

Uncertainty & The Economy

CEDA Economic & Political Outlook

Michael Blythe

Chief Economist
Managing Director
+61 2 9118 1101

February 2020



Delivering unique economic
insights and analysis

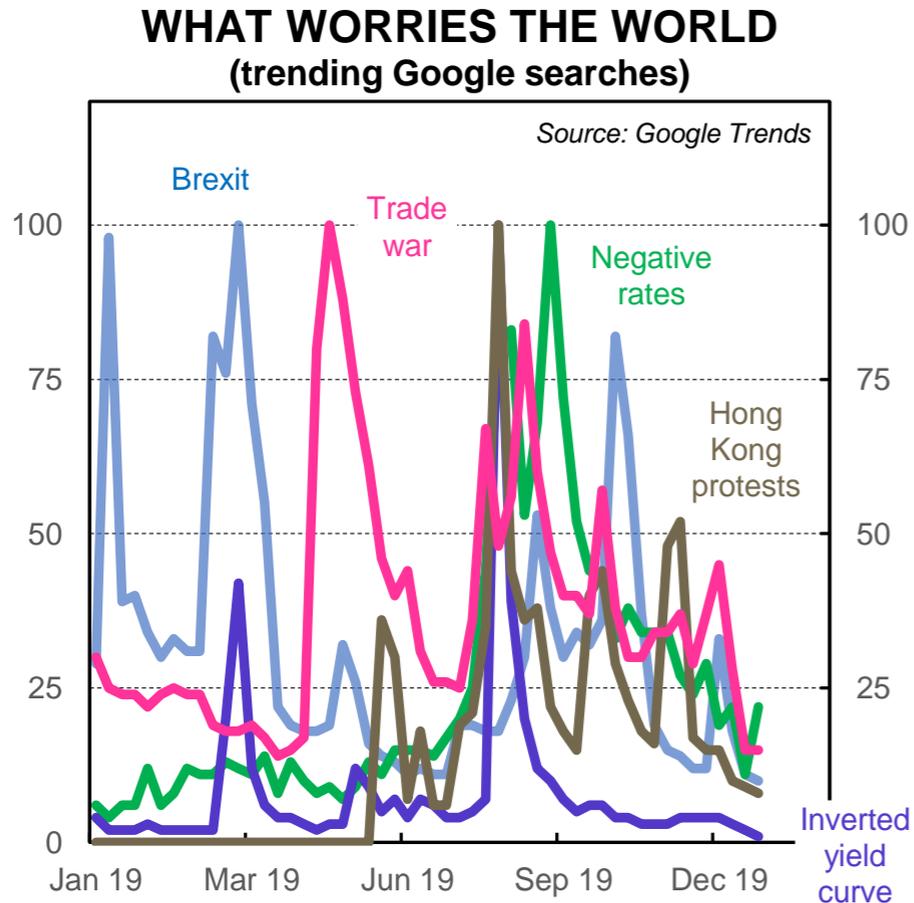


Peter Lee 2016-17
Most valuable domestic
economic analysis

KangaNews 2017-19
Best overall research
provider

The Global Backdrop: Uncertainty

What worries the world?



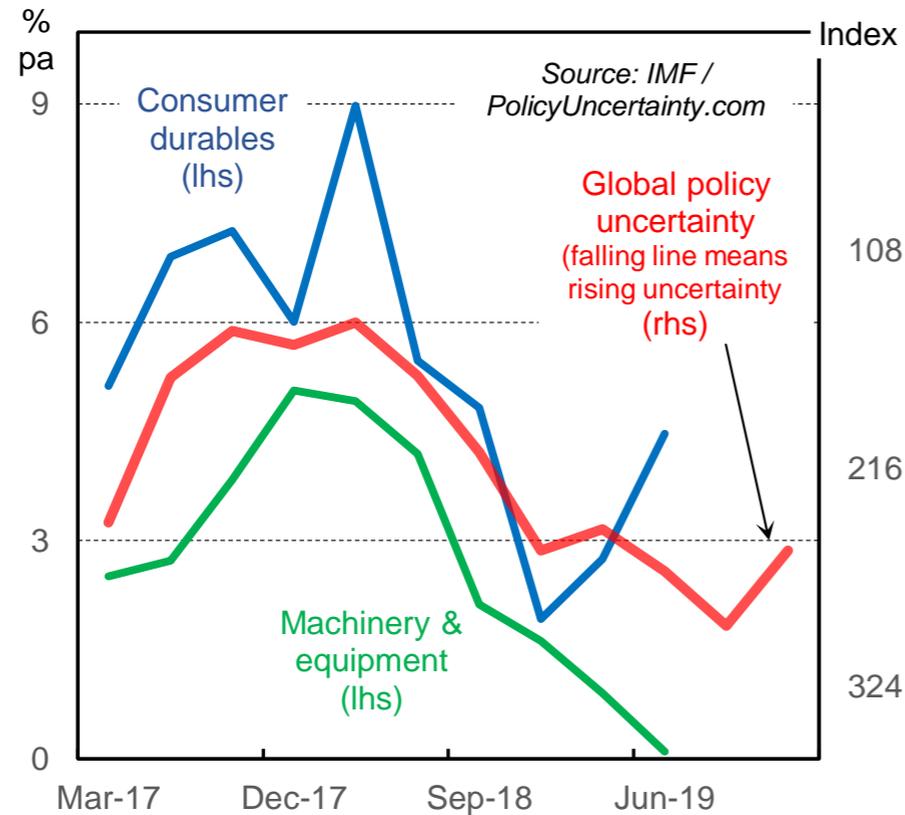
- There are many concerns – some have proved persistent – some have been short lived.
- They include obvious topics like the trade war, Brexit, geopolitics and the China slowdown. But economists and financial markets also worried about more exotic topics like negative bond yields and inverted yield curves.
- In the end, though, all these themes are really a reflection of elevated concern about a global recession.



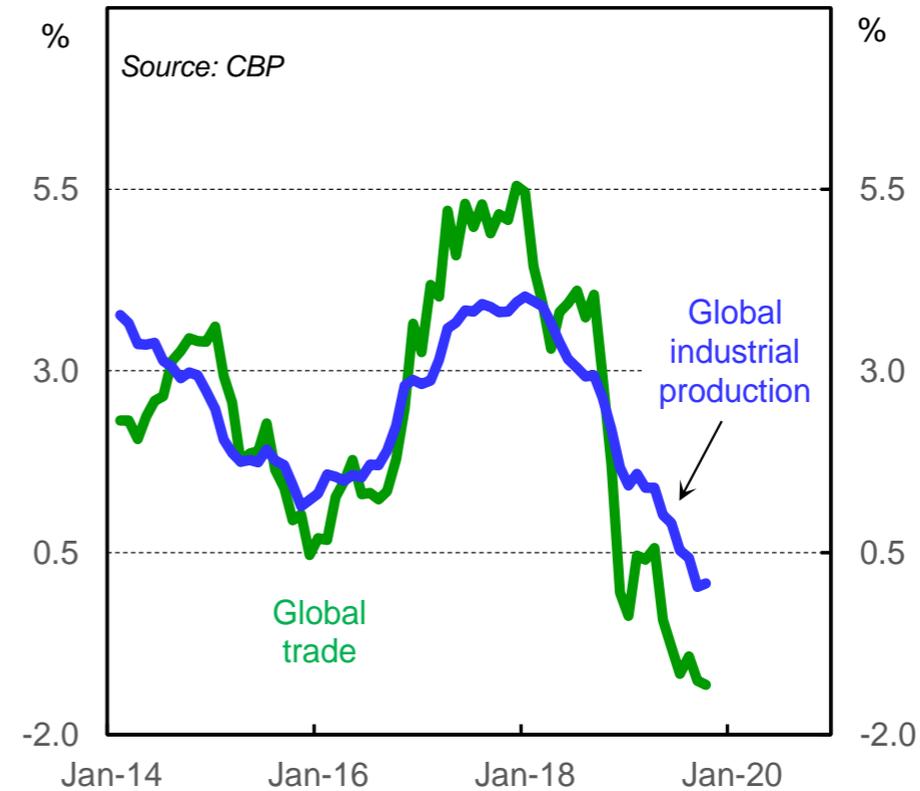
Uncertainty & Activity

Less certainty, less spending, less production & less trade

SPENDING & UNCERTAINTY



TRADE & PRODUCTION (annual % change)

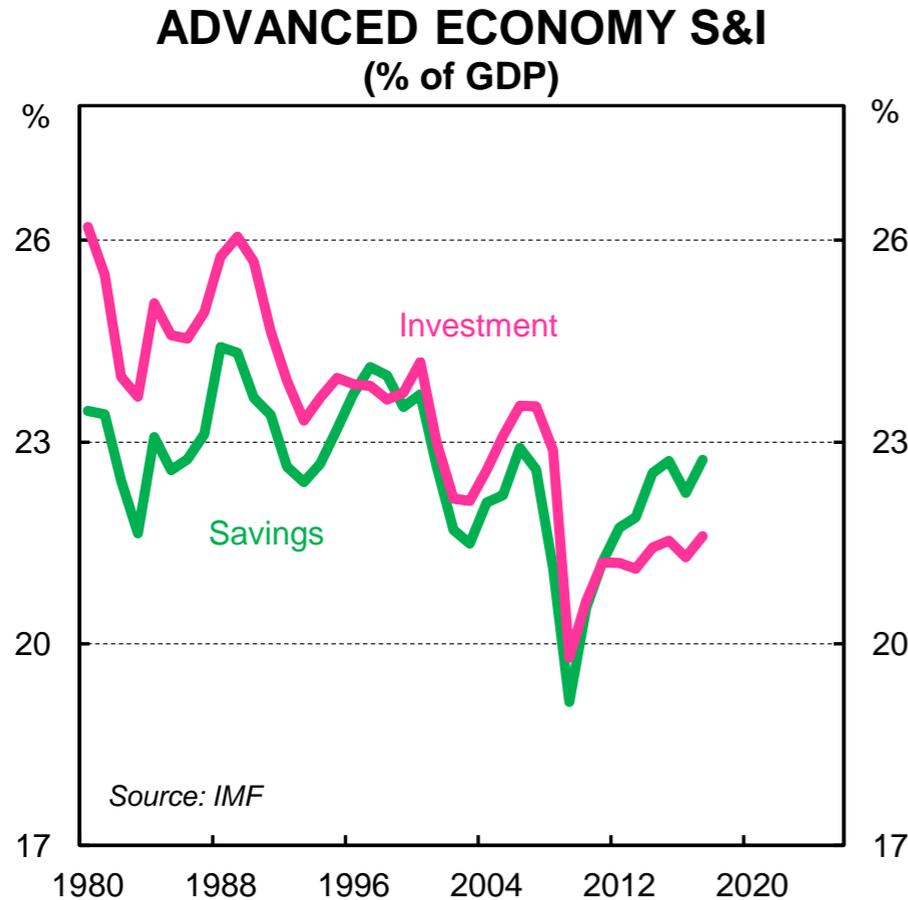


- In an uncertain environment businesses defer investment plans and consumers put off purchases of big ticket items.
- Less demand for capital goods and consumer durables means less industrial production and less global trade.



Uncertainty & Financial Markets

Low interest rates to stay



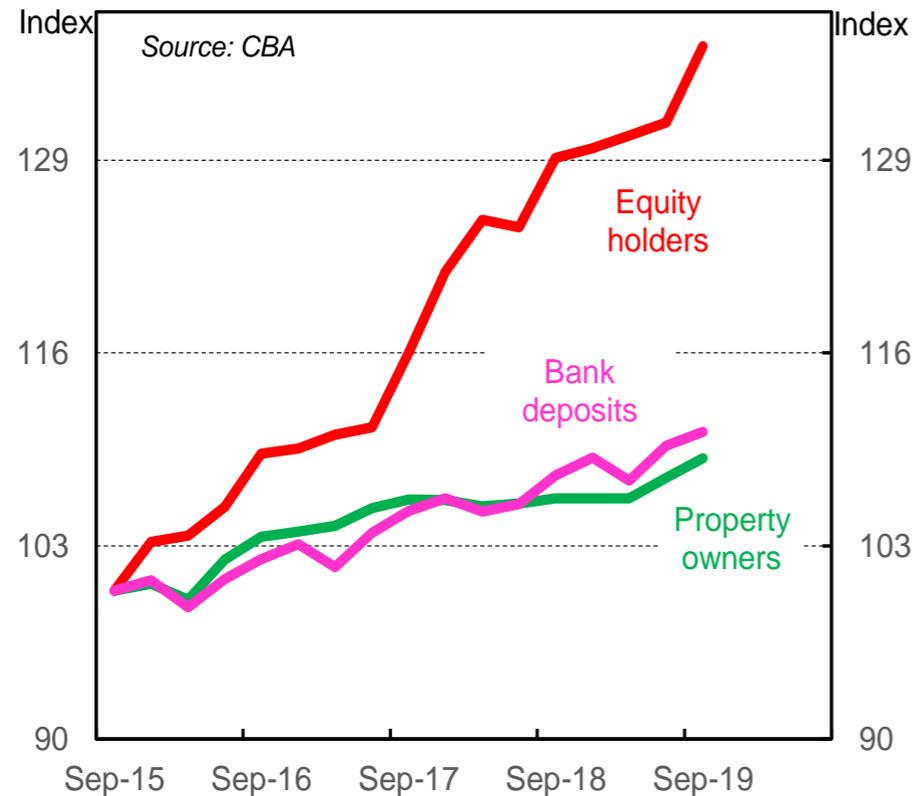
- Shifting savings / investment dynamics in the major economies favour low interest rates.
- A range of uncertainties is encouraging savings and discouraging investment.
- The supply of funds exceed the demand for those funds. The price of money – or interest rate – has to adjust lower.



Uncertainty & Volatility

Risks building

CBA: H/HOLD FINANCIAL ASSETS
(number of holders, start=100)

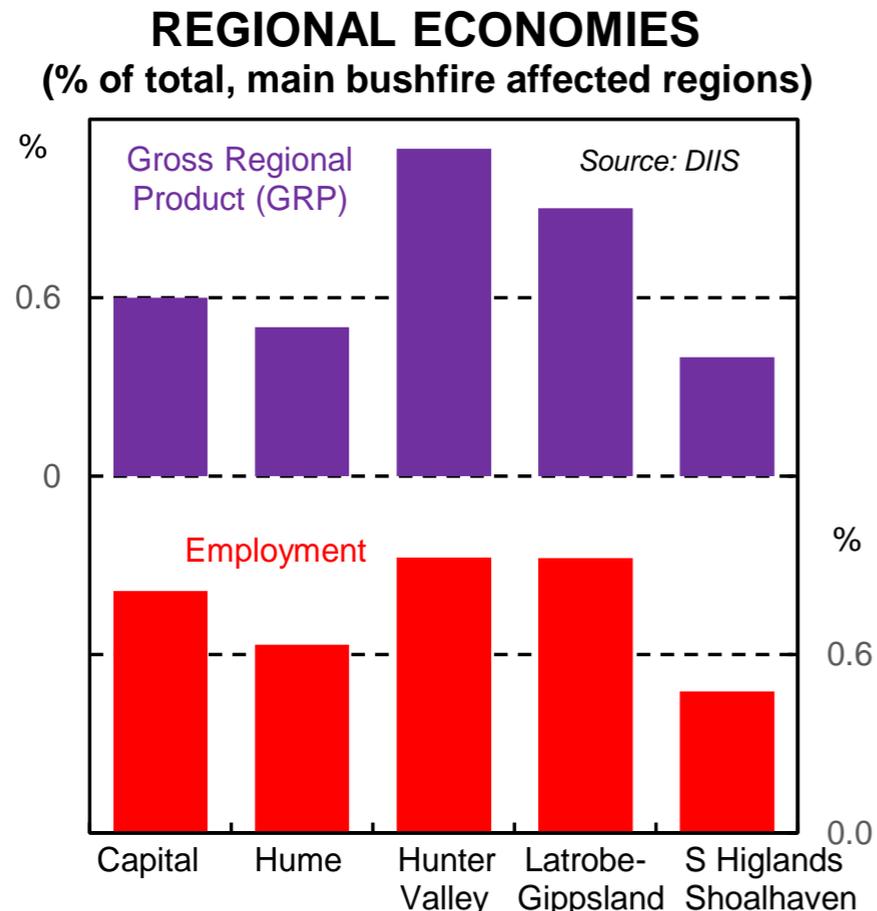


- Low interest rates encourage the pursuit of yield and capital gains, taking on more risk in the process.
- Market volatility is likely to be a persistent theme.



The Starting Point For 2020

The Bushfires – quantifying the impact

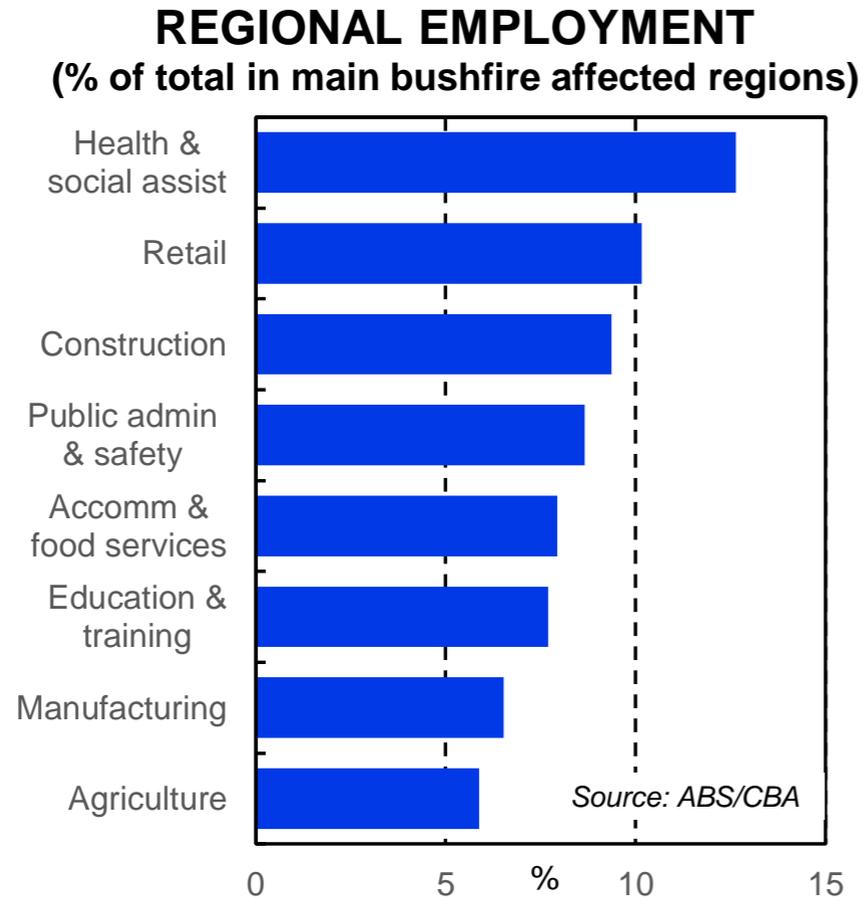


- The bushfires and coronavirus are new risks that could boost uncertainty again.
- Storms and floods are more common natural disasters than bushfires and epidemics.
- Droughts are the most costly natural disaster.
- The main bushfire affected regions (SA4 basis) are Hume, Central, Latrobe-Gippsland, Southern Highlands & Shoalhaven and Hunter Valley.
- The selected regions account for 3.5% of GDP and 3.8% of employment.
- From a sensitivity perspective, a 10% drop in Gross Regional Product would detract around 0.3ppts from Australian GDP growth:
 - the impact would be spread over at least two quarters so it is unlikely the bushfires would drag quarterly GDP growth into negative territory.



The Starting Point For 2020

The Bushfires – some offsets

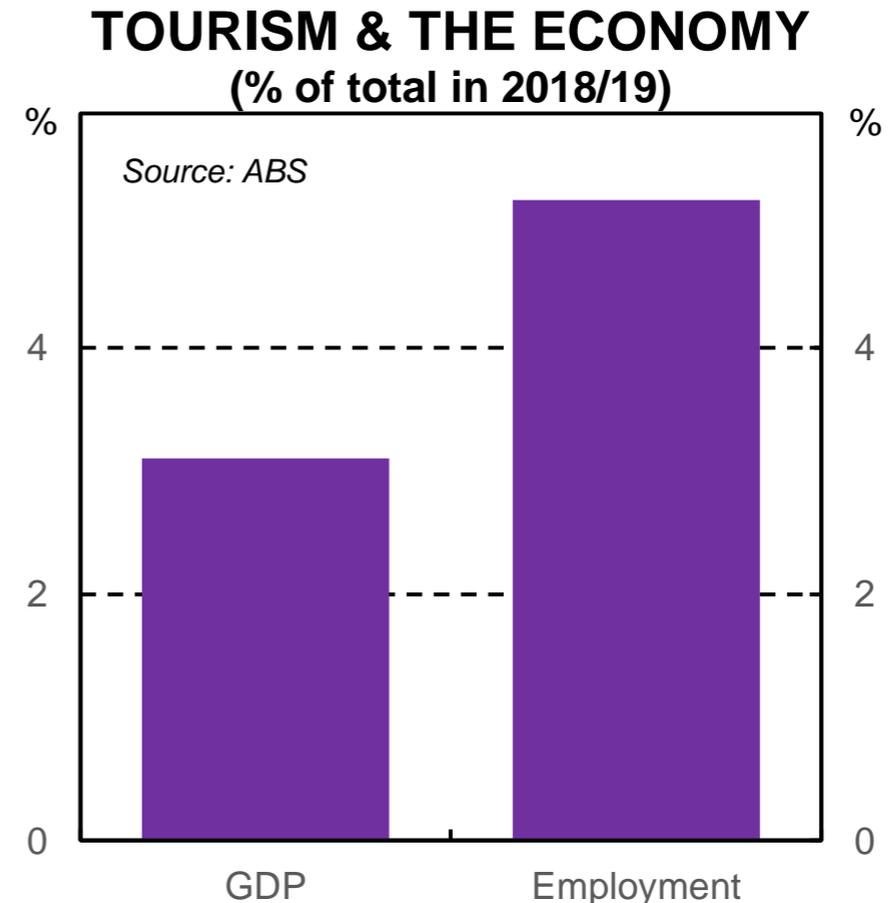
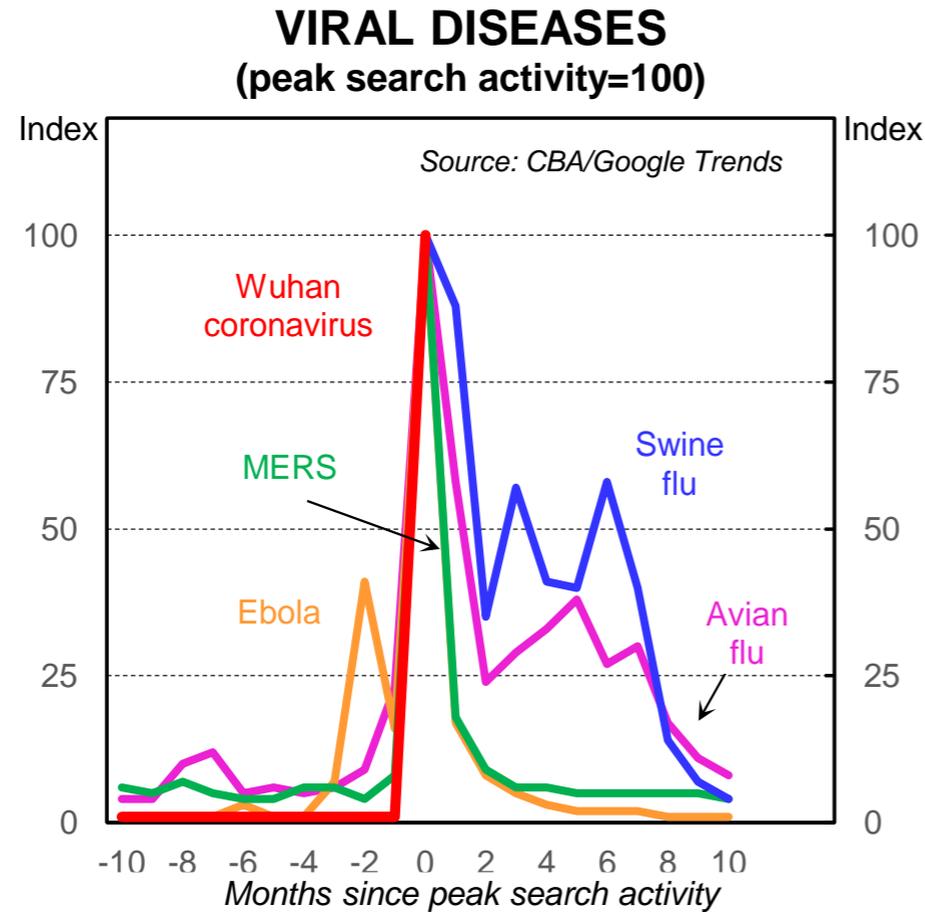


- Employment gives an idea of the economic structure in the regions.
- The employment structure will help reduce the impact:
 - About 31% of employment is in public-sector-related areas such as health care & social assistance, public administration & safety and education & training. Job losses are unlikely in these areas.
 - More than 9% of employment is in the construction sector. This group should benefit from the eventual rebuild.
 - Sectors exposed to tourism in some fashion such as retail trade and accommodation & food services account for nearly 20% of jobs. Job losses seem probable in these areas.



The Starting Point For 2020

Coronavirus – the tourism channel



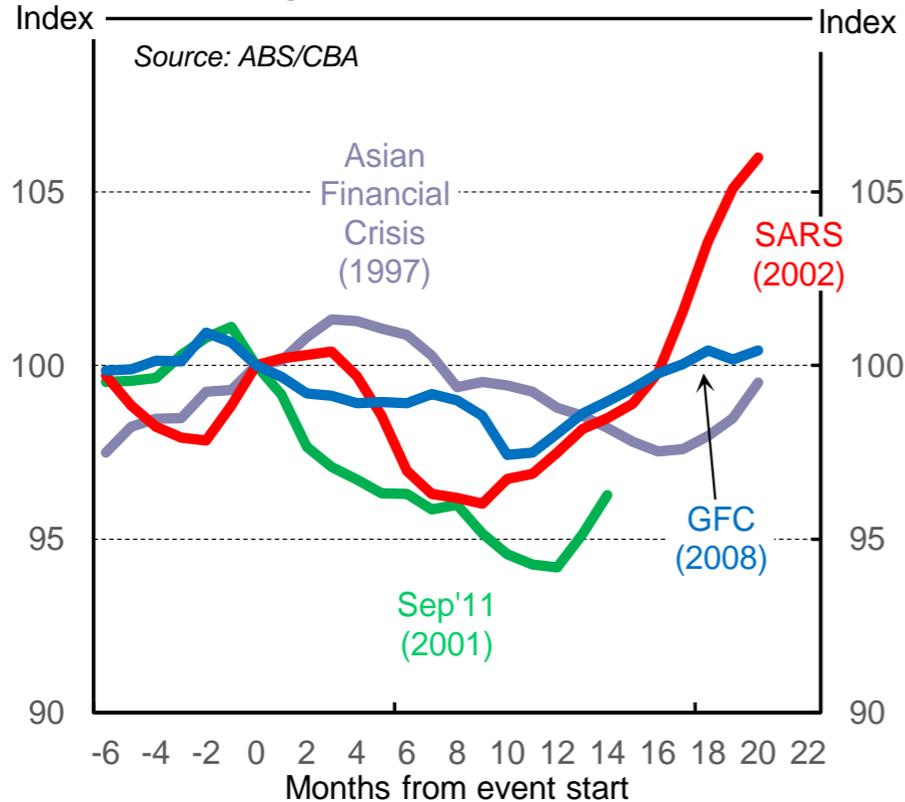
- Tourism accounts for 3.1% of GDP and 5.0% of employment.
- The transmission channels run via reduced spending as consumers become more cautious and avoid social interaction, the impact on confidence (the WHO talks of an “infodemic”), higher costs associated with disease treatment and prevention, the disruption to global supply chains and lower commodity prices.



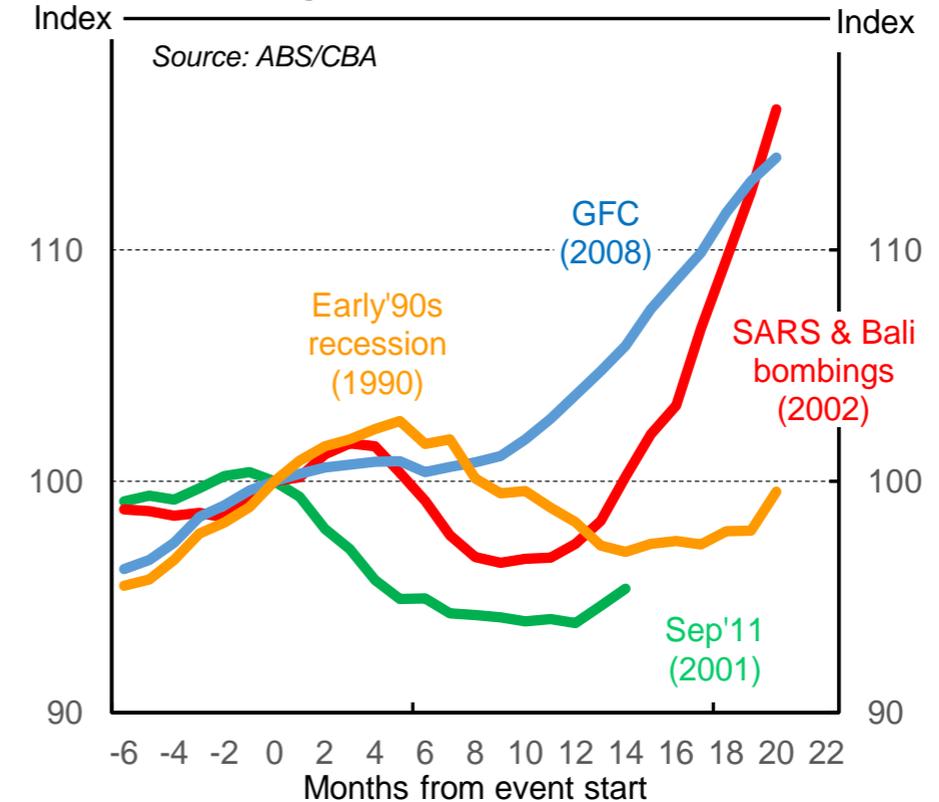
Tourism & The Economy

Coronavirus – outflows as well as inflows

TOURIST ARRIVALS & MAJOR EVENTS (rolling annual, event start=100)



RESIDENT RETURNS & MAJOR EVENTS (rolling annual, event start=100)

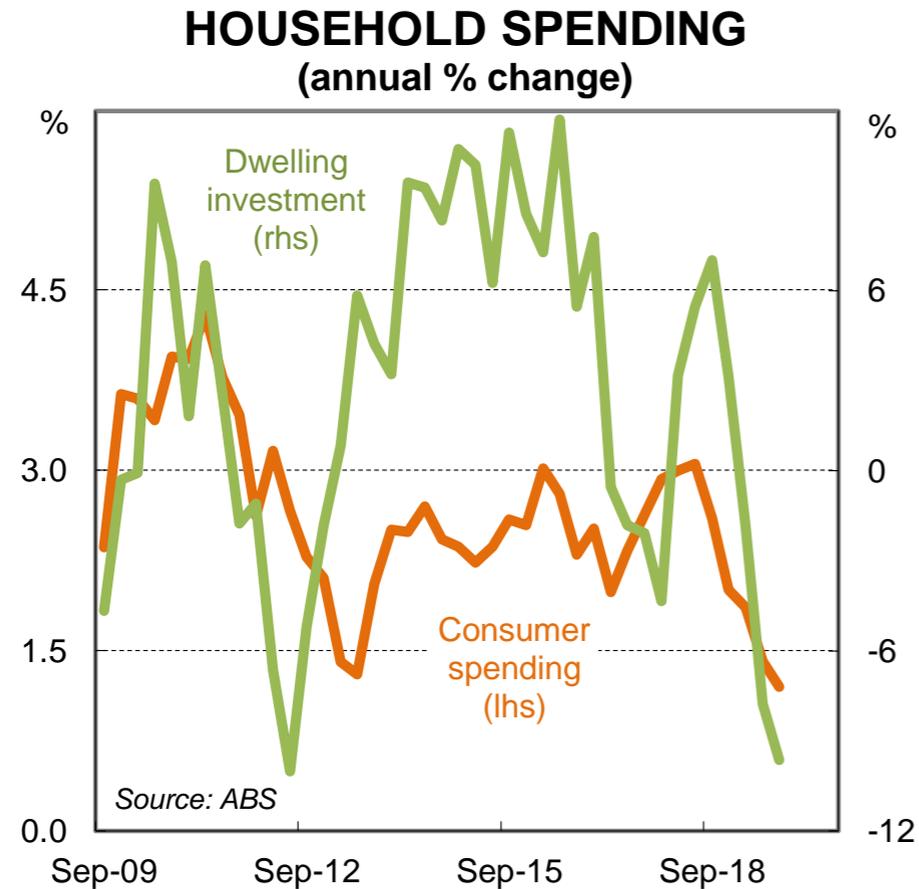


- Major global events, be they economic, geopolitical or geomedical, have a significant impact on tourism flows – in both directions.
- More Australians holiday overseas than foreigners visit Australia.
- Less outbound tourism and more domestic holidays would be a powerful offset.



The Constrained Consumer

The main domestic risk



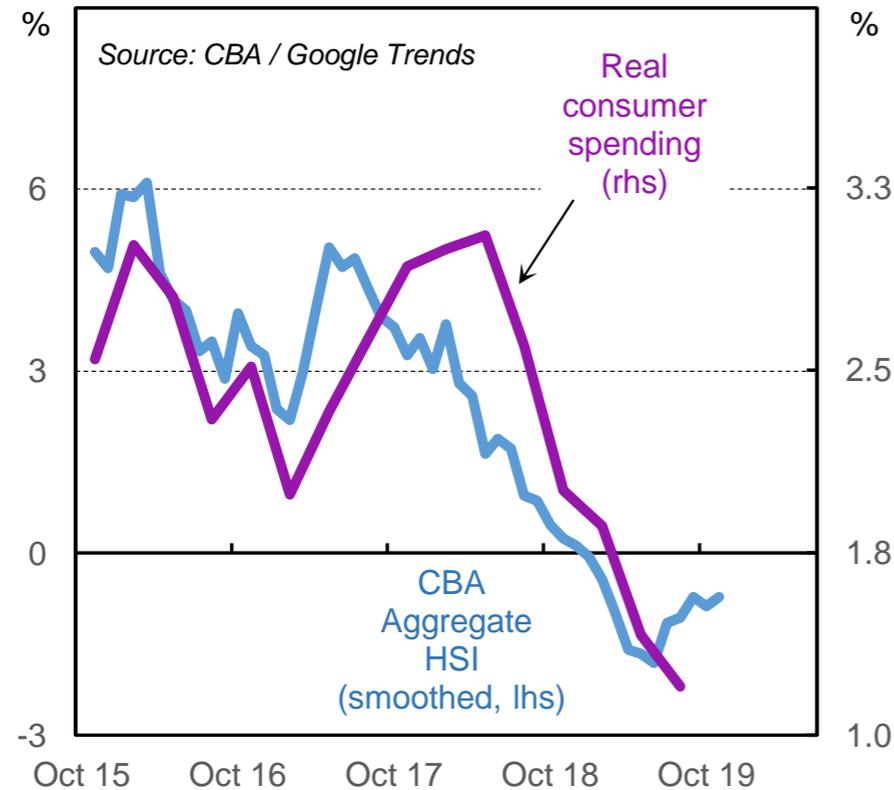
- The more persistent drags on the *domestic* economy are falling residential construction and the constrained consumer.
- The consumer is constrained by weak income growth, job security fears, perceived household budget pressures and stretched balance sheets.
- Falling residential construction follows a record building boom.
- Interest rate cuts and income tax rebates are designed to support household activity.



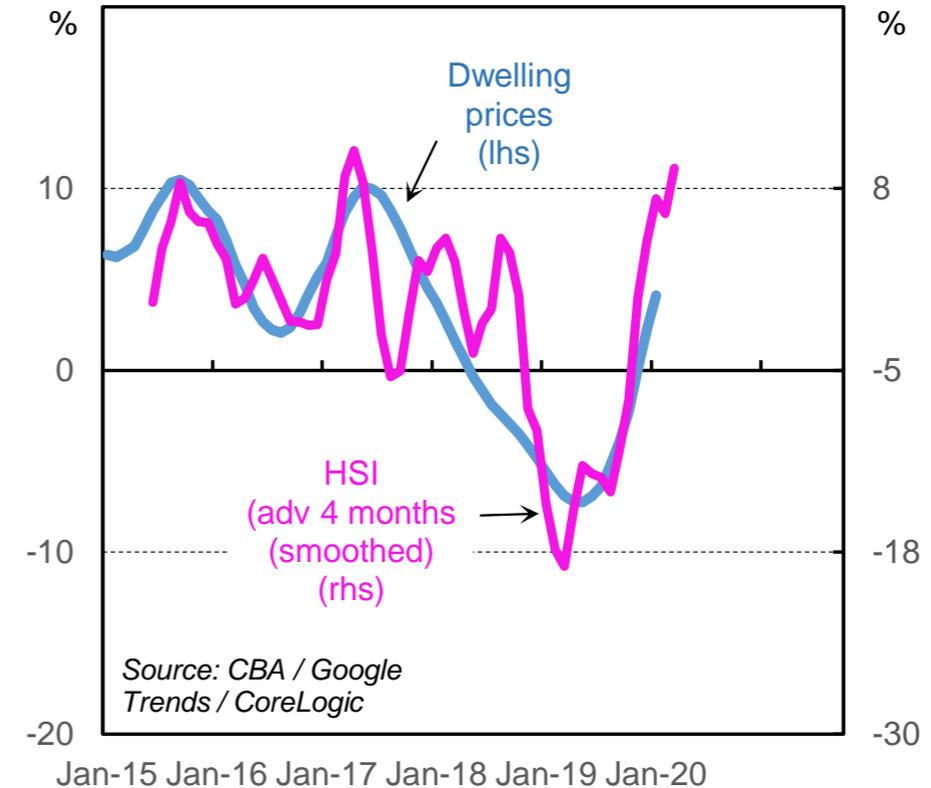
The Message From The HSI

An uneven policy response

CBA HSI: SELECTED ITEMS
(annual % change)



CBA HSI: HOME BUYING
(annual % change)

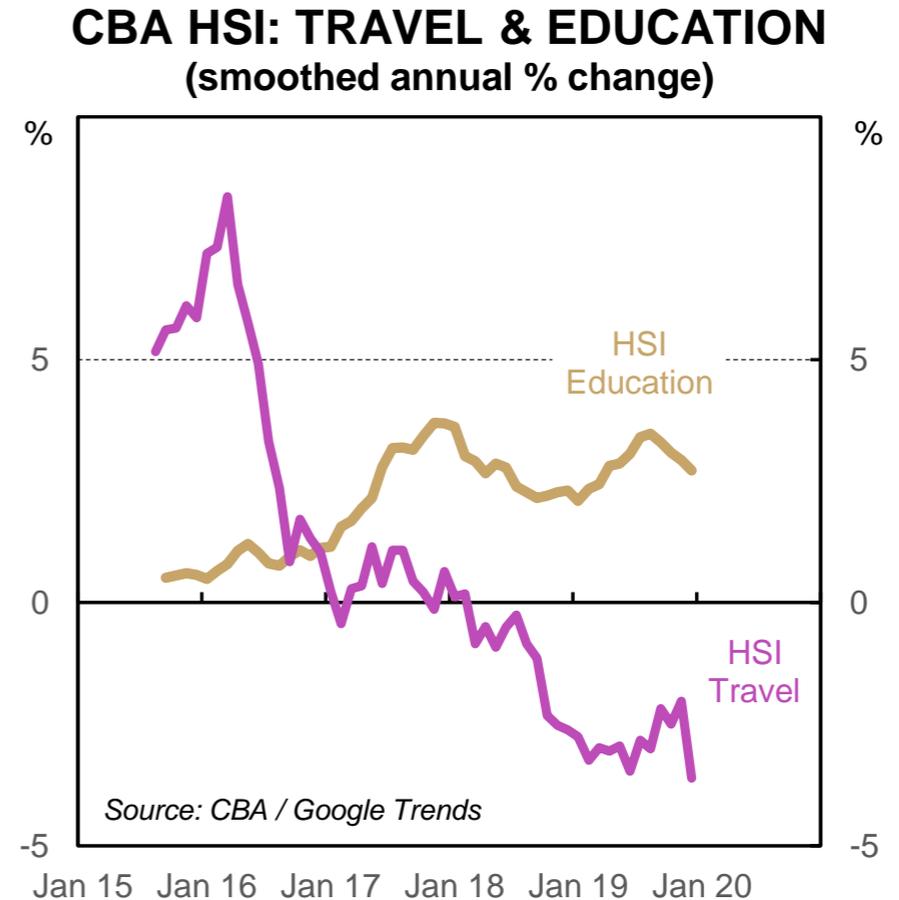
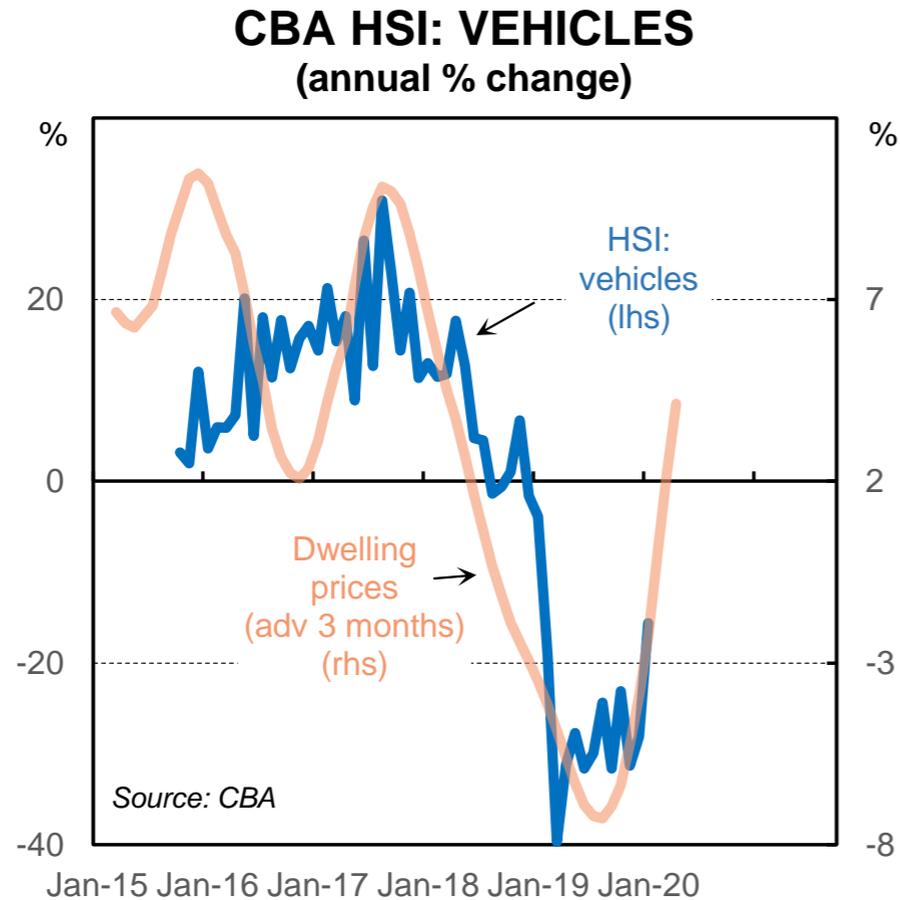


- The *consumer* message from the HSI is that spending intentions edged higher from mid 2019. But it is a fairly limp improvement.
- The improvement in Home Buying Intentions points to further house price gains.



The Message From The HSI

Wealth, fire, smoke & the plague



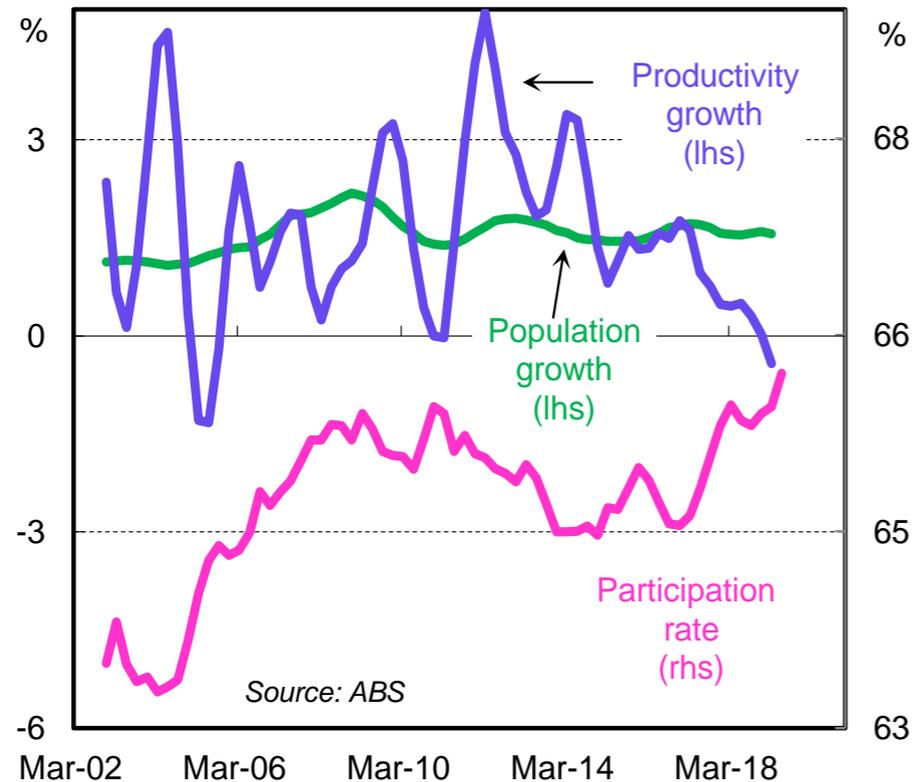
- The improvement in Home Buying Intentions points to a positive wealth effect on consumer spending.
- Travel and education spending intentions are showing early signs of impact from the fires and the virus.



Where To For Policy Makers From Here?

Productivity the key

AUSTRALIA & THE 3Ps

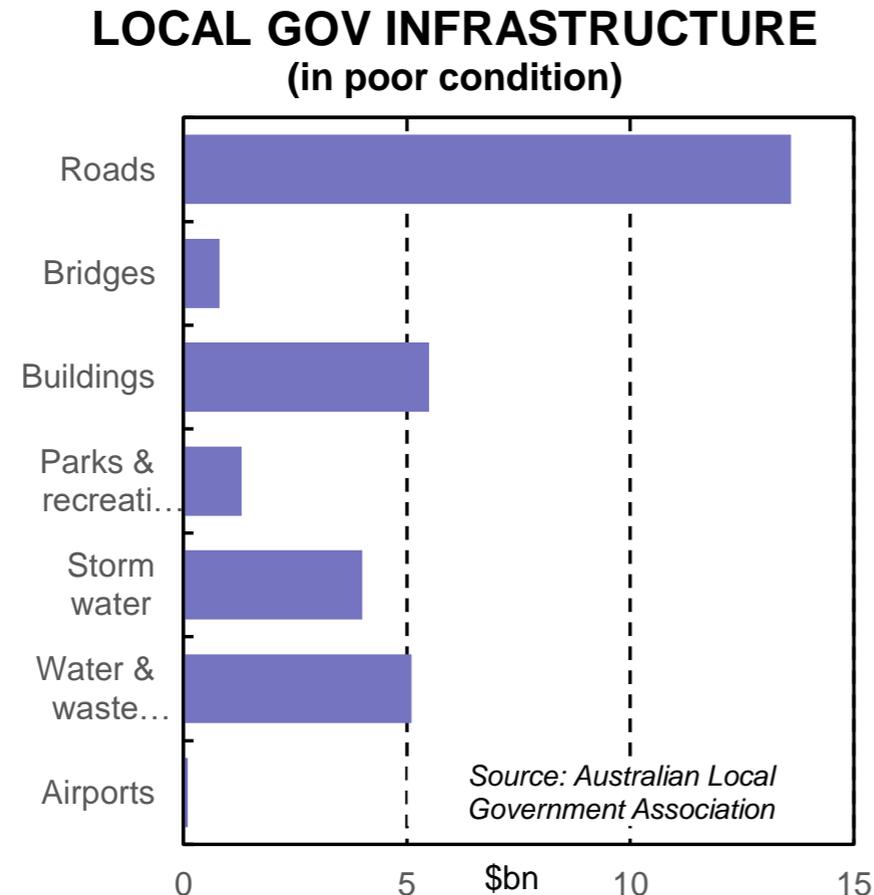


- The pace of economic reform slowed post financial crisis.
- Productivity growth has slowed as a result.
- Better productivity outcomes are necessary to:
 - sustain Australia's potential growth rate over the medium term;
 - promote medium-term income growth and fiscal sustainability in the face of an aging population;
 - provide a source of sustainable growth in real wages.
- The Productivity Commission suggests that key areas for reform are abolishing stamp duty, replacing fuel excise with congestion charging, axing the "better off overall" test in workplace agreements, overhaul of vocational education, energy policy and health service delivery.



Where To For Policy Makers From Here?

Infrastructure: go small

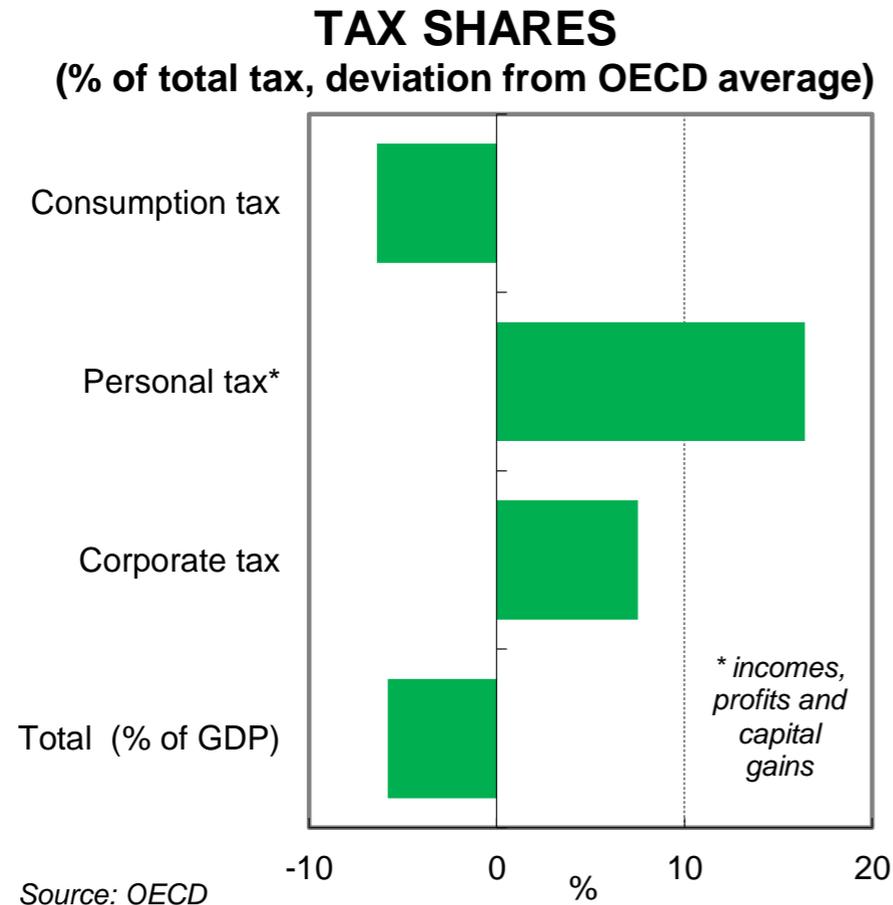


- Capacity constraints (labour, materials) mean that the ability to ramp up “big” infrastructure projects is limited.
- But there is a significant backlog of smaller local government infrastructure assets in need of repair or expansion.
- The Australian Local Government Association estimates of infrastructure asset requirements shows:
 - \$30bn are in “poor” condition;
 - \$24bn need upgrading to meet safety, compliance, social, environmental targets;
 - \$24bn need augmentation to support demand and growth trends.
- Many of these assets are in regional areas.



Where To For Policy Makers From Here?

Dealing with the surplus “fetish”

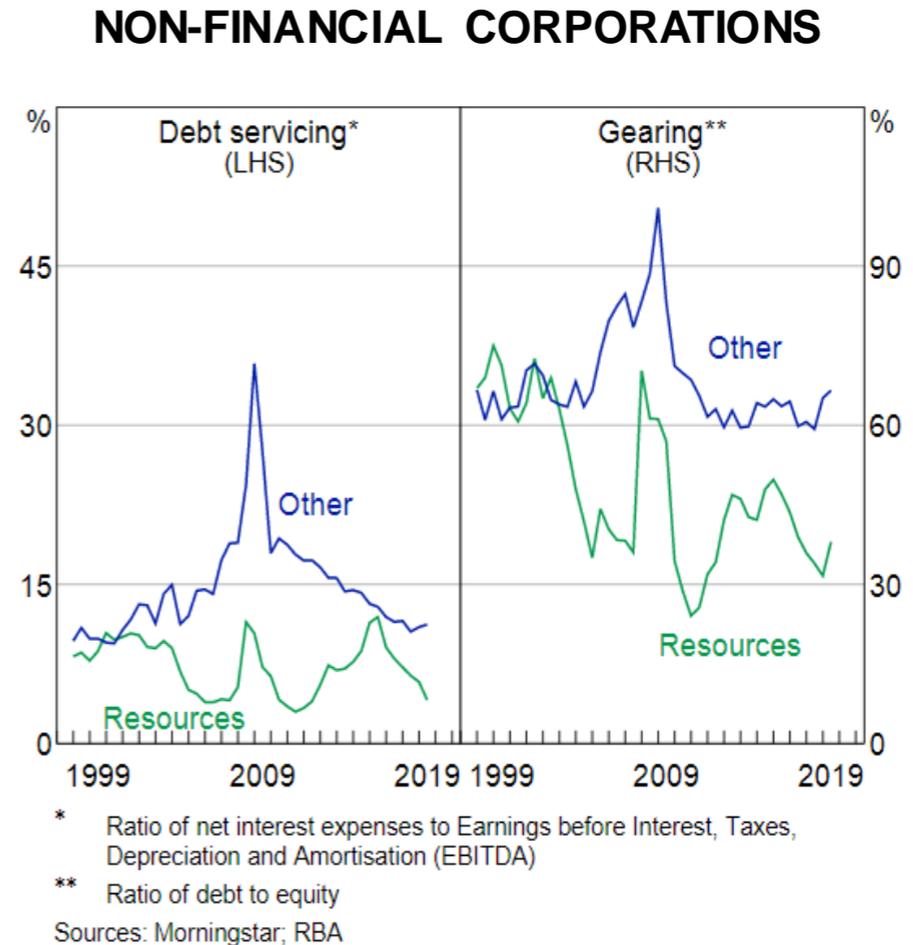
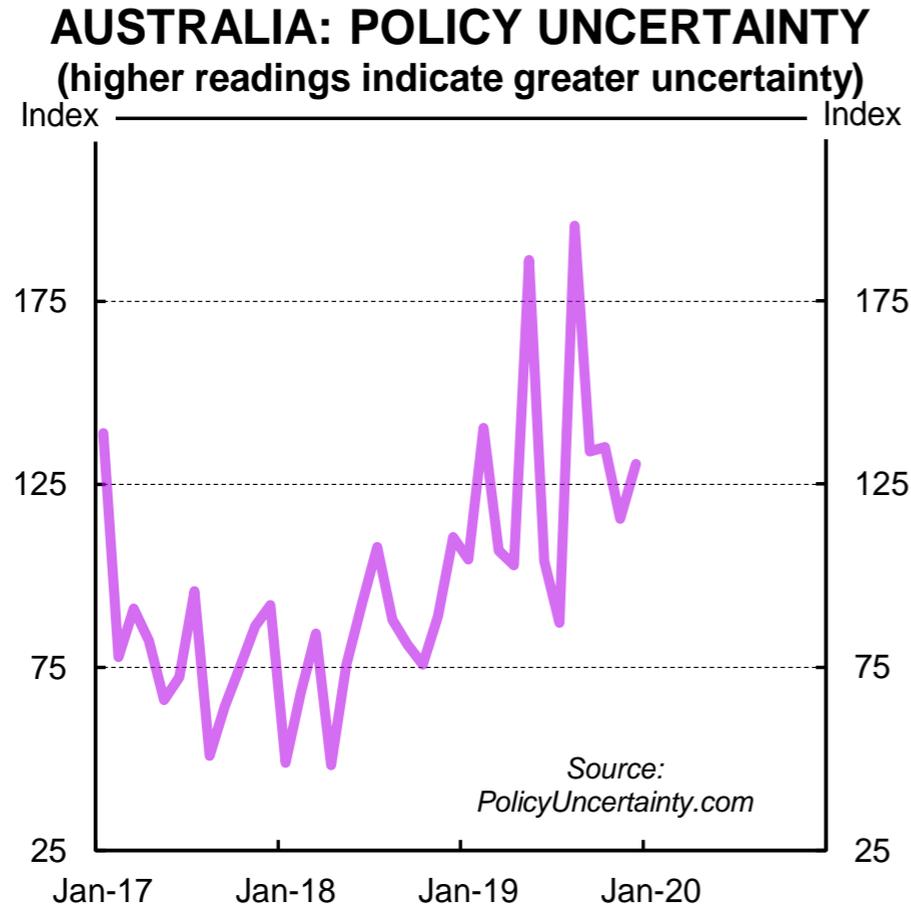


- Conventional fiscal policy is preferable to unconventional monetary policy.
- Public sector balance sheets are in good shape and should be used – income tax cuts the preferred option.
- Relative to the OECD average, Australian tax collections are “overweight” personal income and company taxes and “underweight” consumption taxes.
- The mix of spending and taxing could be shifted in a growth friendly way while leaving the budget bottom line unchanged.
- Company tax and stamp duties impose the largest cost on living standards over time.
- The company tax debate needs to be restarted.



Where To For Policy Makers From Here?

A role for business as well



- Some policy certainty would help (eg energy, climate change).
- Business response to uncertainty is understandable. But a recovery in risk appetite is needed. And justified by the fundamentals.



Important Disclosures & Disclaimer

IMPORTANT INFORMATION AND DISCLAIMER FOR ALL INVESTORS

Intended for the recipient only – Do not forward

The information contained in this report is made available only for persons who are sophisticated or professional investors.

Commonwealth Bank of Australia ABN 48 123 123 124 AFSL 234945 (“the Bank”) and its subsidiaries, including Commonwealth Securities Limited ABN 60 067 254 300 AFSL 238814 (“CommSec”), Commonwealth Australia Securities LLC and CBA Europe Ltd, are domestic or foreign entities comprising the Commonwealth Bank Group of Companies (“CBGOC”). Global Markets Research is a business division of the Bank. CBGOC and their directors, employees and their representatives are referred to in this Appendix as the “Group”.

This report is published solely for informational purposes and is not to be construed as a solicitation or an offer to buy or sell any securities or other financial instruments. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. Clients should consider whether any advice or recommendation in this research is suitable for their particular circumstances, and if appropriate, seek professional advice, including tax and legal advice. The Bank believes that the information in this report is correct and any opinions, conclusions or recommendations are reasonably held based on the information available at the time of its compilation but no representation or warranty, either expressed or implied, is made or provided as to accuracy, reliability or completeness of any statement made in this report. Any opinions, conclusions or recommendations of the Bank contained in this report are subject to change without notice and may differ or be contrary to the opinions, conclusions or recommendations expressed by other business units of the Group. The Bank is under no obligation to update or keep current the information in this report. None of the entities within the Group nor their directors, employees or agents accepts any liability for any loss or damage arising out of the use of all or any part of this report. Any valuations, projections and forecasts contained in this report are based on a number of assumptions and estimates and are subject to contingencies and uncertainties. The inclusion of any such valuations, projections and forecasts in this report should not be regarded as a representation or warranty by or on behalf of the Group or any person or entity within the Group that such valuations, projections and forecasts or their underlying assumptions and estimates will be met or realised. Past performance is not a reliable indicator of future performance. Foreign currency rates of exchange may adversely affect the value, price or income of any security or other financial instrument mentioned in this report. In addition, investors in securities, such as ADRs, whose values are influenced by the currency of the underlying security, effectively assume currency risk.

Financial markets products have an element of risk. The level of risk varies depending on the product’s specific attributes and how it is used. Potential investors should note that the product discussed in the report may be sophisticated financial products that involve dealing in derivatives. The Bank will enter into transactions on the understanding that the customer has: made his/her own independent decision to enter into the transaction; determined that the transaction is appropriate; ensured he/she has the knowledge to evaluate and capacity to accept the terms, conditions and risks; and is not relying on any communication from the Bank as advice. Foreign exchange market pricing ranges in the Bank’s Global Markets Research publications are indicative ranges only and not a guarantee of actual foreign exchange prices being executed by the Bank.

Where ‘CBA data’ is cited, this refers to the Bank’s proprietary data that is sourced from the Bank’s internal systems and may include, but not be limited to, credit card transaction data, merchant facility transaction data and applications for credit. The Bank takes reasonable steps to ensure that its proprietary data used is accurate and any opinions, conclusions or recommendations are reasonably held or made as at the time of compilation of this report. As the statistics take into account only the Bank’s data, no representation or warranty is made as to the completeness of the data and it may not reflect all trends in the market. All customer data used, or represented, in this report is anonymised and aggregated before analysis and is used, and disclosed, in accordance with the Group’s Privacy Policy Statement.



The CBA Spotlight Series does not contain any recommendations but provides commentary on Australian macroeconomic themes. As the CBA Spotlight reports are based on CBA Data, the IB&M Portfolio & Client Analytics (PCA) team provide raw data that may directly or indirectly relate to the themes that have been selected for coverage by the Chief Economist. The PCA team are subject to the same personal conflict requirements and trading restrictions as research, and individuals are wall-crossed per report. CBA Spotlight reports may be viewed in advance of publication by CBA Marketing and Communications in order to produce infographics. Reports are only provided to Marketing and Communications team members under strict wall crossing and during this period their individual trading is monitored.

ANALYST CERTIFICATION AND DISCLAIMER

Each research analyst primarily responsible for the content of this research report, in whole or in part, [confirms] that with respect to each security or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his/her personal views about those securities or issuers and (2) no part of his/her compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by that research analyst in the report. The analysts responsible for the preparation of this report may interact with trading desk personnel, sales personnel and other constituents for the purpose of gathering, synthesizing, and interpreting market information to form an independent view. The analysts responsible for the preparation of this report may not hold, or trade in, securities that are the subject of this report or where they have offered a recommendation. Analysts must disclose, and receive approval, for all outside business interests from Compliance and the Head of Global Markets Research, prior to commencing the activity or within a week of joining the Group. The compensation of analysts who prepared this report is determined exclusively by research management and senior Global Markets management (not including investment banking).

The Group will from time to time have long or short positions in, and buy or sell, the securities or derivatives, if any, referred to in this research report. The Group may also engage in transactions in a manner inconsistent with the recommendations, if any, in this research report. Directors or employees of the Group may serve or may have served as officers or directors of the subject company of this report.

Unless otherwise required and agreed separately, we do not charge any fees for any information provided in this presentation. You may be charged fees in relation to the financial products or other services the Bank provides, these are set out in the relevant Financial Services Guide ("FSG"), relevant Product Disclosure Statements ("PDS"), relevant Terms & Conditions, and/or relevant contract. The Bank's research teams receive a salary and do not receive any commissions or fees. However, they may be eligible for a bonus payment from the Bank based on a number of factors relating to their overall performance during the year. These factors include how well they meet client service standards. Employees may also receive benefits from client such as tickets to sporting and cultural events, corporate promotional merchandise and other similar benefits. See also General Disclosures, "Supervision of Analysts", "Personal Conflicts" and "Group Activity", below.

If you have a complaint, the Bank's dispute resolution process can be accessed in Australia on 13 22 21 or internationally on +61 2 9841 7000.

ADDITIONAL INFORMATION FOR PROFESSIONAL INVESTORS INSIDE AUSTRALIA

This report is made available for informational purposes only. It is not a prospectus or other disclosure document (as defined in the Corporations Act, Australia) that has been or will be filed with the Australian Securities & Investments Commission. This report is only made available for persons who are sophisticated investors or professional investors (as those terms are defined by section 708(8) or (10) and (11) of the Corporations Act 2001 (Cth) or who otherwise is not a retail investor (as defined in sections 761G and 761 GA of the Corporations Act (Cth)).



ADDITIONAL INFORMATION FOR PROFESSIONAL INVESTORS OUTSIDE OF AUSTRALIA (CONT.)

This report is not directed to, or is intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or jurisdiction where such distribution, publication availability or use would be contrary to law or regulation or would subject any entity within the Group to any registration or licencing requirement within such jurisdiction.

Canadian Investors

The information contained herein is not, and under no circumstances is to be construed as, a prospectus, an advertisement, a public offering, an offer to sell securities described herein, solicitation of an offer to buy securities described herein, in Canada or any province or territory thereof.

In Canada, the information contained herein is intended solely for distribution to Permitted Clients (as such term is defined in National Instrument 31-103) with whom Commonwealth Australia Securities LLC (the "US Broker Dealer"), a broker-dealer registered with the US Securities and Exchange Commission and a member of the Financial Industry Regulatory Authority ("FINRA") (CRD# 136321), deals pursuant to the international dealer exemption. To the extent that the information contained herein references securities of an issuer incorporated, formed or created under the laws of Canada or a province or territory of Canada, any trades in such securities may not be conducted through the US Broker Dealer.

Notice of Negative Consent to counterparties that are "Permitted Clients" to receive Fixed Income Research

Counterparties that are "Permitted Clients" but are not registered under the securities legislation of a jurisdiction in Canada as an advisor or dealer, must acknowledge:

- I. The US Broker-Dealer is not registered in the local jurisdiction of the counterparty;
- II. The US Broker-Dealer is a US broker-dealer registered with the US Securities and Exchange Commission;
- III. Substantially all of the assets of the US Broker-Dealer are outside of Canada; and
- IV. There may be difficulty enforcing legal rights against the US Broker-Dealer because of the above.

European Investors

This report is made available in the UK and Europe only for persons who are Eligible Counterparties or Professional Clients, and not Retail Clients as defined by Financial Conduct Authority rules. Commonwealth Bank of Australia is registered in England (No. BR250) and is authorised by the Prudential Regulatory Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Regulation Authority are available from the Bank on request. CBA Europe Ltd is registered in England (No. 05687023) and is authorised and regulated by the Financial Conduct Authority.

Under Article 24 of Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments, the Bank may be required to charge fees for the information provided in this report.



ADDITIONAL INFORMATION FOR PROFESSIONAL INVESTORS OUTSIDE OF AUSTRALIA (CONT.)

Hong Kong Investors

The contents of this report have not been reviewed by any regulatory authority in Hong Kong. This report has been approved for distribution in Hong Kong by the Commonwealth Bank of Australia, Hong Kong branch office, which is a registered institution with the Hong Kong Monetary Authority to carry out Type 1 (Dealing in securities) and Type 4 (Advising on securities) regulated activities under the Securities & Futures Ordinance.

You are advised to exercise caution in relation to the report. If you are in any doubt about any of the contents of this report, you should obtain independent professional advice. This report is only being made available to persons who are:-

- i. 'Professional Investors' as defined in the Securities and Futures Ordinance (cap 571) of Hong Kong; or
- ii. to whom an offer of securities may be made in Hong Kong without the need for a prospectus under section 2 and the Seventeenth Schedule of the Companies Ordinance (Cap. 32 of the Laws of Hong Kong) ("Companies Ordinance") pursuant to the exemptions for offers in respect of which the minimum consideration payable by any person is not less than HK\$500,000 or its equivalent in another currency.

Neither this report nor any part of it is, and under no circumstances are they to be construed as, a prospectus (as defined in the Companies Ordinance) or an advertisement of securities in Hong Kong. The securities referred to in the report have not been, nor will they be, qualified for sale to the public under applicable Hong Kong securities laws except on a basis that is exempt from the prospectus requirements of those securities laws.

Japanese Investors

This report is made available only for institutional customers. Commonwealth Bank of Australia, Tokyo Branch is a licensed banking business authorised by Japan Financial Services Agency.

Korean Investors

The Bank is not licenced to engage in a financial investment business in Korea and nothing in this report shall constitute a recommendation of, offer to sell or marketing of any financial investment product in Korea and is provided to the addressee at its request.

Malaysian Investors

This report is intended only for the addressee and is provided to the addressee at its request. This report is not to be distributed or circulated to the public nor should copies of this report be made or distributed or circulated, nor should information in this report be used in any way or quoted or published in any publication or in the media. The information contained in this report should not be considered a constituting investment advice or a proposal to make available, or to offer for subscription or purchase, or an invitation to apply or subscribe for or purchase any security or enter into any derivative described herein. The addressee must inform themselves about, seek appropriate advice regarding, and observe any restrictions or prohibitions imposed under the relevant laws of Malaysia.



ADDITIONAL INFORMATION FOR PROFESSIONAL INVESTORS OUTSIDE OF AUSTRALIA (CONT.)

New Zealand Investors

The information contained in this report is made available in New Zealand only for persons who are wholesale investors as defined in the Financial Markets Conduct Act 2013 (New Zealand).

People's Republic of China Investors

This report is not an offer to buy or sell financial products or services, nor the solicitation of any offer to buy or sell financial products or services. The financial products referenced in this material may not be offered or sold to any person in the People's Republic of China ("PRC") for the purpose of this report, excluding Hong Kong Special Administrative Region, Macau Special Administrative Region and Taiwan) to whom it is unlawful to make the offer or solicitation. Such products are not and will not be registered with, authorised by, nor approved by any PRC authorities. It shall be the sole responsibility of the recipient of this report to verify his/her eligibility to get access to this report, to purchase any financial products, to obtain any required approval, quota and/or registration and to comply with all applicable regulatory requirements under all applicable legal or regulatory regimes. This report is for intended recipients only and may not be forwarded or presented to any other persons without the prior consent of the Bank.

Taiwanese Investors

The Bank is not licensed to engage in a security or financial services business in Taiwan and nothing in this report shall constitute a recommendation of, offer to sell or marketing of any investment product within Taiwan.

Thailand Investors

This report is only available to institutional investors.

Singaporean Investors

The information in this report is made available only for persons who are Accredited Investors or are Expert Investors as defined in the Securities and Futures Act (Singapore). If you are an Accredited Investor or Expert Investor as defined in Regulation 2(1) of the Financial Advisers Regulations ("FAR"), the Bank is obliged to disclose to you that in the provision of any financial advisory services to you, we are exempted under Regulations 28, 34 and 35 of the FAR from complying with the business conduct provisions of sections 26 (False or misleading statements by licensed financial advisers), 27 (Recommendations by licensees), 29 (Obligation to furnish information) and 36 (Disclosure of interests in securities) of the Financial Advisers Act.



ADDITIONAL INFORMATION FOR PROFESSIONAL INVESTORS OUTSIDE OF AUSTRALIA (CONT.)

US Investors

This report is made available for informational purposes only. The products described herein are not available to retail investors. General macro research may be distributed in the United States by the Bank's New York Branch. The information contained herein is not intended to be an exhaustive discussion of the strategies or concepts mentioned herein or tax or legal advice. Investments and strategies are discussed in this report only in general terms and not with respect to any particular security, derivative or transaction, and any specific investments may entail significant risks including exchange rate risk, interest rate risk, credit risk and prepayment risk among others. There also may be risks relating to lack of liquidity, volatility of returns and lack of certain valuation and pricing information. International investing entails risks that may be presented by economic uncertainties of foreign countries as well as the risk of currency fluctuations. Investors interested in the strategies or concepts described in this report should consult their tax, legal or other adviser, as appropriate.

In the United States, securities products and services are provided solely by or through the US Broker Dealer a brokerdealer registered with the US Securities and Exchange Commission and a member of FINRA. The US Broker-Dealer is a wholly-owned, but non-guaranteed, subsidiary of the Bank. The US Broker-Dealer does not make markets or otherwise engage in any trading in the securities of the subject companies described in our research reports. In the United States, research covering debt securities is only made available to persons who qualify as Qualified Institutional Buyers as defined under Rule 144A of the US Securities Act of 1933, as amended (the "Act") and otherwise abide by the terms of the Notice of Negative Consent below.

Notice of Negative Consent to Qualified Institutional Buyer to Receive Institutional Debt Research

FINRA adopted Rule 2242, "Debt Research Analysts and Debt Research Reports," to address conflicts of interest relating to the publication and distribution of debt research reports. Rule 2242(j) exempts debt research distributed solely to eligible institutional investors ("Institutional Debt Research") from most of the Rule's provisions regarding supervision, coverage determinations, budget and compensation determinations and all of the disclosure requirements applicable to debt research reports distributed to retail investors.

This notice serves to inform you of the US Broker-Dealer's intent to distribute Institutional Debt Research to you while relying on the exemption provided under FINRA Rule 2242. You have separately certified that:

1. You are, or you are authorized to act on behalf of, a Qualified Institutional Buyer (as defined under Rule 144A of the Act).
2. You: (1) are capable of evaluating investment risks independently, both in general and with regard to particular transactions and investment strategies involving a security or securities (including a debt security or debt securities); and (2) are exercising independent judgment in evaluating the recommendations of the US Broker-Dealer pursuant to FINRA Rule 2111.
3. You agree to promptly advise the US Broker-Dealer if any of the representations or warranties referred to in this notice ceases to be true. Based on the aforementioned certifications by you, the US Broker-Dealer is permitted to provide Institutional Debt Research to you under the exemptions provided by FINRA 2242(j). Unless notified by you in writing to the contrary prior to your receipt of our Institutional Debt Research, the Bank will consider you to have given your consent to the receipt of such Institutional Debt Research.

The Bank is a swap dealer provisionally registered with the US Commodity Futures Trading Commission and is a member of the National Futures Association in such capacity (NFA ID 0249150). In the United States, swaps, and products and strategies involving swaps are not suitable for investment by counterparties that are not "eligible contract participants" (as defined in the US Commodity Exchange Act ("CEA")) and the regulations adopted thereunder; or (ii) entities that have any investors who are not "eligible contract participants." Each hedge fund or other investment vehicle that purchases the products must be operated by a registered commodity pool operator as defined under the CEA and the regulations adopted thereunder or a person who has qualified as being exempt from such registration requirement.

