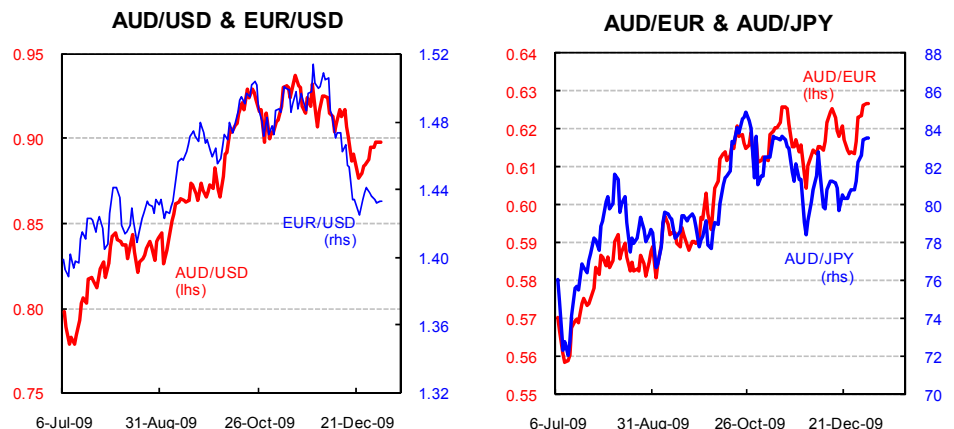
In our view it places the likely low point for the USD, and peak in the AUD/USD, around the middle of next year. Around that time we expect to see the US Fed discussing the need for higher short term interest rates. So interest rate differentials that have favoured the AUD as they widened through the last year, should begin to contract. The AUD's recent peak was USD0.9406 in mid November.

The USD will still have some large negatives that should prevent a major rally over 2010. The US gross government debt levels of 85% of GDP are actually higher than those in UK of 82%. The UK faces a 25% risk of a sovereign rating downgrade in 2010. Though we do not expect a downgrade to the US credit rating, the level of US government debt is likely to encourage some investment out of USD assets. The US is also finding it difficult to fund its current account from portfolio investment, putting downward pressure on the USD.

AUD positives should keep it above USD0.80 in 2010.

The structural influences that we see as positive for the AUD relate to the generally favourable outlook for Australia's exports and domestic growth. From an international perspective, the commodity exporters such as Australia, Canada, Brazil and New Zealand will benefit from Asia's strong demand for mineral, energy and food commodities over the next few years.

It should produce higher relative growth, interest rates and subsequent returns for investors. In our view, it should result in the AUD having less downside against the USD, and the other major currencies like the EUR and JPY over the next few years.



Wages and Inflation Outlook

Tame wages but rising inflation in 2010

- The higher unemployment rate should moderate wages outcomes well into 2010.
- Headline inflation hit the low point in late 2009 and is set to rise to 2.5% in 2010.
- Underlying inflation measures are falling gradually but will turn higher in late 2010.

	CPI		Underlying inflation		Avg Weekly Earnings		Wages Price Index	
	q/q %chg	%pa	q/q %chg	%pa	q/q %chg	%pa	q/q %chg	%pa
Sep 09a	0.7	1.3	0.8	3.8	1.6	4.2	0.7	3.6
Dec 09f	0.7	2.3	0.8	3.6	1.0	4.5	0.8	3.1
Jun 10f	0.6	2.9	0.5	2.7	0.8	3.2	0.9	3.2
Dec 10f	0.6	2.5	0.7	2.2	0.9	3.2	0.8	3.7

Wages measures are moderating.

Wages trends in Australia are favourable from an inflation perspective for 2010. The major influence has been a weaker jobs market feeding into consumer perceptions of rising job insecurity. Employers have shifted towards part-time employment on greater scale than in previous downturns. Employees have been more willing to take wage “freezes” rather than see widespread retrenchments. The result has seen the unemployment rate stabilising at 5.8% in the second half of 2009. Private sector wage outcomes over the past year have moderated to the 3% level.

In comparison, Federal and State public sector wages growth is closer to 4.5%pa.

The inflation outlook has benefited from the lower private sector wages growth. Wage costs are about 60% of all costs. So we expect to see only a gradual rise in the labour cost components of the inflation measures in 2010.

The inflation outlook has benefited from the lower private sector wages growth.

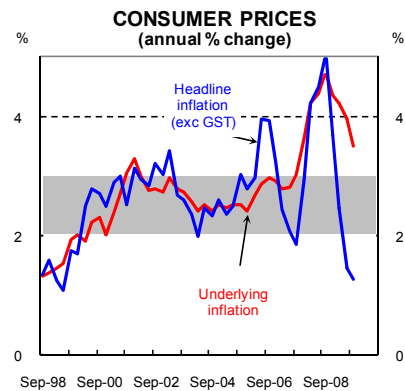
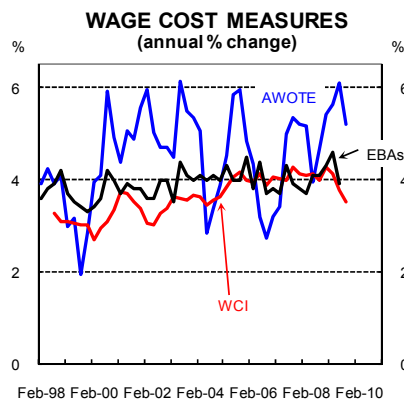
Headline inflation most probably hit the low point of 1.3% in QIII 2009. Lower petrol and financial services prices were the major downward influences on the CPI. By the end of 2010 the CPI is forecast to be back at 2.5%. Obviously, volatile petrol prices will play an important part in that outcome.

Underlying inflation looks set to reach a low point in late 2010 then rise.

The underlying inflation measure is falling from its mid 2008 peak to an expected low in late 2010. But from there it is likely to be rising again.

We expect the RBA to lift the cash rate to 5.0% in late 2010 in anticipation of apparent inflation risks.

The economy has entered another upswing in the business cycle with inflation measures not reflecting the extremely weak levels of activity that followed the 1990s recession and the Asian crisis. In some respects it places a considerable degree of uncertainty over how quickly inflation will rise if the jobs and goods markets respond quickly to firmer activity.



Retail Spending Outlook

More consistent consumer spending coming in 2010

- Retail spending likely to stay “choppy” as stimulus effect fades and jobs outlook remains uncertain.
- Better jobs growth and hours worked in QII 2010 should make retail spending more consistent.
- Rising house prices and a peak in the unemployment rate will help offset negatives from rising interest rates.

Forecasts (%pa)	Retail trade	Food	Dep’t stores	Clothing	Real retail	Jobs
2008/9a	7.8	9.3	7.0	10.9	4.2	-0.2
2009f	3.0	5	3	2.6	2.6	0.5
2009/10f	6	7	6	5	4.5	1.7
2010f	7	8	6	8	4.6	2.0

Weak jobs market winning out as stimulus effect fades.

The Federal Government paid out \$20bn to low and middle income households in two large tranches in late 2008 and early 2009. Most of these funds found their way into retail spending on goods and services, holidays or debt repayment.

The effect on retail sales data was dramatic, with strong monthly rises in December 2008 (+4.0%) and March 2009 (+2.7%). But, since then, the monthly figures have been choppy, averaging a mere 0.1% rise. Annual retail spending was running at 5.6% in October 2009, well down on the 8% rate achieved in early 2010.

The weak jobs market, especially the fall in average working hours, appears to be the major problem. It was overpowered by the positive effects from the Government’s stimulus but is now exerting a large negative on retail spending.

Positive news coming for consumers and retailers in 2010...

We expect to see a consistent rise in monthly consumer spending trends through 2010. In our view the list of positives building on the economic and wealth front will offset the negatives from rising interest rates. The major positive is a turn in the jobs market. We expect consumers to react favourably to consistent jobs growth and the peak in the unemployment rate (at around 5.8%) in the first half of 2010.

...on jobs....

Both of these should lift consumer confidence. Combined with the wealth effect from rising house prices, and a firmer share market, it should mean consistent rises in monthly consumer retail spending. Higher residential construction should also lift spending on hardware and materials. Annual growth in retail trade is forecast to rise through its 6%pa average of the past 10 years in mid 2010.

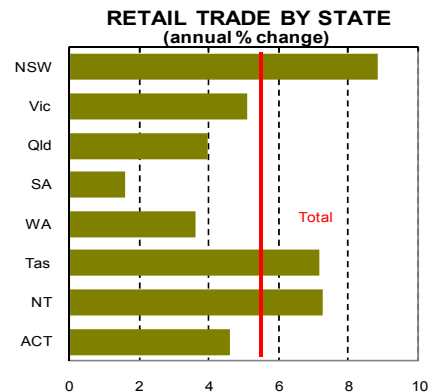
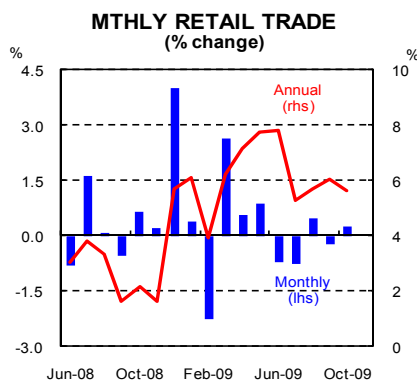
.... and wealth measures.

Expected wages growth of around 4%pa is also a positive for spending in 2010. Consumers, in our view, have significant “precautionary” savings built up over the past year that could be gradually be spent in retail areas. On our estimates about 30% of the total stimulus payments are still held as savings and could be spent as confidence builds in 2010.

Higher petrol prices a risk factor for retailing.

One of the risks for the retail environment in 2010 could be petrol prices. So far the rising AUD has enabled petrol prices to remain well below the “negative impact threshold” of 135c/litre. We still expect the AUD to remain mostly above USD0.90 over 2010. But oil prices may rise through USD100/bbl if oil demand and world growth is stronger than currently forecast.

Monthly retail figures have averaged a small 0.1% rise since early 2009.



NSW has strongest annual growth of 8%pa.

Services Sector Activity, Weak But Improving

Australian Industry Group-CBA Performance of Services Index subdued

- Services sector recovery is relatively subdued according to the Ai Group CBA business survey.
- New orders and deliveries are the weakest components of business activity.
- Survey suggests the depth of contraction is abating, with improvements in leading components.

	May-09	Jun-09	Jul-09	Aug-09	Sep-09	Oct-09	Nov-09
PSI total	39.9	50.2	44.1	48.0	49.3	54.8	52.5
Sales	39.1	55.2	47.5	49.1	48.4	59.7	55.4
New orders	34.9	51.5	45.7	47.1	50.7	58.5	56.7
Employment	46.0	48.5	45.4	48.6	49.9	48.6	50.5
Stocks	40.9	46.1	36.8	47.9	43.8	52.2	44.6
Deliveries	38.6	45.3	38.4	47.0	51.1	52.1	49.6
Input costs	58.6	62.9	65.6	63.9	62.8	57.3	66.0

The PSI is showing clear signs of rising activity.

The Ai Group CBA Performance of Services Index is showing clear signs of recovery compared to the deep recessionary conditions expected earlier this year.

The PSI is a diffusion index. Any figure above 50 indicates an expansionary phase for that category. The distance from 50 indicates the strength, or weakness, of activity. The overall index of business conditions was at 52.5 in November, down slightly from October's 54.8 and just above the expansionary levels of 50. But the rebound indicates that overall GDP growth will rise to the 3%pa level in 2010.

Sales, orders, employment and prices have recovered.

Sales, orders, employment and prices have recovered over the past few months.

This is occurring against a background of still low inventory and delivery levels.

It means, in our view, that any uptick in activity, if sustained will tend to lift profitability and productivity.

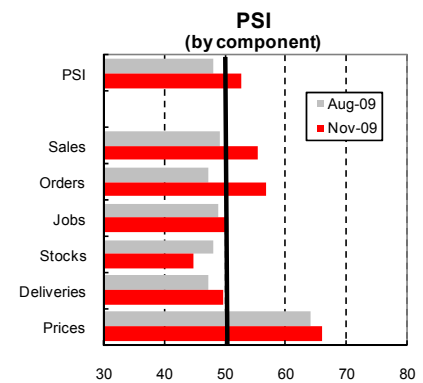
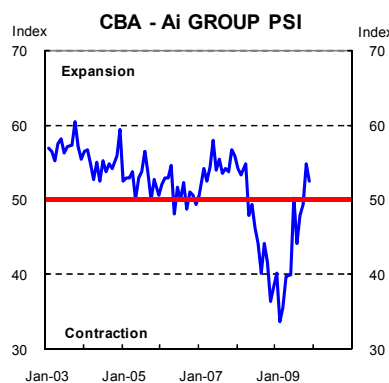
The lift in prices reflects the the flow-on of the AUD's weakness in late 2008 and early 2009. Consequently the AUD's recent strength should help limit the need for further price rises.

One of the areas showing marked improvement is the PSI employment indicator.

One of the areas showing marked improvement is the PSI employment indicator.

When compared against the actual ABS services sector jobs outcomes there is a close correspondence.

The pick-up in the PSI jobs indicator is positive for both services sector and overall employment growth next year. Private sector services sector jobs are around 45% of total employment.





Residential Construction Outlook

Low rates and stimulus to boost construction

- Residential construction turns on low mortgage rates, high demand and First Home Owners Boost.
- Public and private sector residential commencements expected to rise strongly over next two years.
- Population growth of 2.1%, or 443k, in the year to June 2009 continues to lift housing demand.

	Dwelling Commencements, '000s	Population growth '000s	Dwelling Investment (ex Alts & Adds) \$bn	Alterations & additions spending \$bn
2007/08a	159	359	55.4	32.4
2008/09a	131	443	52.4	31.1
2009/10f	160	480	57.0	31.0
2010/11f	184	480	62.0	34.0

Residential construction

Residential construction set to rise over the next few years.

Construction lending data has rise sharply from the lows of the past year.

Population growth is running at 439k.

We expect dwelling commencements to be around the 160k level in 2009/10.

First home buyer grants to boost construction of dwellings, lifting supply.

State construction levels could remain divergent.

The private and public residential sectors are set for a major boost in construction spending over the next few years. Construction lending data has risen sharply from the lows of the past year.

It will follow a particularly weak outcome for residential construction in 2008/9 of 131k new dwellings. That is significantly below CBA's estimate of underlying housing demand, based on population growth, of 185k.

Population growth is running at 443k (or 2.1%pa) in annual terms, driven by high levels of net migration. Population growth, driven by net migration, is assumed to remain high.

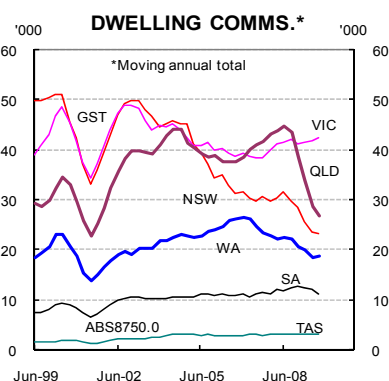
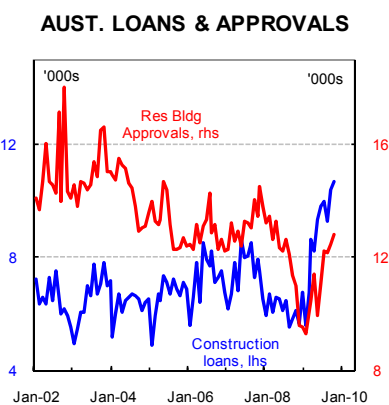
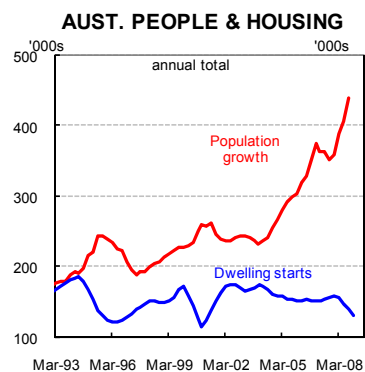
The after effects of the 50-year low in mortgage rates and the First Home Owner Boost should see new housing construction rebound strongly over the next few years.

We expect dwelling commencements to be around the 160k level in 2009/10, rising to 184k in 2010/11. First home buyer activity is seen as the initial driver of the pickup in construction activity. Since the introduction of the boosted first home buyers' grant and cuts to interest rates, the number of first home buyers has nearly doubled.

Rising house prices are rebuilding wealth and supporting consumer confidence and should add to the construction surge as some owners of existing homes decide to build new dwellings.

Public sector dwelling construction is also rising strongly with funding from the Federal Government.

State construction activity levels could remain divergent over the next few years. Victoria has been performing strongly despite higher mortgage rates. NSW construction has been sliding for the past 5 years but should stabilise and rise gradually in 2010.





Resource Commodities

Stronger medium term outlook

- Anticipation of international economic recovery has contributed to the recovery in base metal and oil prices since early 2009.
- We believe that base metal prices may pull back in the near term but will strengthen over the period from late 2010 to 2012.

Base metal and oil prices have recovered strongly since early-2009.

Base metal and oil prices have recovered strongly (USD terms) from the low levels of early-2009. We expect that base metal prices may pull back in the short-term (next 3 – 6 months) but that base metal prices will cycle higher from late 2010 and into 2011 and 2012. We expect that oil prices (USD terms) will firm modestly over 2010 but may then push higher in 2011. However, there are significant risks about the outlook for base metal and energy prices.

Anticipation of international economic recovery has aided base metal prices.

Base metal prices have recovered strongly since early 2009. The recovery in base metal prices has reflected a number of influences. Anticipation of international economic recovery has been a significant factor supporting commodity prices. As well, Chinese imports of a number of the base metals were particularly strong over much of 2009, although generally easing since the middle of the year. At times, the fragility of the USD has also supported base metal prices.

We believe there is a risk of a short term (in the next 3-6 months) pullback in the price of a number of base metals, including aluminium, copper, lead, nickel and zinc.

We believe the copper price has risen ahead of the improvement in copper market fundamentals. The copper market is likely to be in annual surplus in 2009 and remain in surplus, albeit much reduced, in 2010. Similarly, the zinc market is likely to be in annual surplus in 2009 and remain so in 2010.

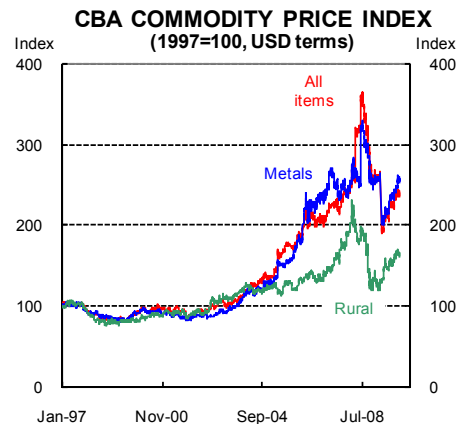
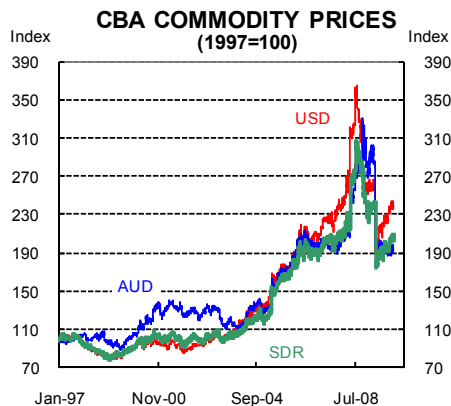
However, we expect that base metal prices will cycle higher from late 2010 through to 2012. The international economic recovery is likely to have gained more traction by this time. We expect that the copper, lead and zinc markets will be quite finely balanced over the 2011 to 2013 period. However, any recovery in the aluminium price over this period is likely to be limited by the persistence of surplus capacity. Similarly, gains in the nickel price will likely be constrained by surplus capacity.

We expect the oil price to lift slightly in 2010.

We expect the oil price to lift slightly over the course of 2010, increasing further in 2011. The oil price in 2010 is likely to benefit from anticipation of international economic recovery. However, there is adequate oil capacity to meet growth in demand.

We expect the gold price to rise to above USD1,200/oz by mid-2010.

We expect the gold price (USD terms) to move back above USD1,200/oz in the first half of 2010, benefiting from the continued fragility of the USD. However, a number of factors that are currently supporting the gold price are likely to turn over the second half of 2010 and in 2011, contributing to a fall in the gold price. In particular, CBA is forecasting the USD to recover ground over the second half of 2010 and in 2011. The US Federal Reserve is also expected to begin increasing US interest rates from the second half of 2010.





Agricultural Commodities

It's been a wild ride!

- Global agricultural commodity prices have been on the rebound in 2009 after slumping during the GFC.
- The softs have led the charge, with sugar up 150% and cotton up 100% from their late 2008 lows.
- World wheat prices have proven resilient despite a weak fundamental backdrop.

The unfolding global economic recovery helped set the scene.

Agricultural commodity markets – and indeed financial markets more broadly – have been on a wild ride over the past 18 months, with the global economy planted firmly in the driver's seat. Key themes for 2009 have been the recovery in world equity markets, USD weakness and strengthening energy markets. And as always, prevailing seasonal conditions and the impact on output has been an influence on price.

USD ag prices have recovered strongly.

The 2005 to 2008 bull run in ag commodity prices was completely wiped out during the GFC. But the faster than expected recovery in the global economy provided a big boost to prices across the board. Since posting lows in March, the CBA Rural Commodity Price Index (USD terms) has risen around 40%. But Aussie dollar prices have not enjoyed the same recovery. The surging local currency, from 60 US cents to over 90 US cents, has resulted in local prices having a flat to downward bias during 2009.

International wheat prices have proven resilient.

International grains prices have been volatile around a slightly downward trend during 2009. Both US wheat and corn prices experienced their yearly lows in September, but prices have since firmed by 20-30%, largely supported by the slow US corn harvest and USD weakness. Prospects of tightening global coarse grain supplies in 2010 also supported prices in this segment. US wheat prices have proven resilient despite weak fundamentals. Global wheat supplies are approaching decade highs, and low cost suppliers continue to be more competitive than the US into key export markets.

Dryness has supported east Aust grain prices.

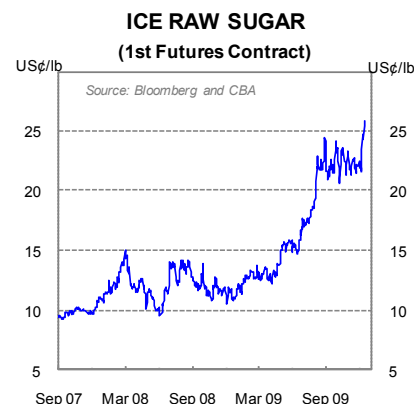
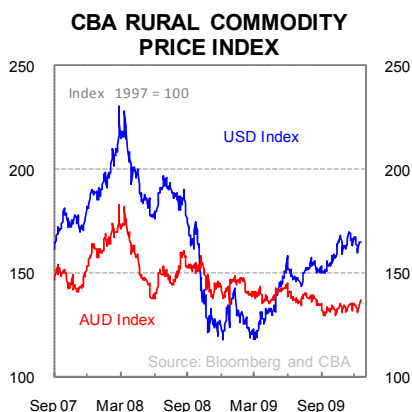
Australian grain prices have remained firm, despite AUD strength. Unfavourable seasonal conditions in NSW and QLD in H1'09 caused a downgrade to winter grain production estimates, and resulted in significant differential pricing between regions. And the prospect of a poor summer grain crop has exacerbated these differentials.

Sugar was the talk of the town in 2009.

The international sugar market stood head and shoulders above the rest in 2009, surging around 150% from December 2008 to current values ~USc26.00/lb (ICE Raw No.11), the highest level since 1981. The two largest consecutive global supply deficits on record have been the catalyst. Global tightness in supply will persist in 2010, particularly H'10, helping support prices. Long term prices may come under pressure as producers respond to record returns and as seasonal conditions improve.

And cotton prices also surged.

Global cotton prices rebounded in 2009 after slumping during the GFC. Current global prices (ICE 1st Contract), at ~USc75.00/lb, are double their late 2008 lows. The improving global economic environment, declining global cotton production prospects and expectations of a sharp fall in global stocks helped lift values. These themes are also likely to be evident throughout 2010.





State Growth Comparisons

2010 should see return to trend growth

- State growth rates should return to trend by the end of 2010 despite higher interest rates.
- Consumer spending and business investment to rise through 2010. Unemployment rates to peak at 6%.

SFD Forecasts* (%pa)	NSW	Vic	Qld	SA	WA	Tas	NT	ACT	Aust.
2007/8a	3.9	6.1	4.0	2.3	6.2	6.8	8.4	2.2	4.7
2008/9a	-0.4	0.3	-2.3	0.1	2.0	-2.2	-1.2	-0.5	-0.4
2009/10	2.7	3.2	4.1	2.2	4.5	2.5	5	3.0	3.2
2010/11	3.3	3.5	4.5	3.0	5.0	2.5	5	3.0	4.0

*Real State Final Demand. Australian figure is real gross national expenditure. See forecast pages for more details.

States avoided the worst and should grow near trend in 2010.

Australia's economy has avoided the worst fallout from the Global Financial Crisis (GFC). Thanks to good luck and good management. The latter is via large RBA interest rate cuts and the \$20bn in cash "helicoptered" to low and middle income families in late 2008 and early 2009 by the Federal Government. The good luck came via strong population growth and exports to Asia holding up relatively well.

NSW and Victoria are leading the upturn.

NSW and Victoria had more exposure to the sectors most affected by the GFC – the white collar jobs in finance, stockbroking, property and business services, and parts of retail. So their economies suffered initially in the 2008 downturn. While the white collar employment appears to have turned for the better there are still clear problems with weakening manufacturing and commercial and industrial construction activity.

Queensland and WA will follow and move higher in 2010 and 2011.

But the second wave of the GFC dragged down the mining regions as mines were closed and projects cancelled or delayed. The result was that Queensland, WA and NT will have a modest fall in mining construction and operations to contend with until mid 2010. But its duration looks to be short because of the mineral commodity price resurgence. China's favourable growth projections are now the major influence on Australia's export volumes and prices over the next few years.

South Australia and Tasmania will benefit from residential upswing.

South Australia and Tasmania do not have high exposures to those sectors worst affected by the GFC. That limits the job and income loss that could have occurred. They will benefit from the lift in residential construction activity that we expect from the combination of very low mortgage rates and relatively high First Home Owners grants and related concessions.

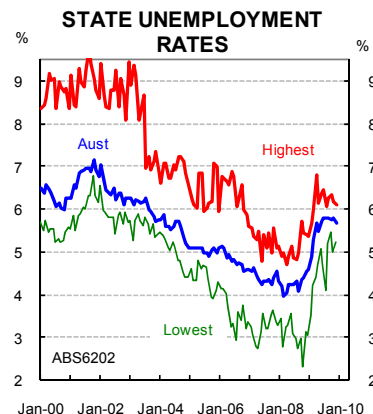
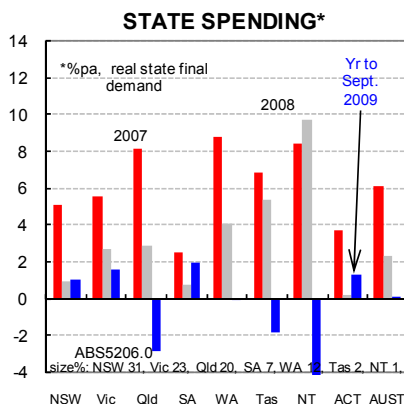
Commercial construction activity still appears most at risk of a slowdown.

From a national perspective, new commercial and industrial construction activity appear most at risk of a protracted downturn. Still rising vacancy rates in both areas will add to the concerns of oversupply. Planned construction will be reduced as valuations adjust to lower rents. However, record levels of Federal and State Government spending will lift utilities (electricity, gas and water) and transport (road and rail) investment over the next 5 years. Additionally, smaller scale and more numerous projects in the education and health sectors will begin to lift jobs and activity measures from late 2009 and through 2010. Engineering related expenditures are forecast to rise strongly which may prevent material and skilled labour costs from reflecting the generally weaker levels of economic activity.

But Government infrastructure spending will cushion parts of the economy.

State growth rate will return to trend in 2010.

Unemployment rates are set to peak at 6%.



Equity Markets

Rebound, then consolidation

- Global share markets have posted solid gains since reaching lows in early March.
- A period of consolidation has been in place since mid October.
- The Australian share market is expected to record gains of 10-12 per cent over 2010.

Global share markets enter a period of consolidation.

Global equity markets have entered a period of consolidation after a strong rally from early March to mid October. The proxy for the world share market – the Morgan Stanley Capital International Index – soared 70 per cent from March 9 to October 19, but has since largely traded sideways. Overall the world share market looks likely to have gained 24 per cent in 2009 after falling 42 per cent in 2008.

Australia expected to finish in the middle of the pack.

In Australia, the All Ordinaries hit its low point on March 6 and rallied 56 per cent to the year's high on October 15. In line with other global markets, the Australian share market has also been trading water since mid October, but has lost just under 4 per cent from peak levels. After losing 43 per cent in 2008, the Australian All Ordinaries finish 2009 at 4882.7, a gain of around 33 per cent.

Across global share markets, Australia finished in the middle of the pack in 2009 just as it did the previous year. Currently Australia is in 44th spot of the 72 bourses monitored by CommSec but it has out-performed most European and North American markets.

Domestic economic recovery expected to gain momentum.

The best performing share market so far this year has been Russia, with the IRTS index up 124 per cent. Sri Lanka, Argentina, Ukraine and Peru are also amongst the top performers. Interestingly, Russia and the Ukraine were amongst the worst performers in 2008.

Asia economies, in particular China, will underpin global growth.

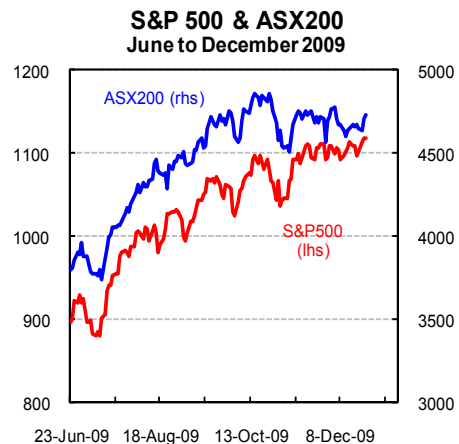
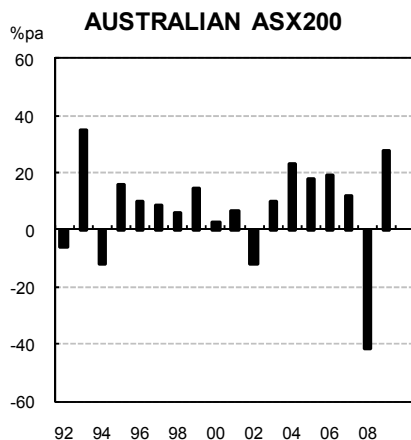
Only 9 of the 72 share markets have eased in 2009 with last year's best performer – Ghana – currently the worst performer, down 49 per cent.

Looking forward we believe investors will start 2010 with renewed confidence. While 2009 will be known as the year of GFC, 2010 will be the year of recovery. The domestic economy is expected to gain momentum over 2010 driven by the construction sector. China, and Asia more generally, will provide the momentum for global growth. The US is generally expected to experience a 'U-shaped' recovery, but with improving conditions in the US labour and housing markets, this view may prove conservative.

More 'normal' growth expected in 2010.

In 2010 we expect the Australian share market to record more 'normal' growth of around 10-12 per cent after the solid rebound experienced in 2009. Risks are to the upside given the risk of sharply higher commodity prices as the global economy recovers.

CommSec expects the All Ordinaries to lift from current levels near 4,700 to 5,300 by June 2010.





Growth, Interest Rate & AUD Forecasts

March Quarter 2010

	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11
	(a)	(a)	(a)	(a)	(f)	(f)
Economic activity %pa						
Private final demand	4.4	4.6	5.9	1.8	1.6	4.5
Household spending	2.8	4.2	4.0	1.3	2.4	3.4
Dwelling investment	-4.3	1.9	1.3	-1.9	2.9	12.6
Business investment	16.1	8.3	15.3	6.7	-2.6	6.1
Public final demand	3.7	4.2	4.2	4.2	5.8	1.0
Domestic final demand	4.2	4.5	5.5	2.4	2.5	3.7
Inventories (contrib. to GDP)	-0.3	0.3	0.2	-0.9	0.7	0.3
GNE	3.9	4.8	5.6	1.4	3.2	4.0
Exports	2.3	4.0	3.9	2.3	2.0	8.4
Imports	7.3	9.2	14.1	-2.5	7.1	13.1
Net exports (contrib. to GDP)	-0.9	-0.9	-2.0	1.0	-1.1	-1.2
GDP	3.1	3.8	3.7	1.1	2.1	3.1
Prices and wages %pa						
CPI	4.0	2.1	4.5	1.5	2.9	3.1
Underlying CPI	2.9	2.8	4.4	4.0	2.7	2.8
AWOTE	3.2	5.0	4.0	0.0	3.0	4.1
Wages Price Index	4.1	4.0	4.2	3.8	3.2	4.0
Real h/hold disposable income	4.7	6.0	2.4	4.2	2.7	3.6
Terms of trade 2007/8=100	88.9	94.7	99.8	107.5	102.8	109.8
Labour market						
Employment %pa	2.9	2.9	2.6	1.1	0.8	2.1
Unemployment rate %	5.0	4.5	4.2	4.9	5.8	6.0
External accounts						
Current account: \$bn	-54.3	-59.4	-73.2	-37.7	-62.0	-64.6
Current account: % of GDP	-5.4	-5.4	-6.2	-3.0	-4.9	-4.7
CBA Commodity Index USDs						
Metals Index	179	239	183	258	251	263
Energy Index	235	225	311	399	283	350
Rural Index	128	140	183	145	163	167
Total Index	184	212	258	266	241	267
Interest rates (end period)	Cash Rate	90 Day Bank Bill	3 Year Swap	5 Year Swap	10 Year Swap	10 Year Bond
Mar-09	3.25	3.14	3.91	4.51	5.03	4.42
Jun-09	3.00	3.19	4.84	5.54	5.99	5.52
Sep-09	3.00	3.38	5.40	5.83	6.02	5.36
Dec-09	3.75	4.14	5.41	5.85	6.25	6.25
Mar 10(f)	4.25	4.50	5.95	6.10	6.50	5.80
Jun 10(f)	4.50	5.00	6.25	6.30	6.60	5.90
Sep 10(f)	4.75	5.30	6.40	6.40	6.70	6.00
Dec 10(f)	5.00	5.50	6.50	6.50	6.75	6.10
Mar 11(f)	5.00	5.60	6.55	6.55	6.75	6.10
Exchange rates (end period)	AUD/USD	AUD/JPY	AUD/EUR	AUD/GBP	AUD/NZD	AUD/CHF
Mar-09	0.69	68	0.52	0.48	1.24	0.79
Jun-09	0.81	78	0.58	0.49	1.25	0.88
Sep-09	0.88	79	0.60	0.55	1.22	0.91
Dec-09	0.90	83	0.62	0.55	1.23	0.94
Mar 10(f)	0.95	86	0.63	0.55	1.20	0.94
Jun 10(f)	0.98	93	0.63	0.54	1.20	0.96
Sep 10(f)	0.95	91	0.63	0.51	1.19	0.98
Dec 10(f)	0.90	88	0.61	0.50	1.18	0.97
Mar 11(f)	0.88	88	0.61	0.49	1.17	0.97

AUD expected to peak against USD around mid 2010

The AUD is expected to peak against a weak USD around mid 2010.

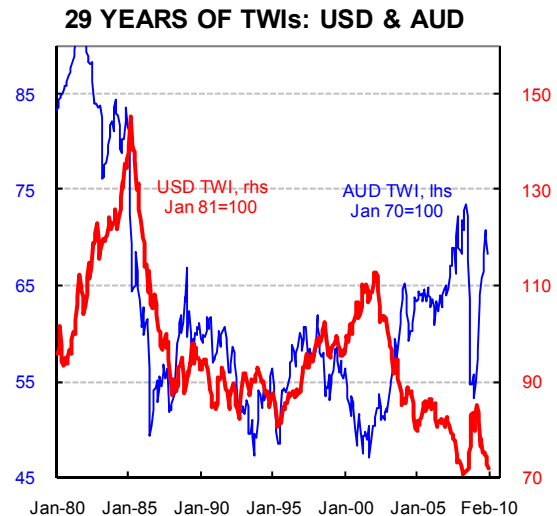
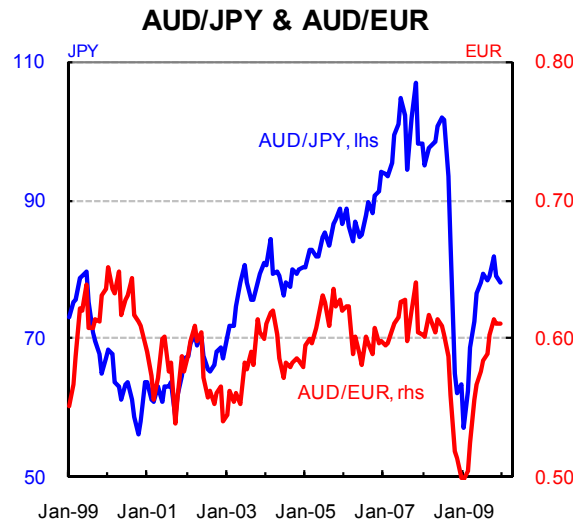
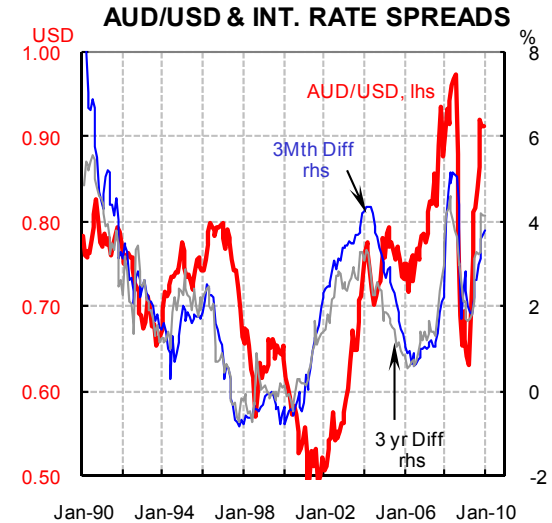
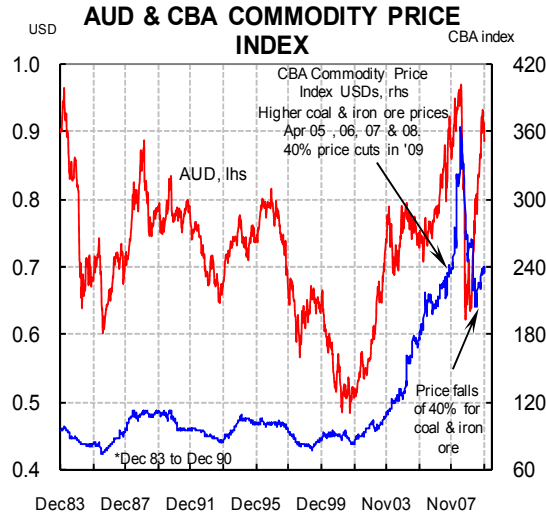
Near the end of 2009 the AUD was around USD0.88, significantly higher than the February 2009 low of USD0.6350.

Many ingredients are expected to keep the AUD above the USD0.80 level next year. The major one is weakness in the USD.

The other factors, in our view, are more widespread optimism on the world growth outlook for 2010 and wide interest rate differentials in the AUD's favour. The Global Financial Crisis drove the world economy into recession in 2009. But there are clear signs that the US and European economies will recover, growth-wise, through 2010. That is favourable for commodity producers like Australia. Bulk iron ore and coal prices could rise by 20% in April 2010.

Australian 3 month interest rates are at 4.1% while those in the US are 0.25%. Markets expect rate rises in the US after mid 2010. Australian cash rates look set to rise by another 1% through 2010. So firm interest rate support for the AUD is set to continue.

We expect the AUD to reach USD0.98 in Q1 2010 and USD0.90 at end 2010.



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SALES TEAMS

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	Credit		SA
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			QLD
		Asia	
		London/Europe	
			New Zealand
Melbourne		New York	Metals Desk
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