

Colonial First State Global Asset Management

Implications of massive sovereign debt issuance

Stephen Halmarick
Head of Investment Markets Research
Colonial First State Global Asset Management

28 September 2009

Disclaimer

Product Disclosure Statements (PDS) and Information Memoranda (IM) for the funds issued by Colonial First State Investments Limited ABN 98 002 348 352, Commonwealth Managed Investments Limited ABN 33 084 098 180, and CFS Managed Property Limited ABN 13 006 464 428 (collectively CFS) are available from Colonial First State Global Asset Management. Investors should consider the relevant PDS or IM before making an investment decision. Past performance should not be taken as an indication of future performance.

No part of this material may be reproduced or transmitted in any form or by any means without the prior written consent of CFS. This material contains or is based upon information that we believe to be accurate and reliable. While every effort has been made to ensure its accuracy we cannot offer any warranty that it contains no factual errors. We would like to be told of any such errors in order to correct them. **Past performance should not be taken as an indication of future performance.**

This material has been prepared for the general information of clients and professional associates of CFS. You should not rely on the contents. To the fullest extent allowed by law, CFS excludes all liability (whether arising in contract, from negligence or otherwise) in respect of all and each part of the material, including without limitation, any errors or omissions.

This material is intended only to provide a summary of the subject matter covered. It does not purport to be comprehensive or to render specific advice. It is not an offer document, and does not constitute a recommendation of any securities offered by CFS. No person should act on the basis of any matter contained in this material without obtaining specific professional advice.

Colonial First State Global Asset Management is the consolidated asset management division of Commonwealth Bank of Australia ABN 48 123 123 124.

Copyright © Colonial First State Group Limited 2009

All rights reserved.

Agenda

- ∅ Global developments
- ∅ Some history on the Australia CGS market
- ∅ Recent developments in supply of Australian bonds
- ∅ Expected developments in supply of Australian bonds
- ∅ Structural changes: IWT, State guarantee, bank guarantee
- ∅ The return of ILBs
- ∅ Repricing credit risk
- ∅ Liquidity
- ∅ Volatility

Source: Colonial First State Global Asset Management

Global developments

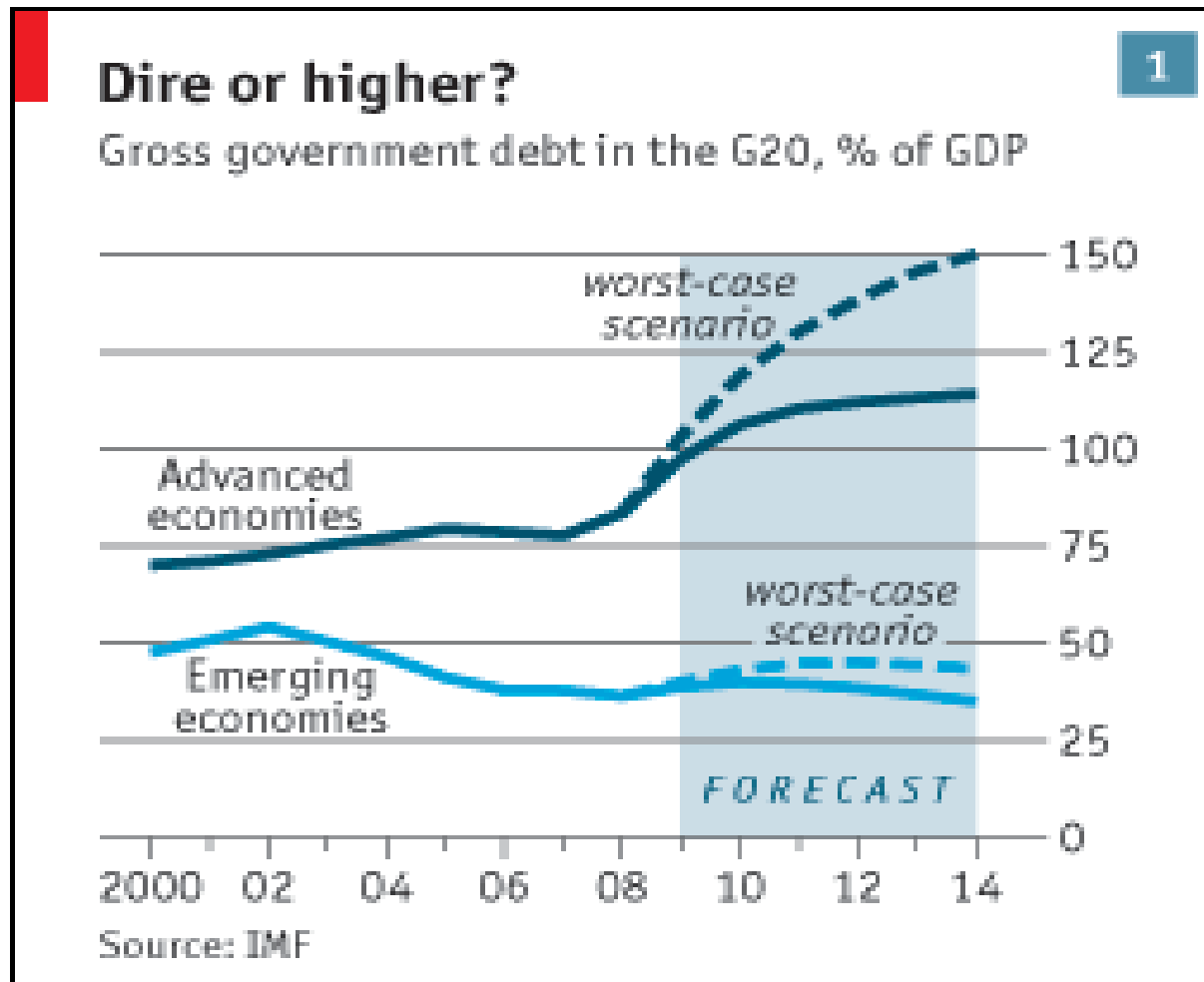
The Economist: June 11 2009

Ø “Gross public debt of 10 largest countries will be 106% of GDP in 2010 and 114% in 2014...up from 74% in 2007 and increase of \$US9 trillion. Governments have never borrowed so much in peacetime. Their huge debts will shape the world economy for a decade.”

Prof . Nouriel Roubini. 27 August 2009

Ø “Governments will have to manage perceptions. Today’s investors remain willing to bankroll Federal spending without any clear or firm indication of how the fiscal crisis – and it is a crisis of extraordinary proportions – is going to be dealt with. That won’t last. Clear indications will soon be needed as to how and when public finances will be repaired. That doesn’t have to be accomplished soon – but it does have to be communicated soon.”

G20 gross government debt



Source: The Economist

Lots of repair needed

The good, the bad and the ugly

3

Government debt, % of GDP

	Gross debt 2007	Net debt 2007	Gross debt 2014*	Fiscal adjustment required†
Australia	15.4	-6.0	16.6	1.2
Britain	46.9	30.2	87.8	5.7
Canada	64.1	23.4	66.2	1.0
France	70.1	34.4	89.7	4.5
Germany	65.5	44.5	91.0	1.8
Italy	113.2	87.6	129.4	4.8
Japan	170.6	85.9	234.2	14.3
South Korea	28.9	-37.7	51.8	-0.7
Spain	42.7	19.1	69.2	3.1
United States	62.9	43.0	106.7	3.5

* Forecast † Difference between forecast primary budget balance in 2014 and primary balance needed for debt sustainability as calculated by the IMF

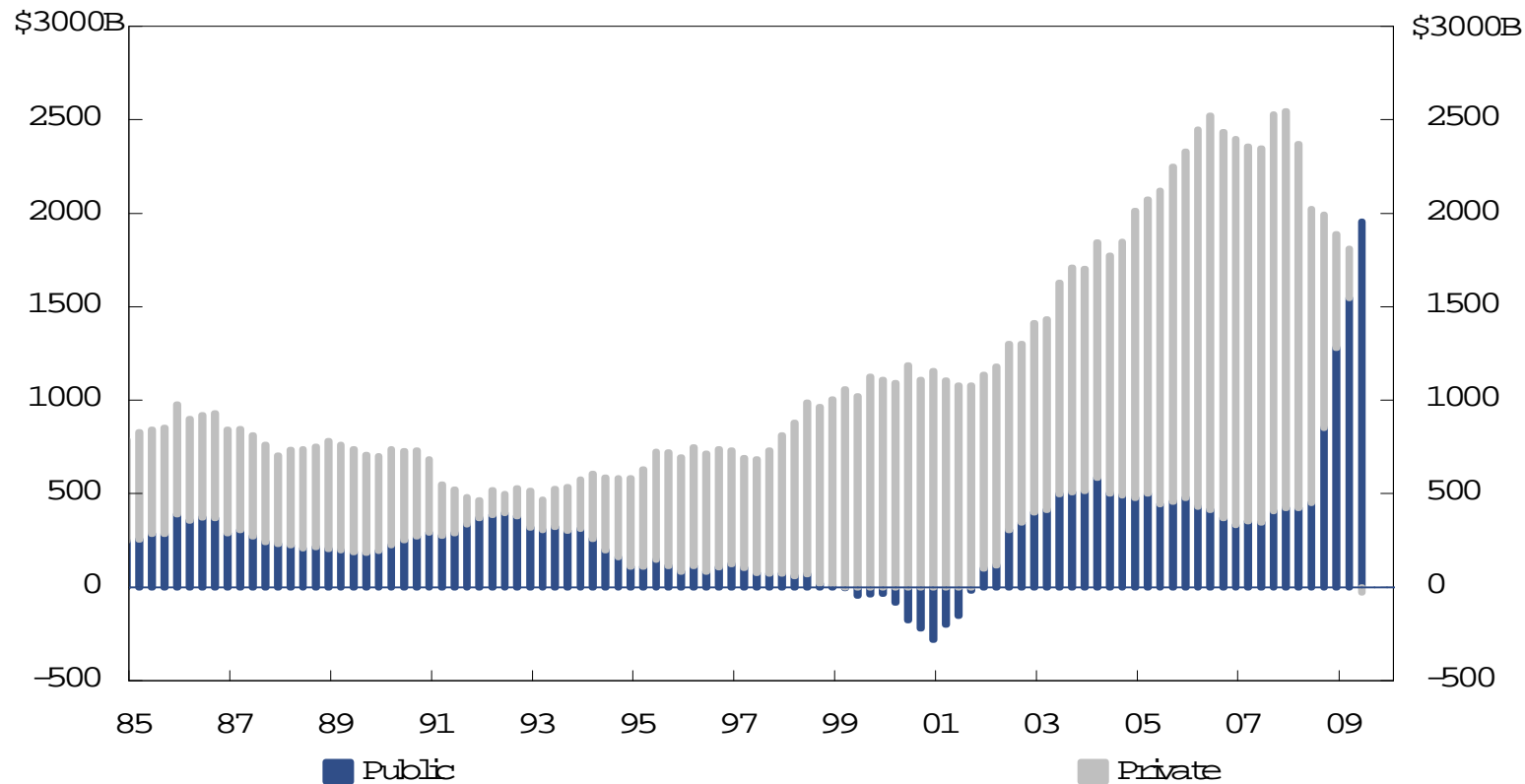
Sources: IMF; OECD;
The Economist

Colonial
First State

Global Asset Management

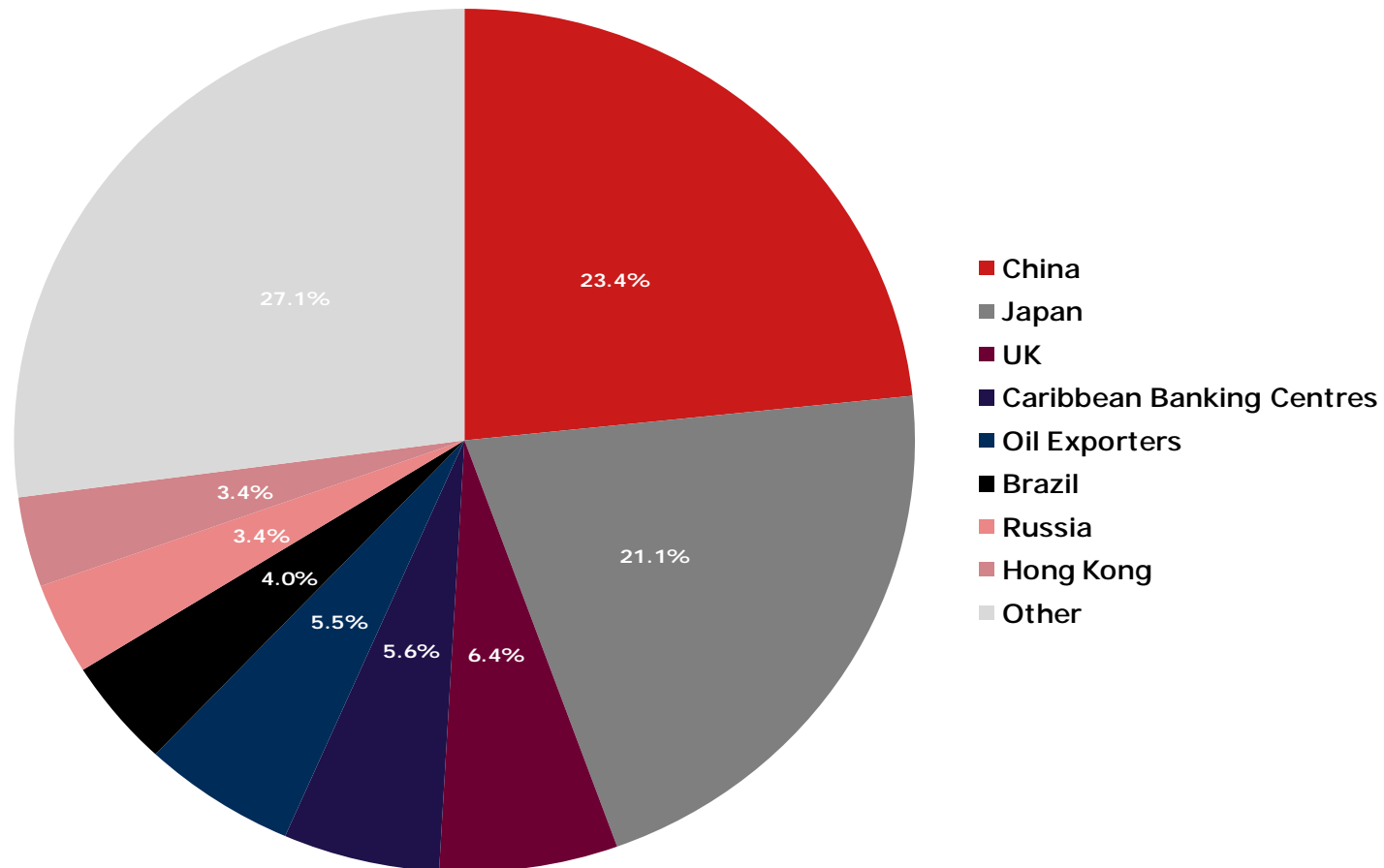
US private debt shrinks as public grows

Year-to-Year Change in Domestic Nonfinancial Debt (\$USbn),
1985-2Q 09



Source: Citi Investment Research & Analysis

Who is buying US Treasury's?

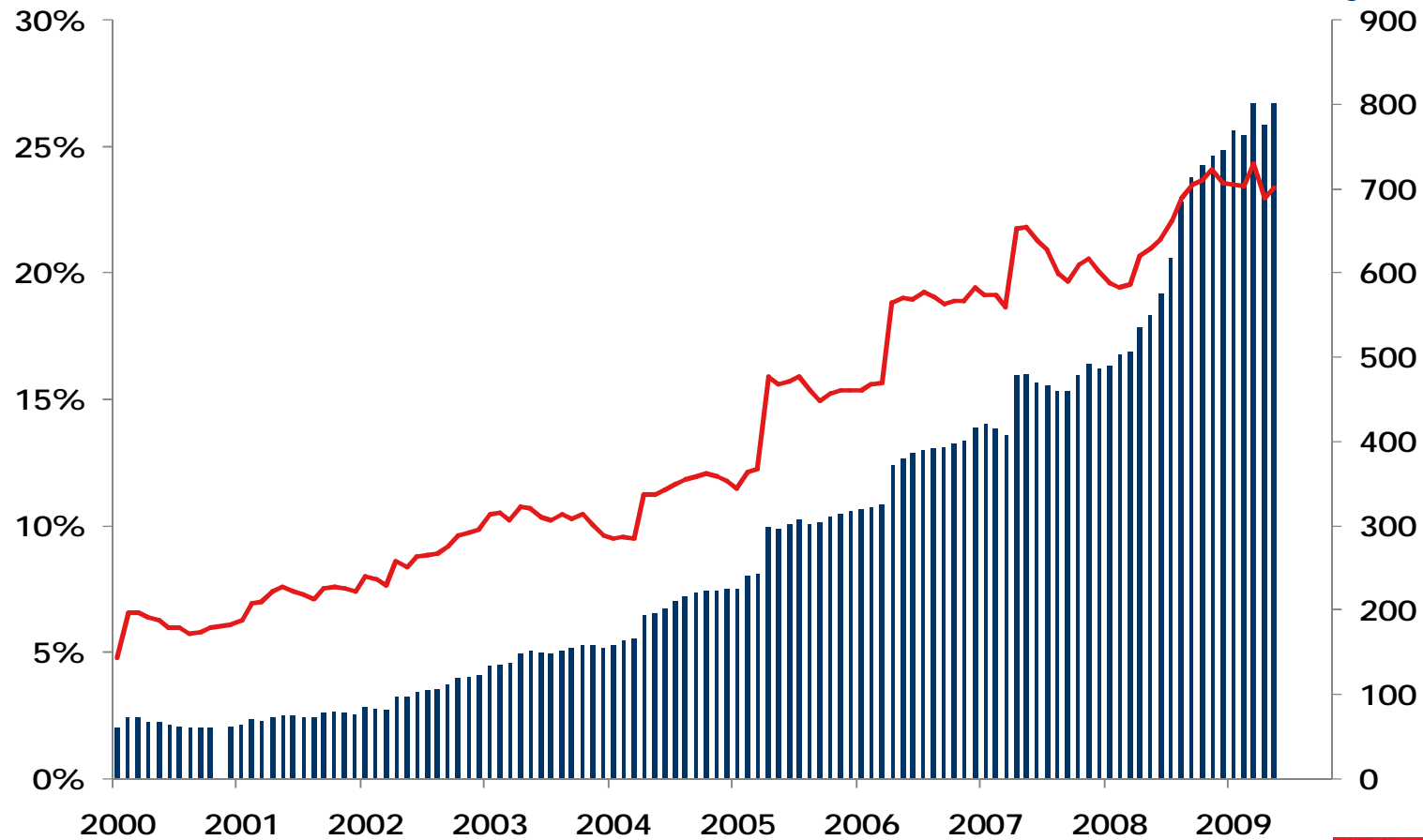


Source: US Treasury. Data as at July 2009

China seems happy to keep lending

China holdings as % total US Treasuries

Value of China holdings, \$USbn



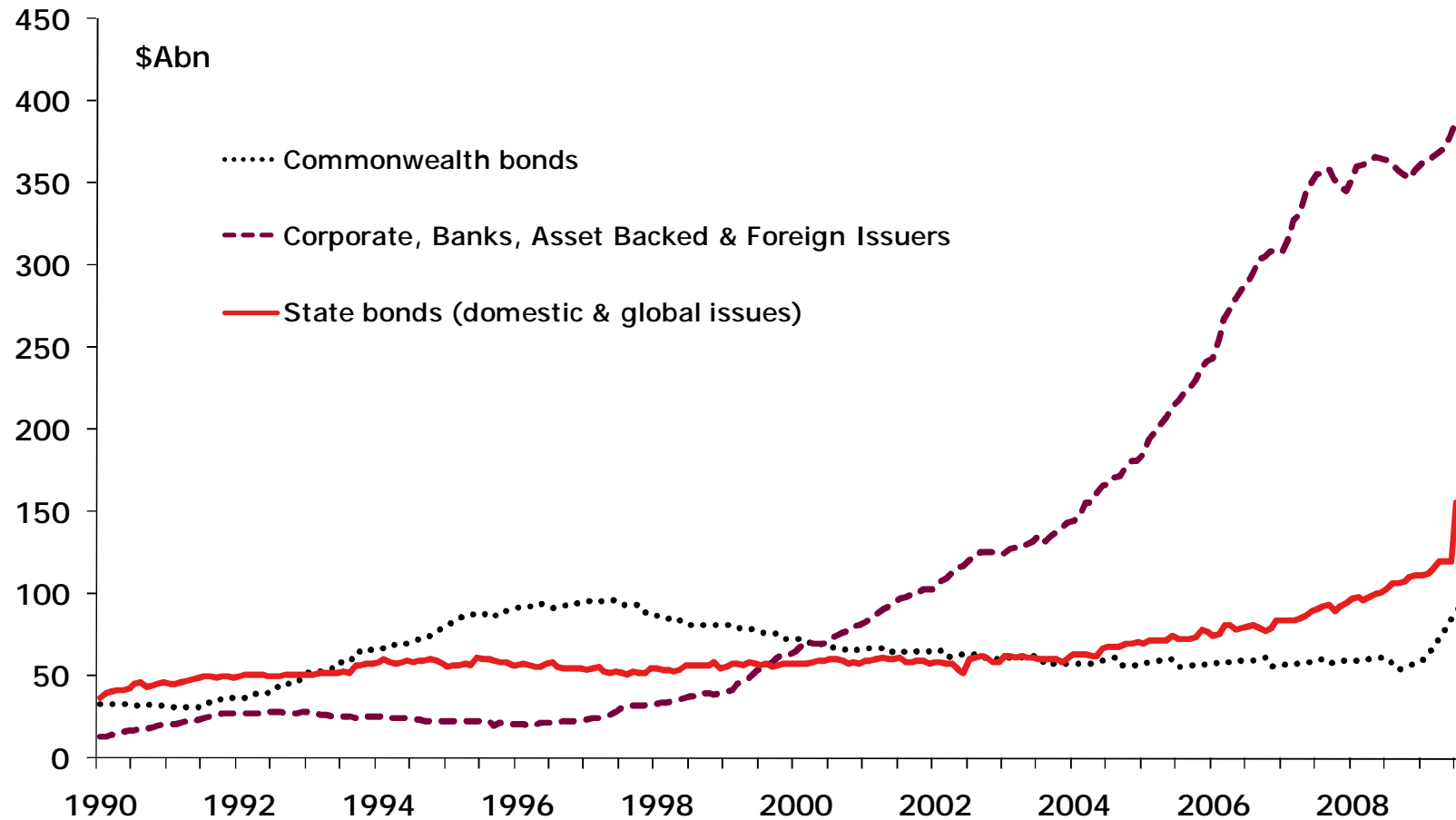
Source: US Treasury. Data as at July 2009

US 10yr bond yields



Source: US Treasury

AUD bonds on issue: Commonwealth, State and Corporate



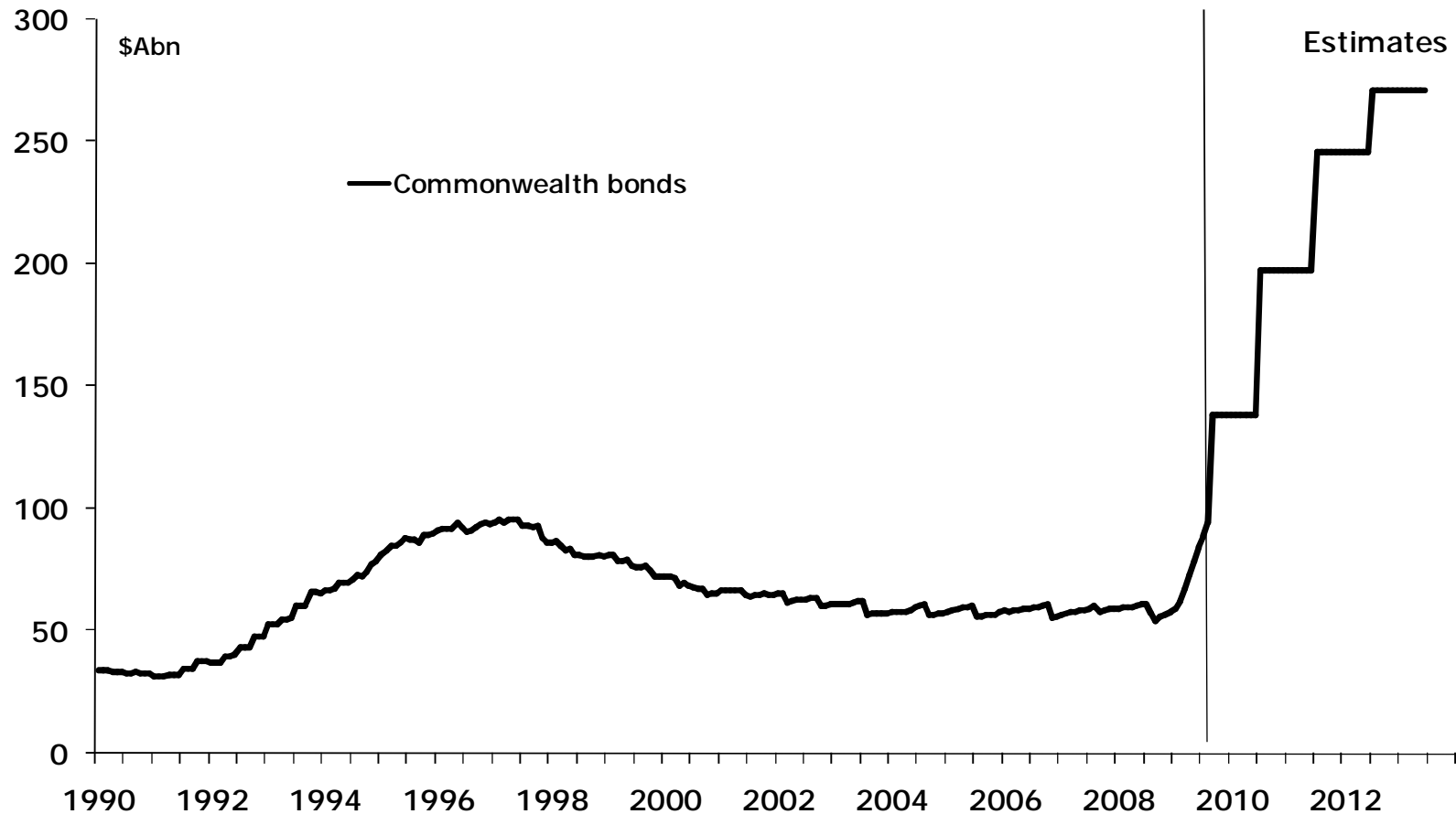
Source: RBA, Commonwealth Treasury, NSWTC & QTC.

Commonwealth borrowing needs

\$Abn	08/09	09/10	10/11	11/12	12/13
Budget deficit	35.9	59.8	58.9	48.5	25.1
Maturities	5.1	6.0	16.1	7.1	7.7
Total funding need	41.0	65.8	75.0	55.6	32.8
Bond issues	31.6	60.0	75.0	55.6	32.8
Net bonds issued	26.5	54.0	58.9	48.5	25.1
"Hot stock" on issue	84.4	138.4	197.3	245.8	270.9
Total CGS on issue	101.1	155.1	214.0	262.5	300.8*

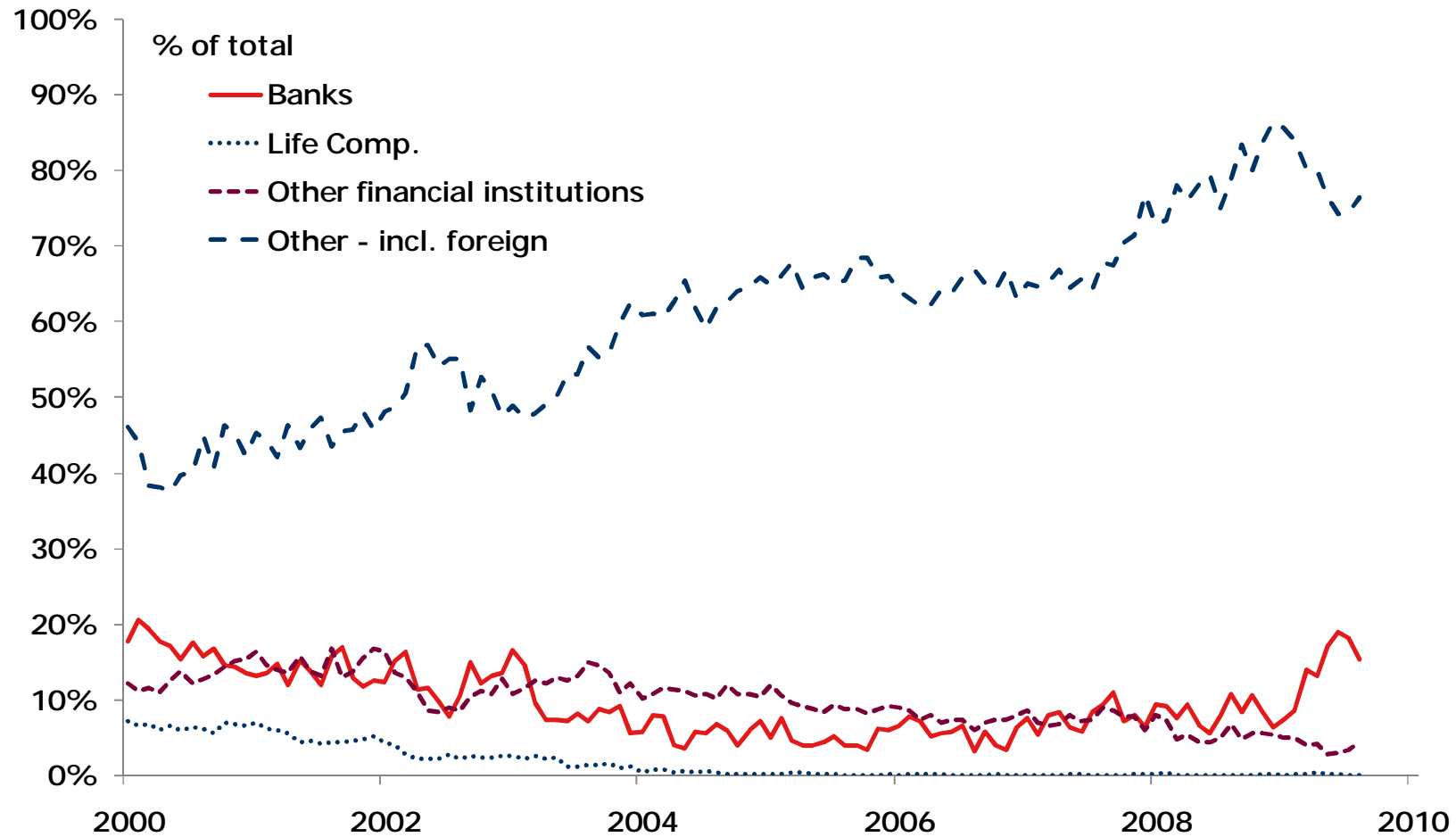
Source: Commonwealth Treasury and Colonial First State Global Asset Management.
 *Commonwealth estimate. Numbers may not add due to rounding.

Commonwealth bonds on issue



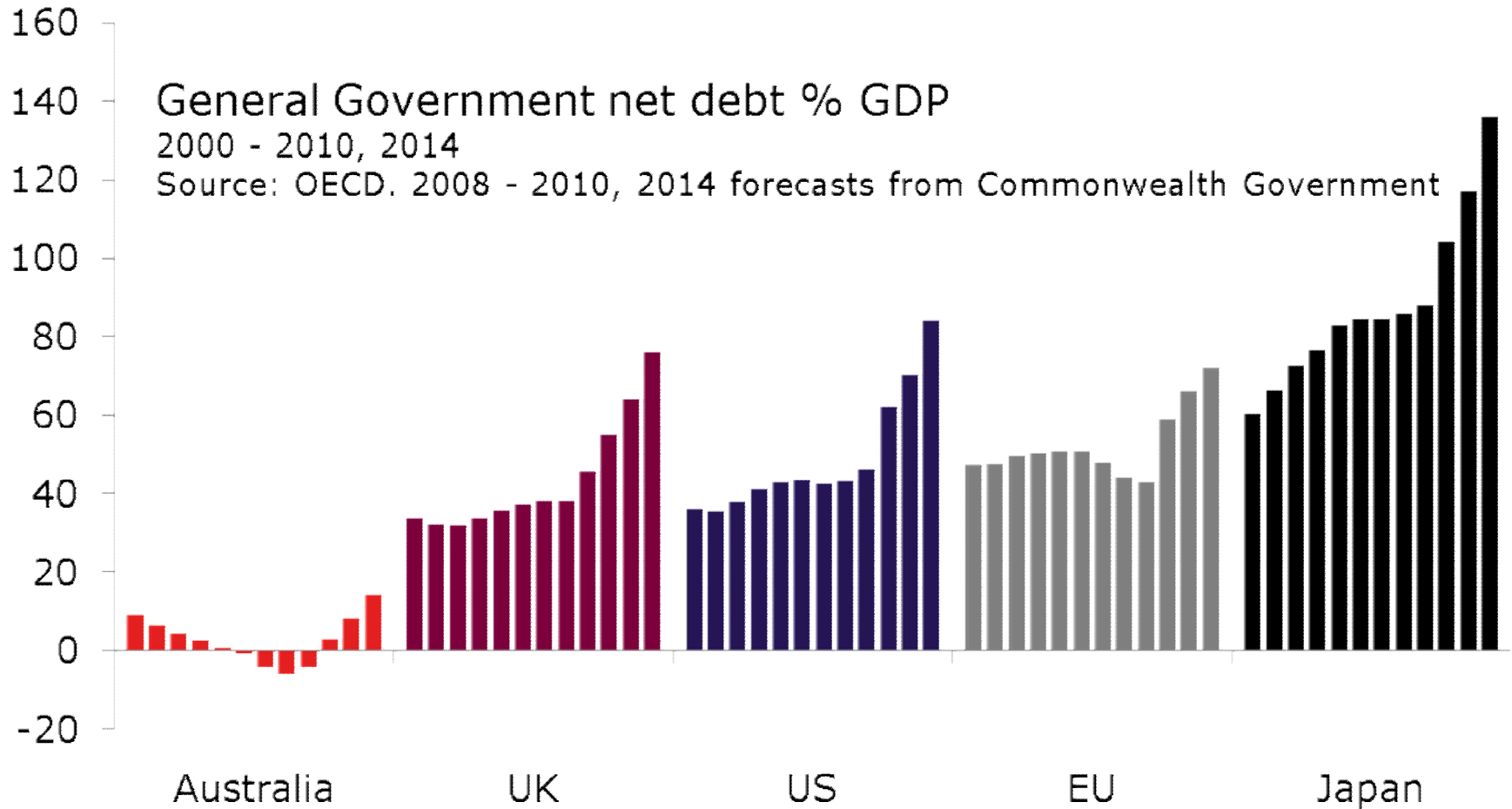
Source: Commonwealth Treasury and Colonial First State Global Asset Management

Share of CGS held by investors



Source: RBA

General government net debt % GDP



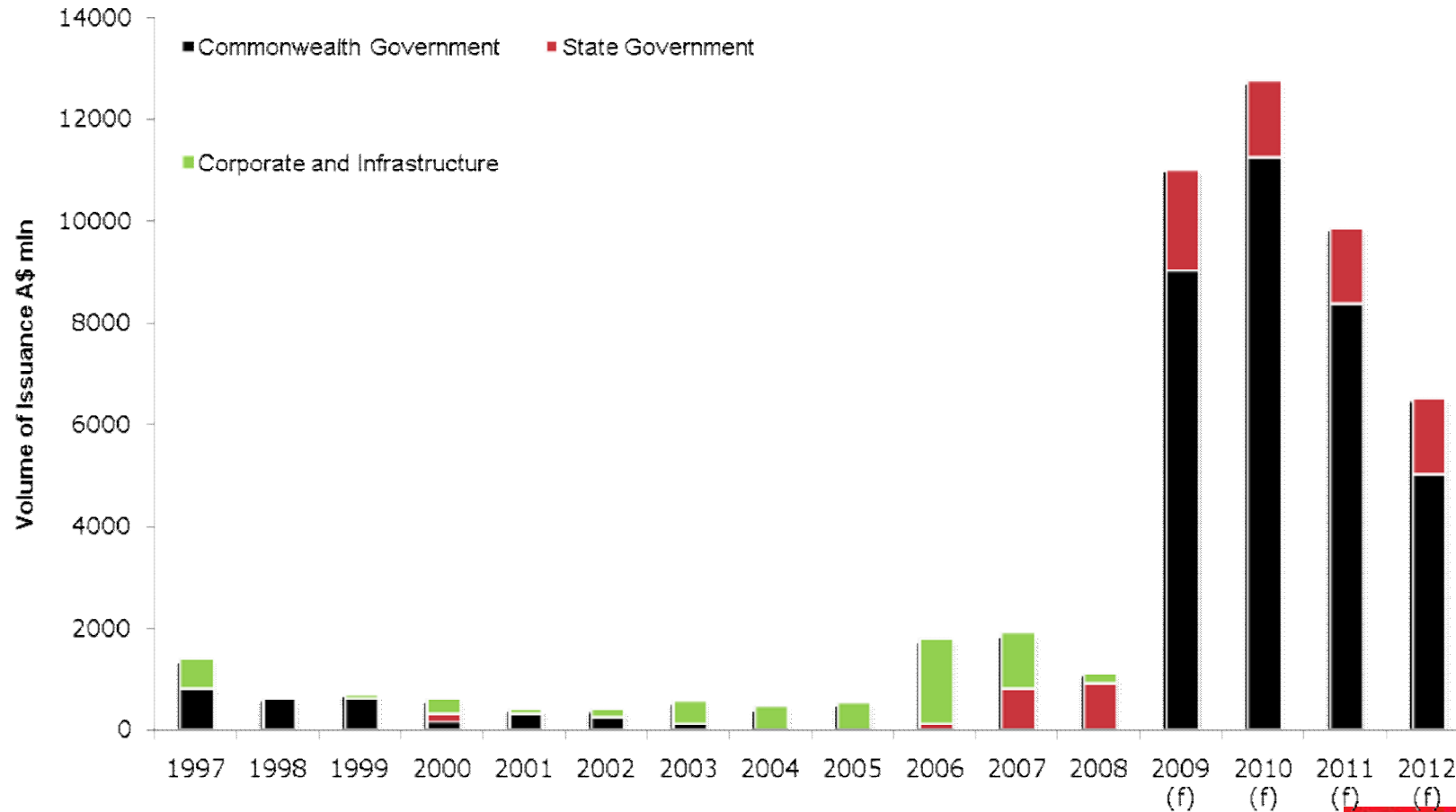
Source: Commonwealth Budget 2009/10

Structural changes in Australia

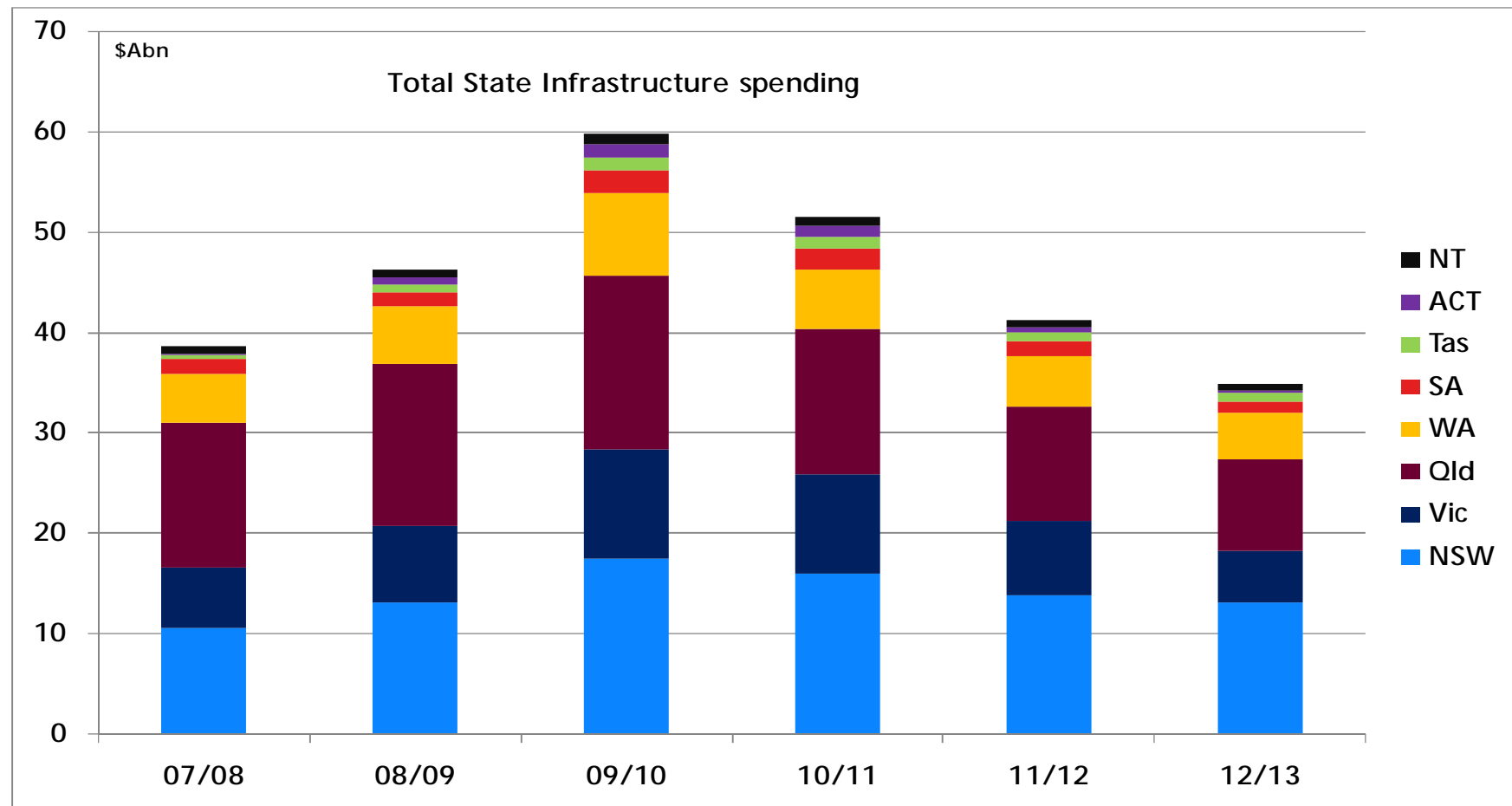
- ∅ Inflation index linked Commonwealth market is about to be re-born.
- ∅ No Commonwealth issuance since 2003.
- ∅ New 20 September 2025 CIB will be issued by a book-build late this month or early October.
- ∅ AOFM will build the 2025 to a benchmark bond, starting at a minimum of \$A1bn – demand is expected to be very strong.
- ∅ Abolition of IWT on CGS before year-end is a positive and will bring C'wealth into line with States and Corporates.
- ∅ APRA discussion paper on bank capital needs points to banks having to hold significant more “liquid” government bonds.

Source: Colonial First State Global Asset Management

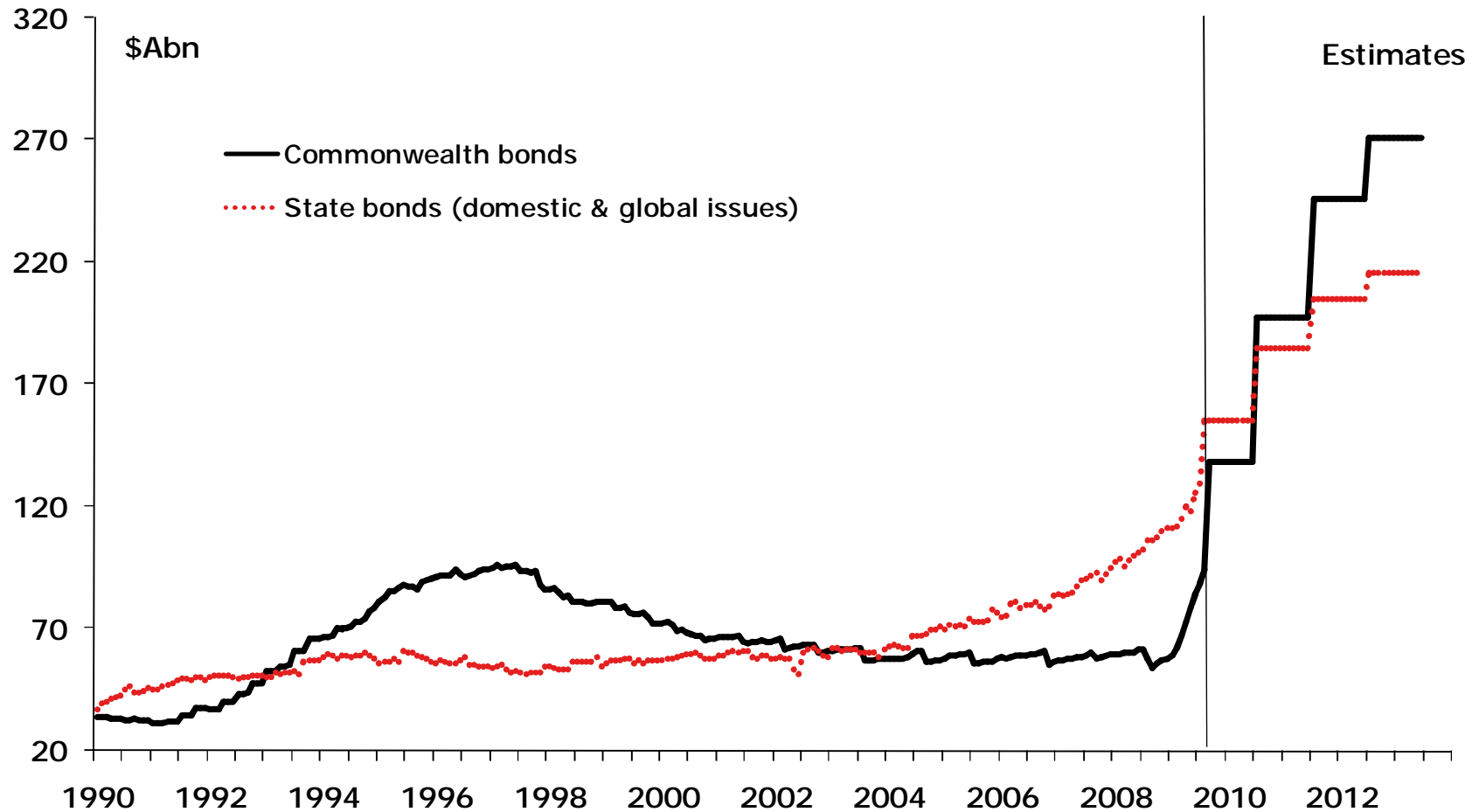
The return of the index linked market



State infrastructure spending plans



State gov't bond supply to also rise



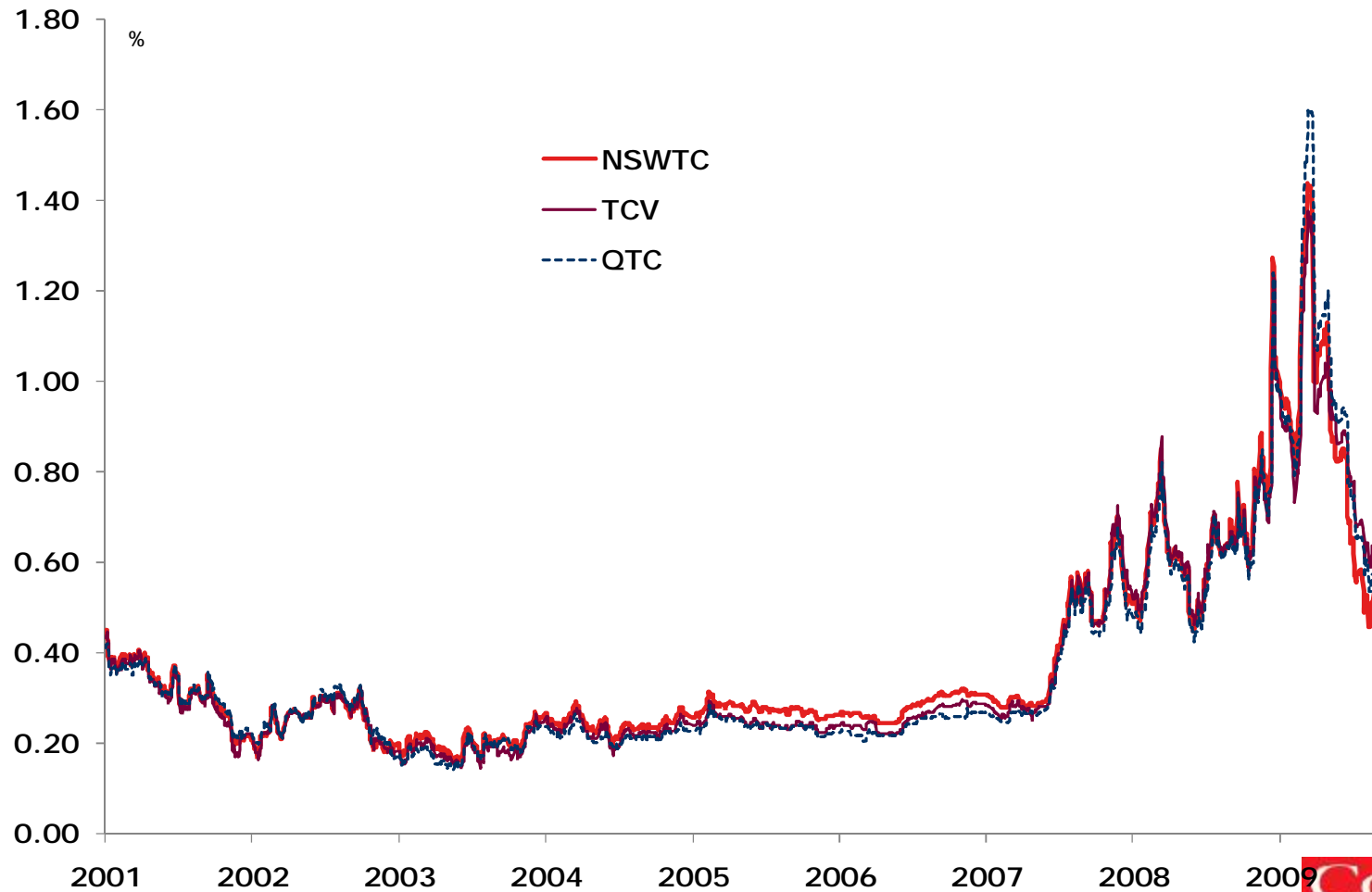
Source: Commonwealth and State Treasury and Colonial First State

Summary of State details

State	Borrowings 2009/10 \$Abn	Use of C'wealth guarantee	Credit rating S&P/ Moody's	Cost of C'wealth guarantee. Existing/New
NSW	10.4	Yes	AAA/Aaa	15bp/30bp
Victoria	5.6	No	AAA/Aaa	n/a
Qld	22.5	Yes	AA+/Aaa	20bp/35bp
WA	5.1	No	AAA/Aaa	n/a
SA	2.2	No	AAA/Aaa	n/a
Tasmania	0.8	No existing/ Yes new	AA+/Aaa	-/35bp

Source: State Treasury's, S&P and Moody's

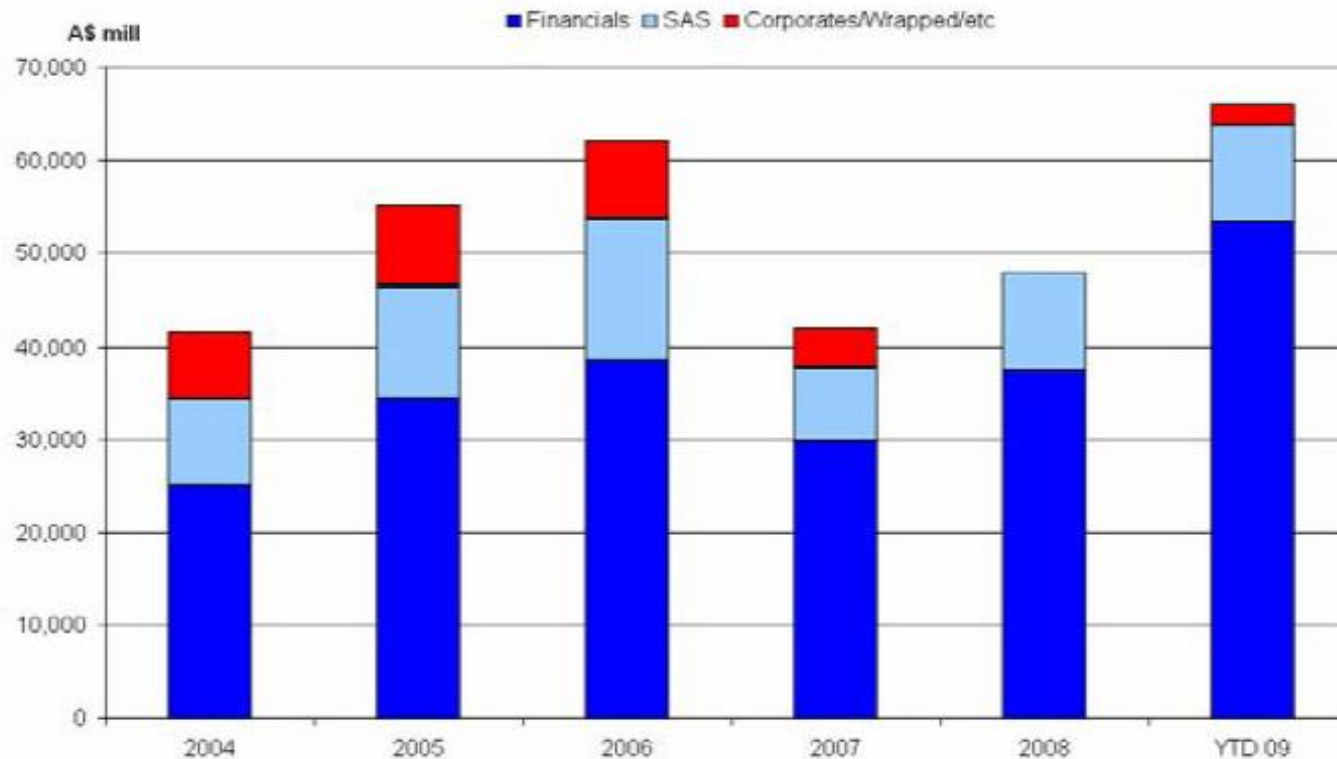
NSWTC, QTC & TCV 10yr spreads to CGS



Source: Citi Australia

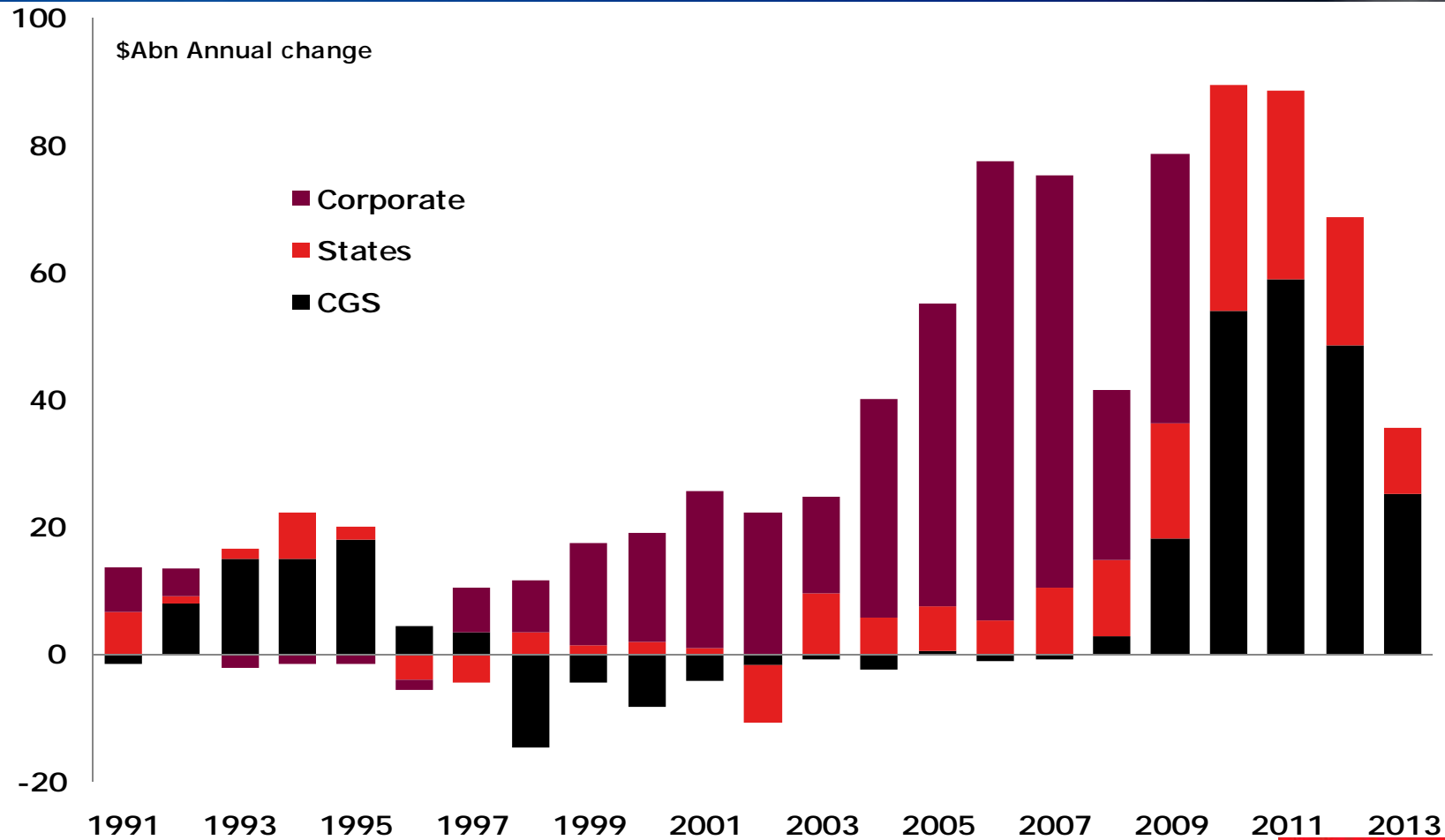
Corporate bond supply

AUD corporate & financial issuance



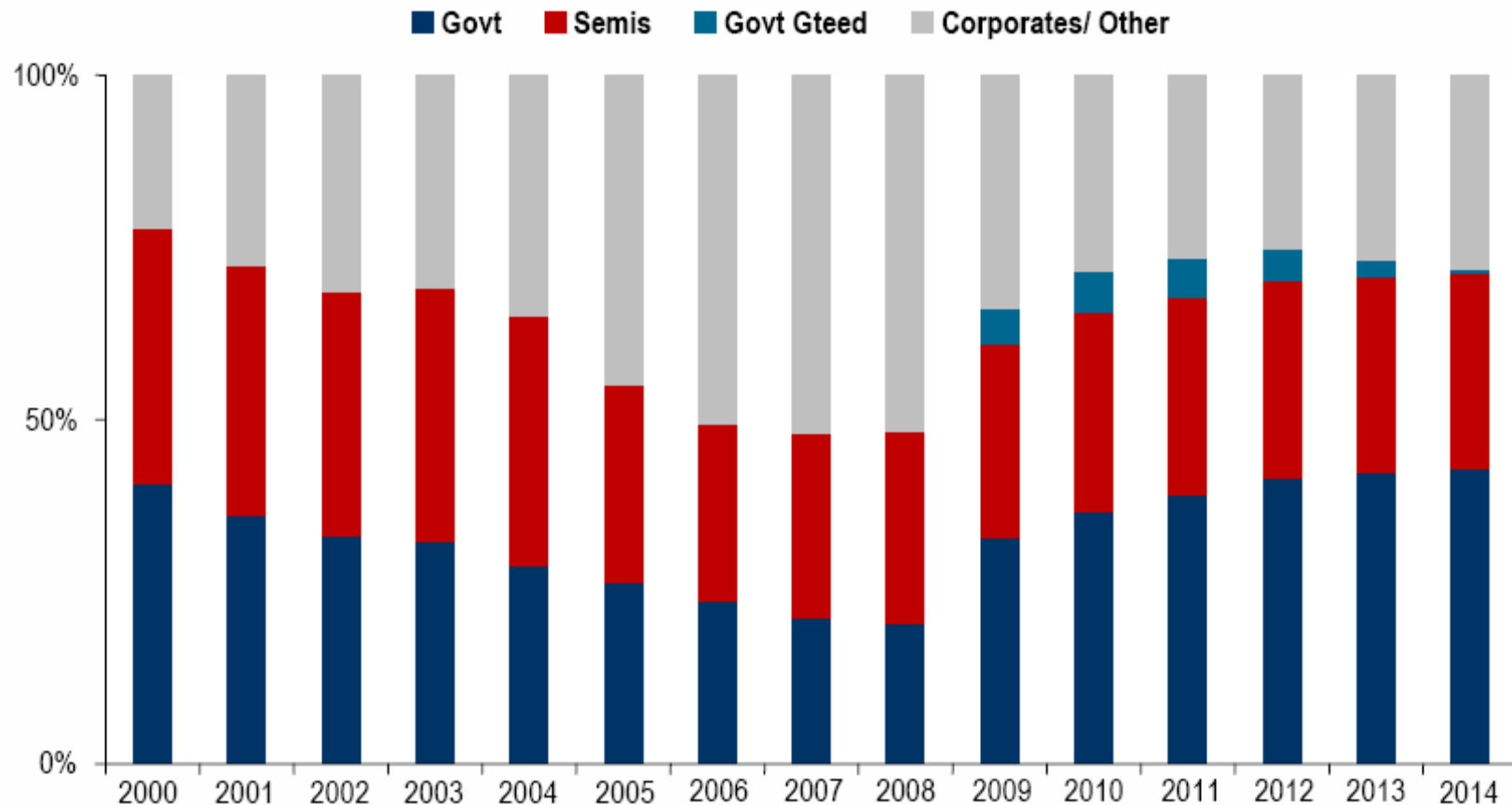
Source: Citi Investment Research & Analysis

Total bond market supply



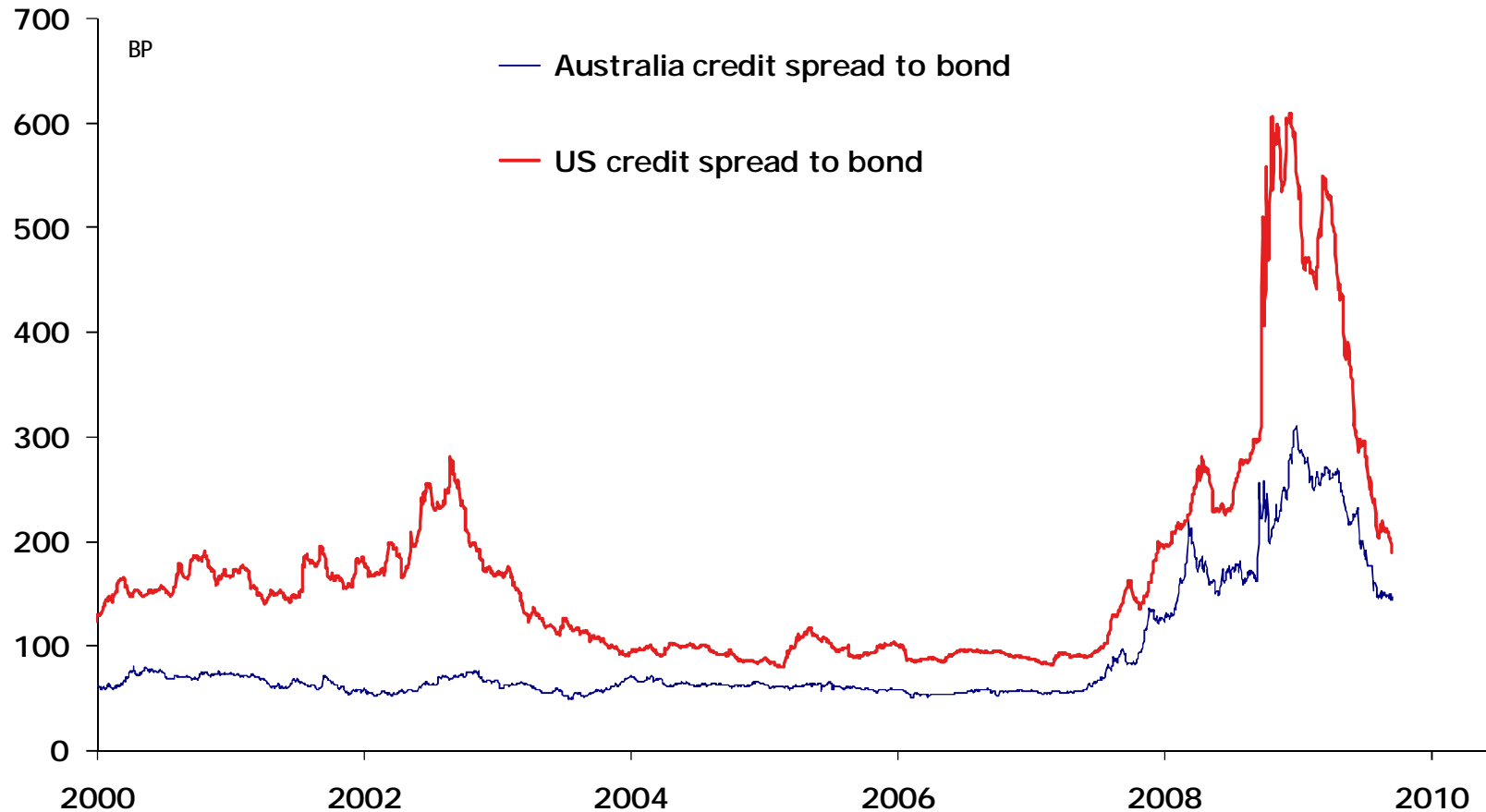
Source: RBA & Colonial First State Global Asset Management

The changing structure of the UBS Composite Bond Index



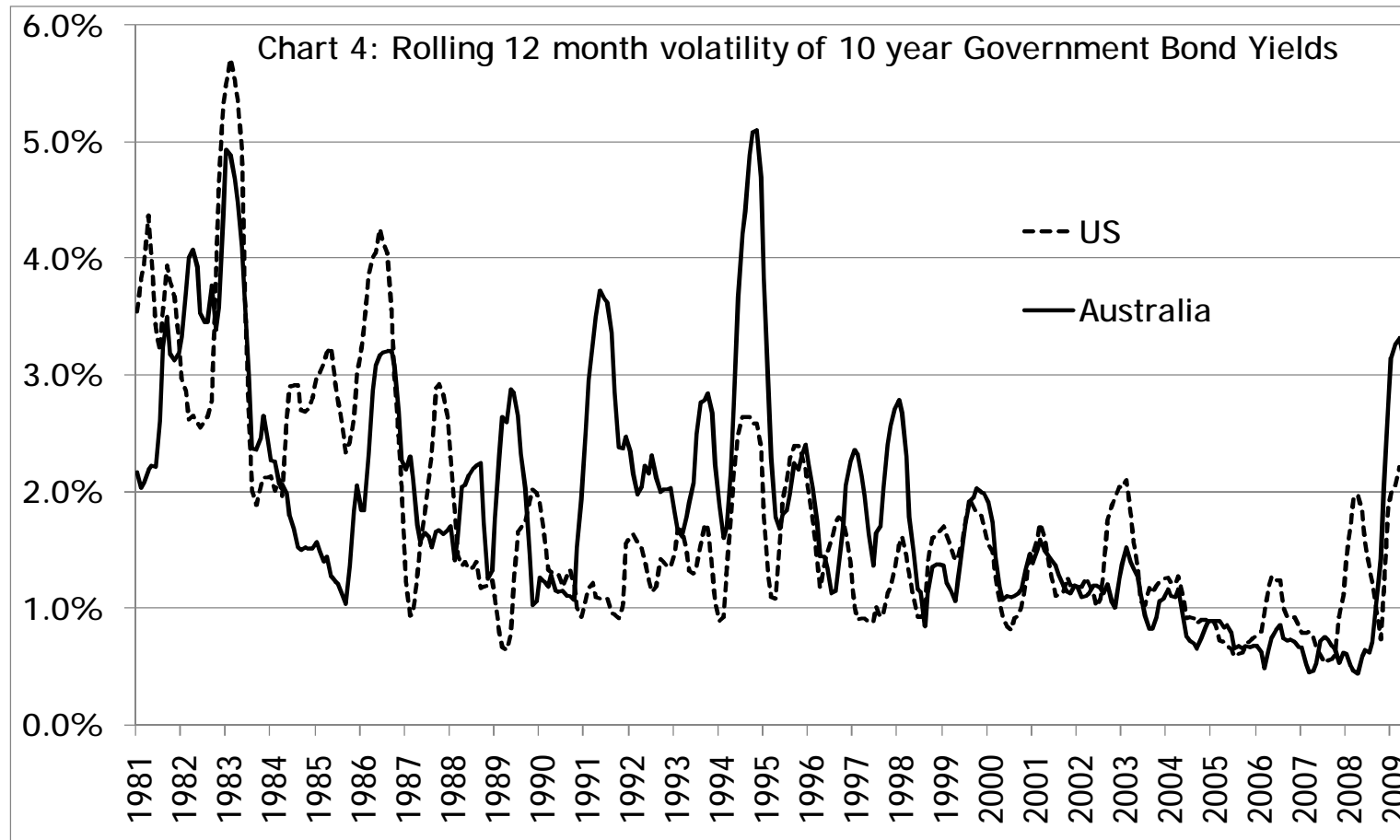
Source: UBS Investment Research.

The "GFC" – Credit 'crisis' is over



Source: Citi. Data to 16 September 2009.

Bond market volatility



Source: Colonial First State Global Asset Management

Summary

- ∅ A legacy of GFC will be massive government debt issuance.
- ∅ Significant concerns exist over sustainability of this debt.
- ∅ But little sign of global investors shying away from government bonds.
- ∅ For Australia, increase in supply is meaningful, but will add much-needed liquidity and no signs of indigestion.
- ∅ C'wealth will become a much larger share of local bond market, supported by re-birth of ILB, IWT abolition and proposed APRA changes.
- ∅ State bond supply supported by C'wealth guarantee.
- ∅ Corporate bond supply dominated by banks.
- ∅ Credit risk to be repriced in “new normal”.
- ∅ Markets will likely be more concerned with liquidity and volatility.