

more give, less take



# Economic Report

## China-Australia Free Trade Agreement – Highlights

Group Economics November 2014

# Introduction

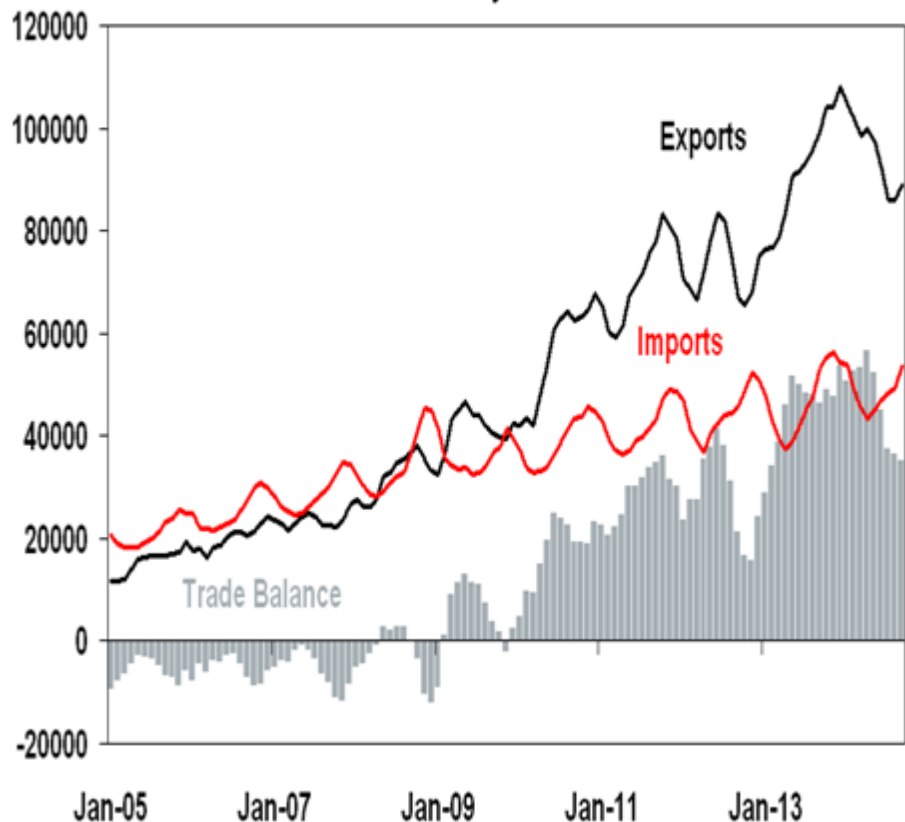
## The Chinese-Australia Free Trade Agreement (FTA)

- Improved access for Australian food exports – phased tariff removal on dairy, beef, sheep-meat, wine, horticulture, seafood, hides-skins-leather
- Agreement allows discretionary barriers for beef and whole milk powder, for Australian exports above an agreed volume
- Some industries miss out (rice, cotton, sugar) – sensitive domestic sectors in China
- Improved access for Australian resource exports – tariff removal on coal, alumina and several other mineral ores
- Improved market access for Australian service providers – including finance, healthcare, legal services, construction and mining services
- Facilitates increased Chinese investment in Australia – increasing FIRB screening threshold for private sector investment projects
- This FTA generally well received by business, unlike some previous FTAs where lack of progress in market access in key areas was criticised
- These are all valuable initiatives but need to see more detail

# Annual goods exports to China worth \$90 Billion but being squeezed by falling resource prices

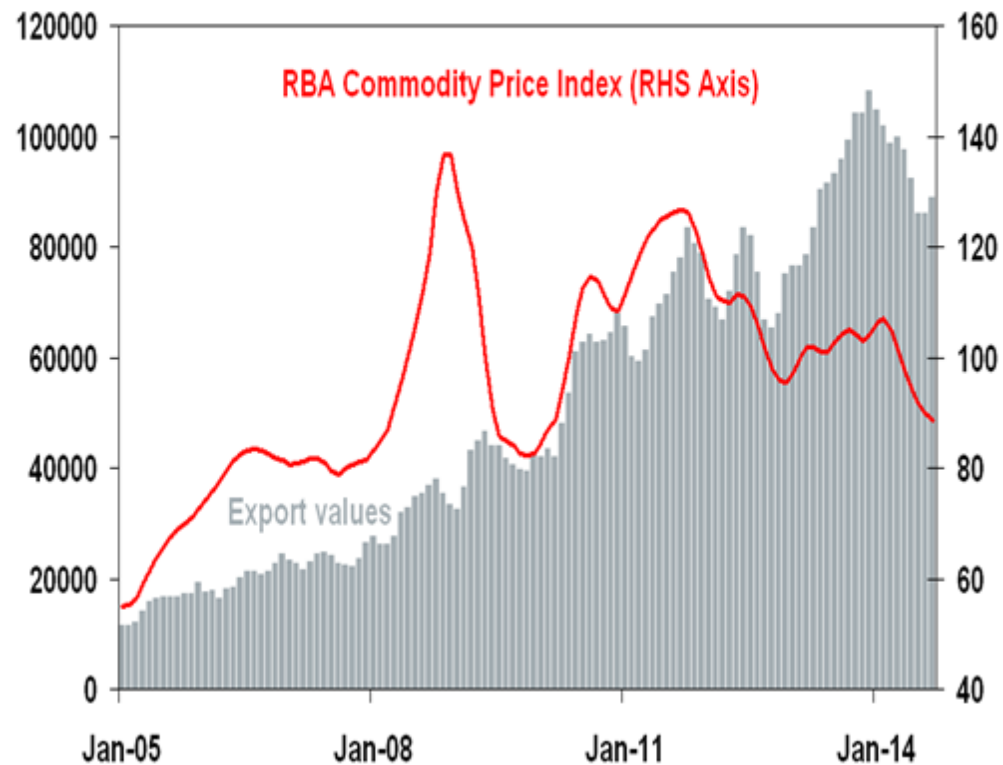
### Australian Merchandise Trade with China

Annualised monthly trade \$ Million

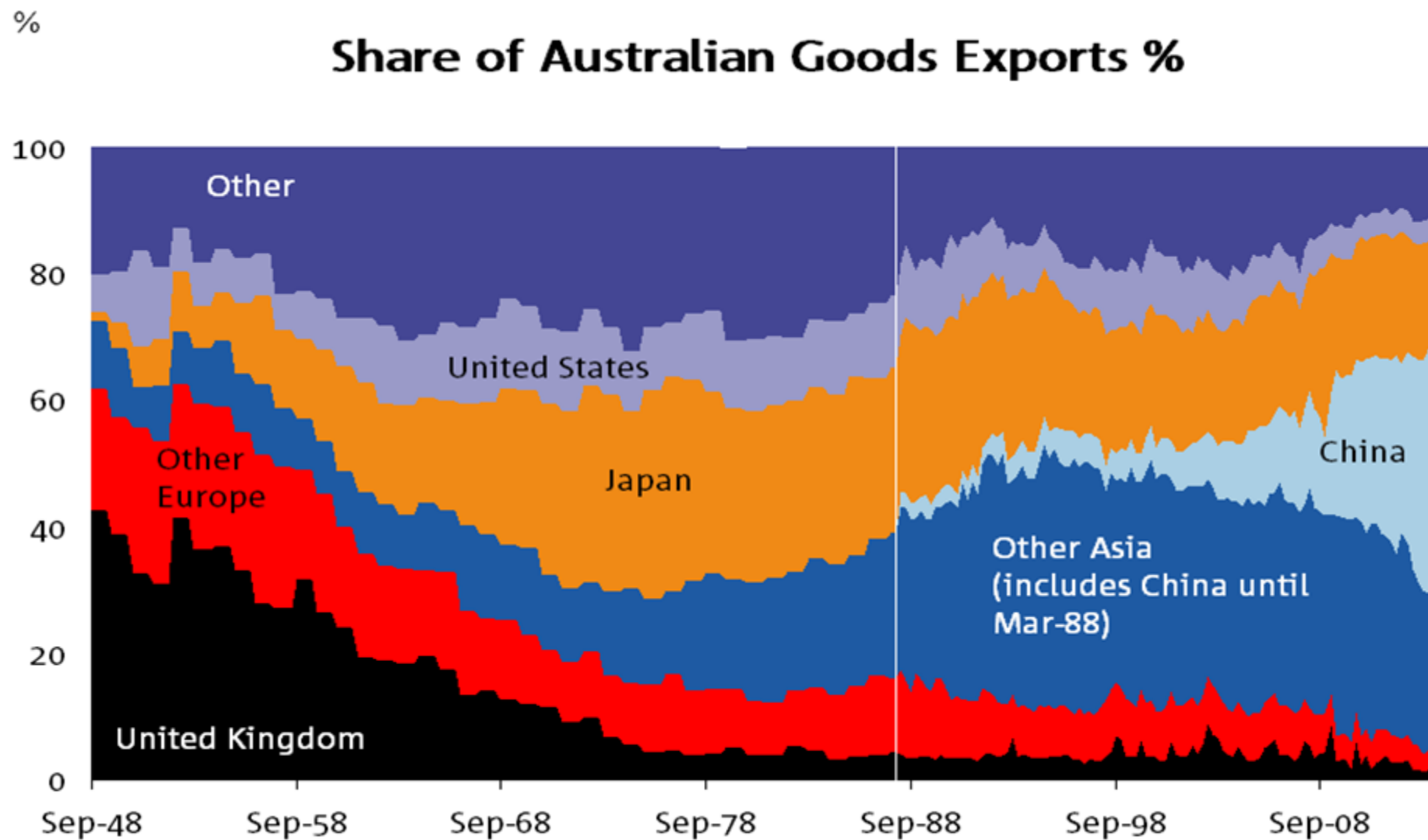


### Merchandise exports to China and Commodity Prices

Monthly \$ Million and 2012/13 Price Index



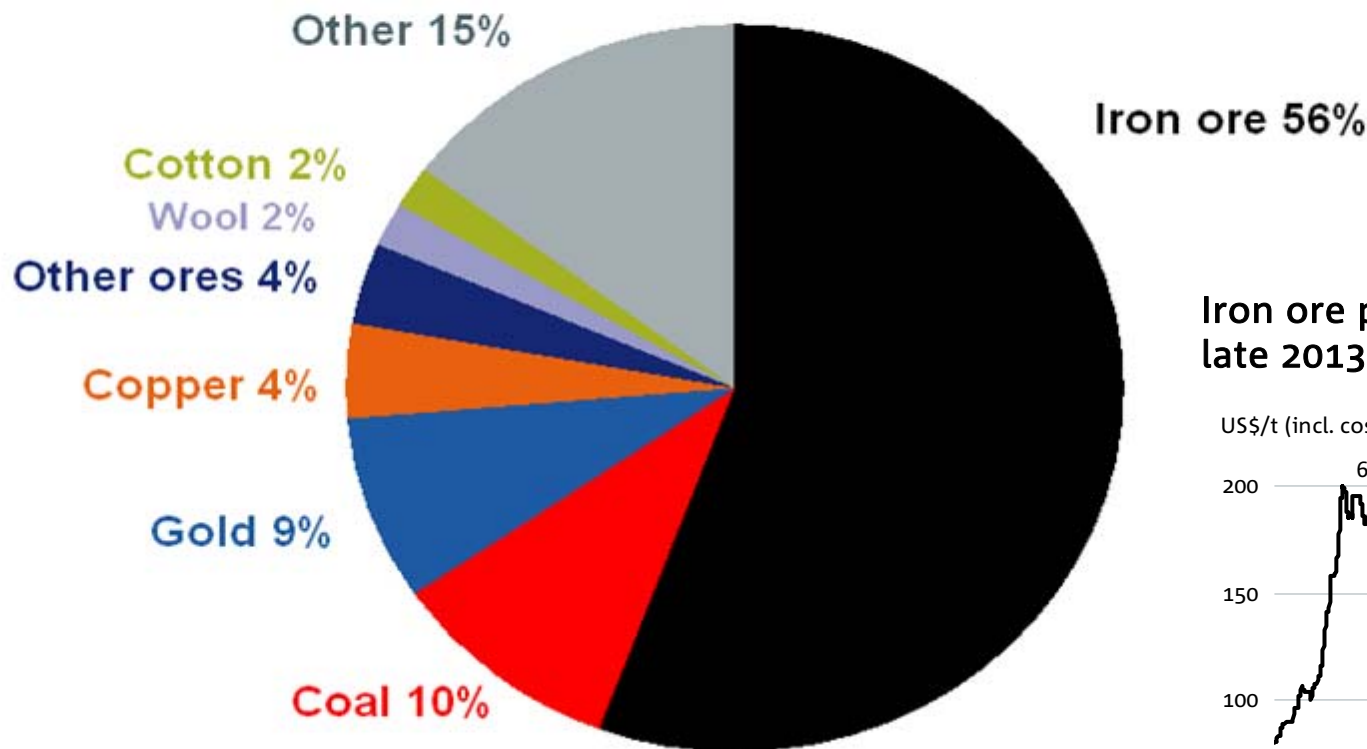
# China our biggest export market, displaced Japan and now takes one-third of all merchandise sold



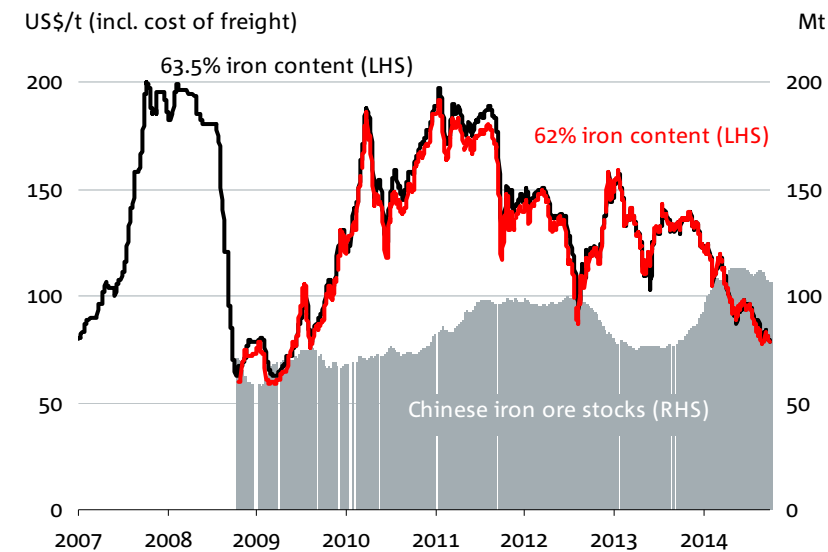
Source: RBA, ABS, NAB Economics

# Commodity base of goods trade – iron ore accounts for over 50% of total exports

## Composition of Australian Exports to China % Share 2013



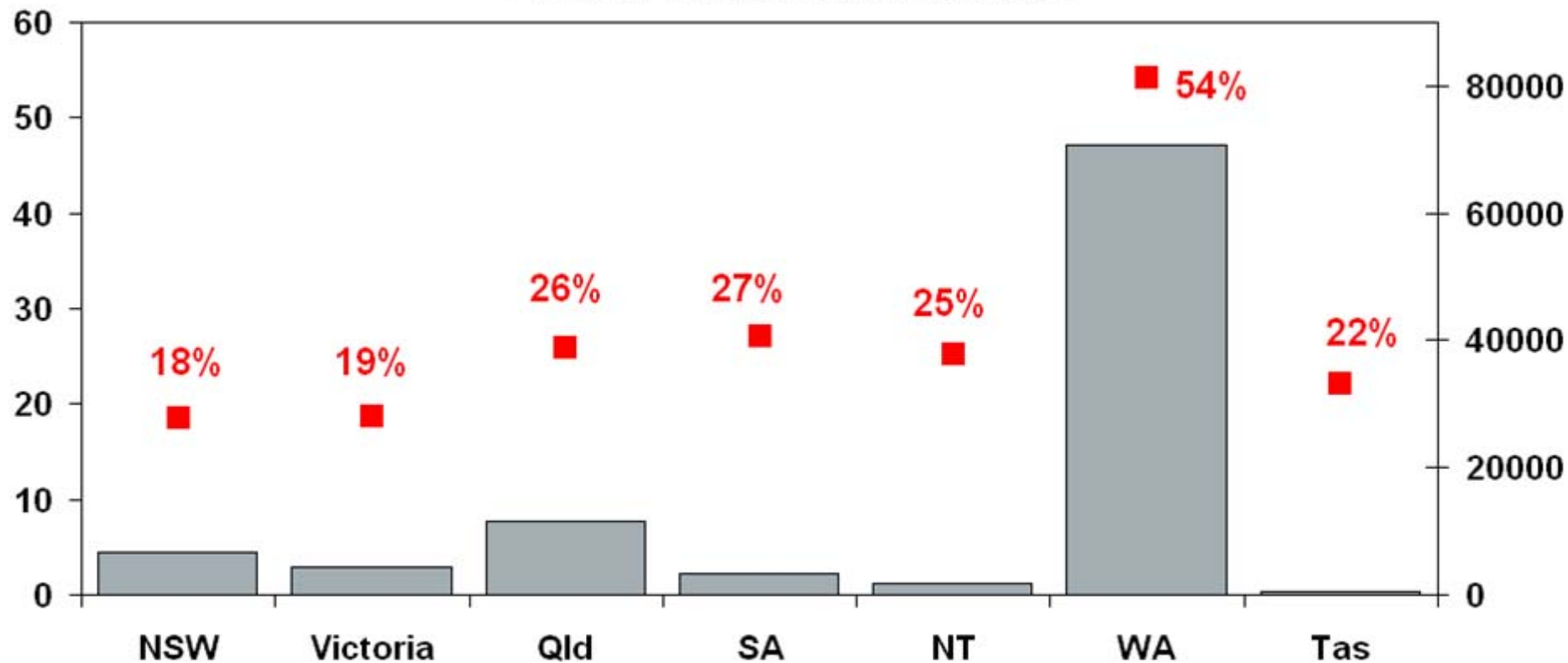
Iron ore prices have trended down since late 2013



Source: Bloomberg, Thomson Datastream, NAB Economics

## Biggest bilateral trade flows involve WA – 70% of Australian exports and over half WA total

Goods exports to China by Australian State or Territory  
2013/14 \$ Million and % Share



■ EXPORTS TO CHINA (RHS AXIS)

■ CHINA'S SHARE OF TOTAL STATE/TERRITORY EXPORTS

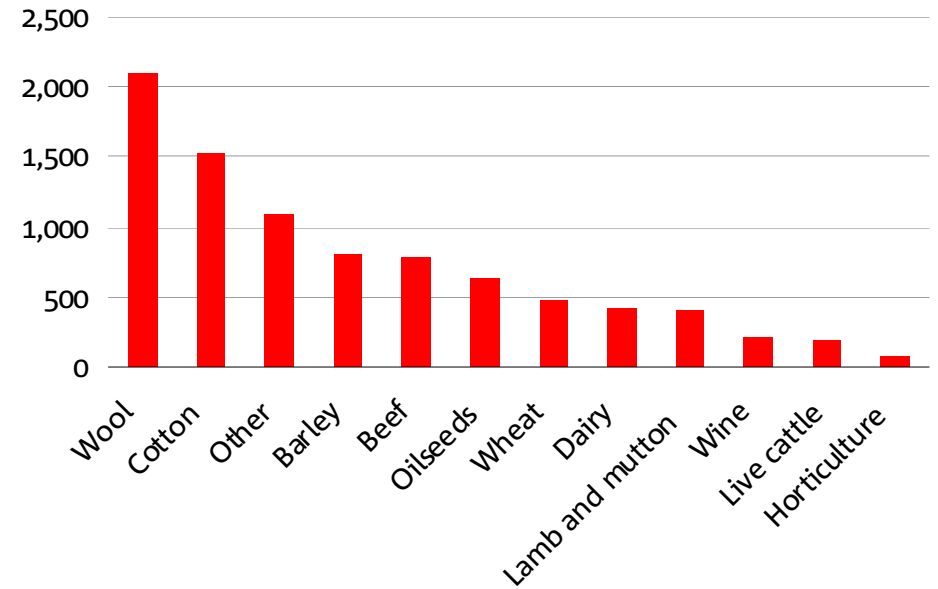
# Agriculture

## Australian fruit exports to China (AUD million)

Product	2011-12	2012-13	2013-14
Oranges	0.3	4.1	13.3
Mandarins	0.4	3.1	7.9
Cherries	0	0.9	3.0
Table grapes	0.6	13.3	1.0
Mangoes	0.2	0.2	0.9
Apples	0	0	0.1
Other fruit	0.1	0.2	0.3

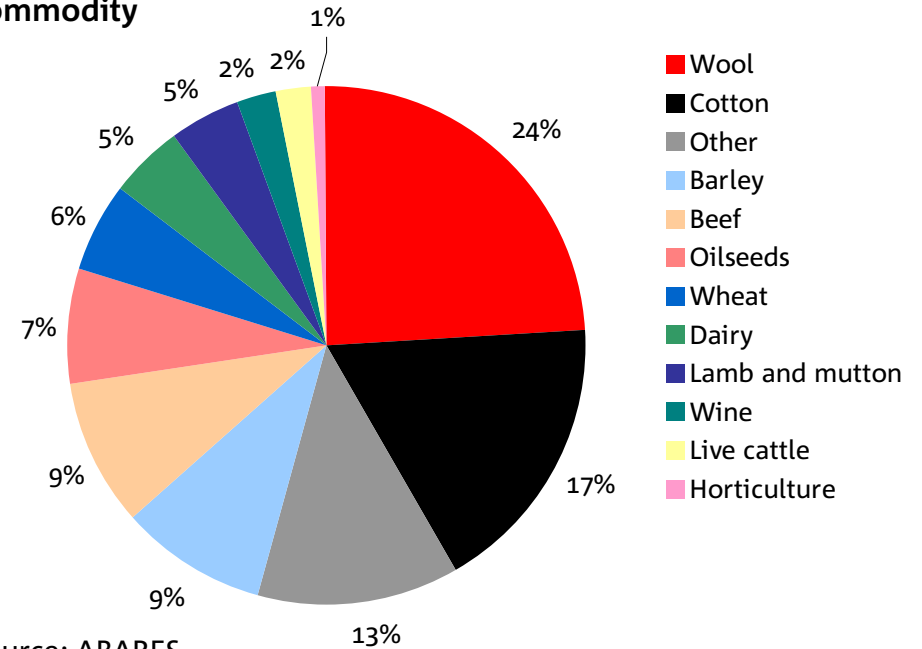
Source: AHEA, UN Comtrade

## Australian agricultural exports to China by sector 2013-14 (AUD million)



Source: ABARES Note: wool column includes sheep skins

## Australian Agricultural exports to China 2013-14 – share by commodity

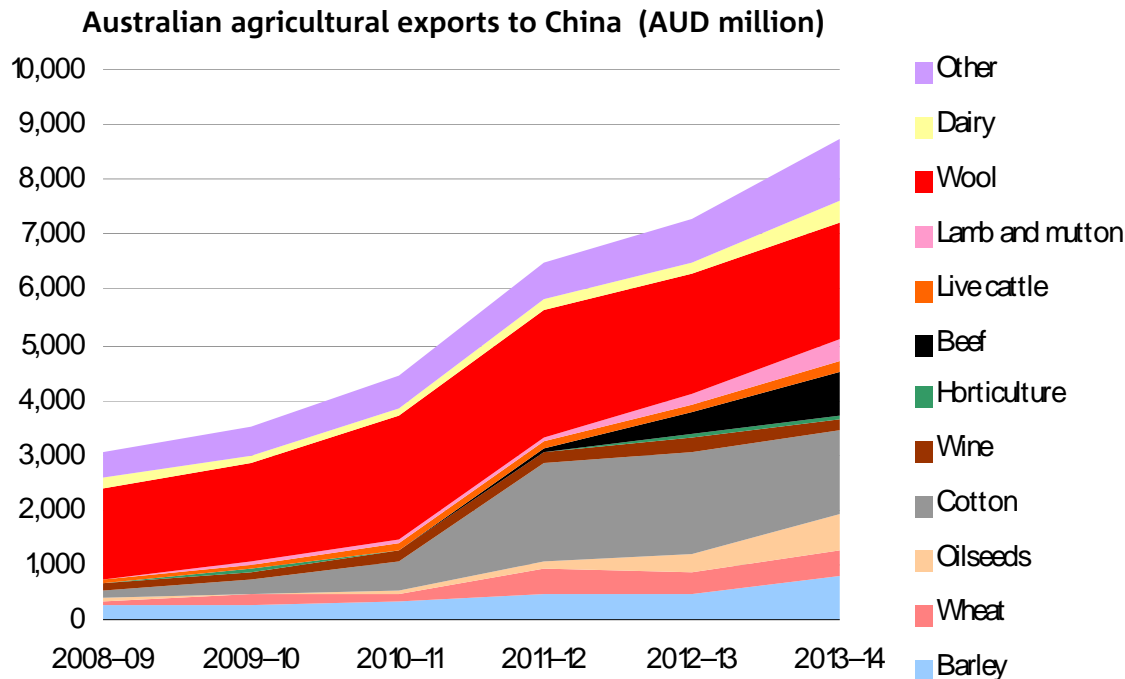


Source: ABARES



# Agriculture

- The FTA includes significant reductions Chinese tariffs applied to Australian imports. The FTA will reduce tariffs to zero over several years for Australian dairy, beef, live animals, lamb and mutton, wine, horticulture, barley, seafood, hides skins and leather as well as processed foods. The FTA also creates an Australia-only duty free quota for wool. There are no changes to tariffs or market access for Australian rice, wheat, cotton or sugar.
- China is Australia's largest agricultural export market, valued at AUD8.7 billion in 2013-14 –23% of Australia's total agricultural exports for the year. This is up from only 11% five years earlier.
- Australia's agricultural exports to China are dominated by fibres. Over 40% of the total export value in 2013-14 was fibres – wool, cotton and animal skins. Grains, in particular barley, wheat and oilseeds, are also important, as is beef.



## Chinese tariff reductions for Australian producers

Commodity	Current tariff	New tariff	Timeline
Dairy	12-25%	0%	4-11 years
Beef	12-25%	0%	9 years
Live animals	10%	0%	4 years
Lamb and mutton	12-23%	0%	8 years
Wine	14-20%	0%	4 years
Horticulture	Up to 30%	0%	4 years*
Barley	3%	0%	Immediately
Seafood	14-15%	0%	4 years
Hides, skins, etc.	5-14%	0%	2-7 years

Source: DFAT *\*for most products*

## Chinese WTO tariff rate quotas for Agricultural Commodities

Commodity	Quota (kt)	In quota tariff	Over quota tariff
Wheat	9636	1%	68%
Corn	7200	1%	50%
Rice (short/medium)	2660	1%	50%
Rice (long grain)	2660	1%	N/A
Cotton	894	1%	Variable
Sugar	1945	15%	50%
Wool	287	1%	38%
Wool tops	80	3%	38%

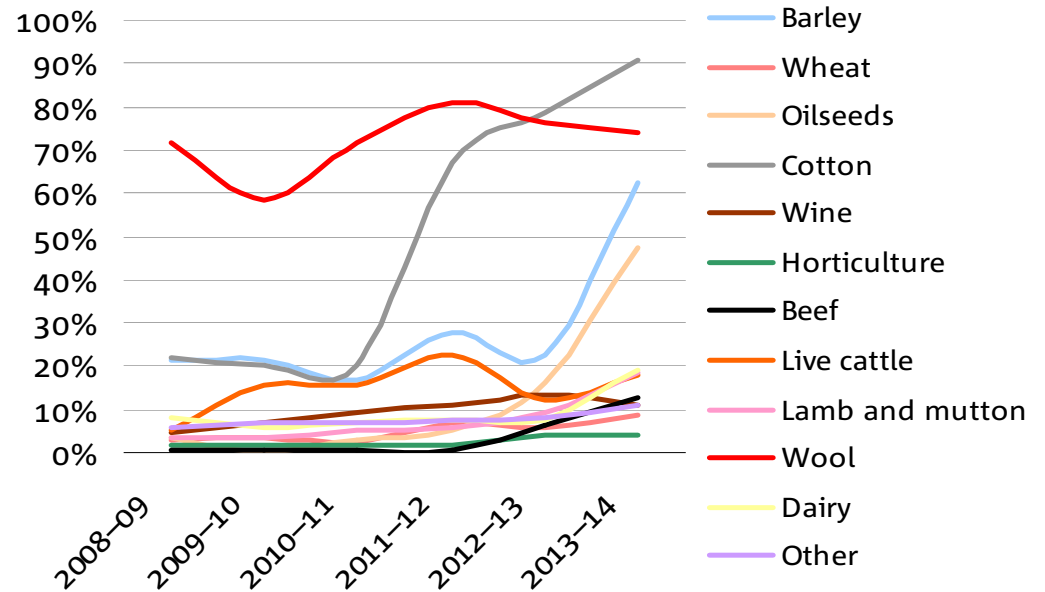
Source: USDA



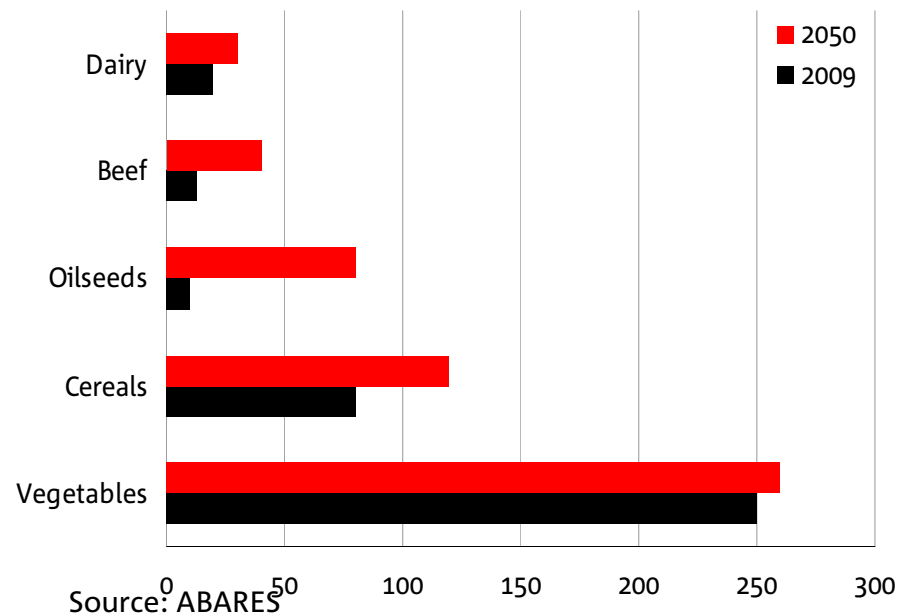
# Agriculture

- While reductions in tariffs for Australian, dairy, beef, lamb, wine and horticultural producers are welcome, these five sectors make up only 22% of agricultural exports to China.
- Agricultural sectors more heavily dependent on exports to China, such as wool and cotton, do not enjoy much more favourable treatment under this FTA, notwithstanding the Australia-only duty free quota for wool. Sectors increasingly dependent on China, such as oilseeds and barley, have mixed fortunes. While China's already low 3% tariff on Australian barley is cut to zero effective immediately, oilseeds do not enjoy improved tariff rates or market access.
- Forecasts by the USDA and ABARES highlight the extent of potential growth in Chinese food demand, flowing into greater imports. Between 2013 and 2023 the USDA predicts a virtual doubling in Chinese imports of cotton and beef, 60% rises in pork and oilseeds and 30% in barley. Wheat and sorghum imports are not expected to grow. ABARES modelling forecasts that between 2009 and 2050 Chinese imports of beef should rise 10 fold, fruit by 200%, dairy by 165%, sugar by 100% and cereals by 50%. Sheep and goat meat has the biggest predicted rise in imports between 2009 and 2050 – almost 20 fold.

Share of total Australian agricultural exports sent to China



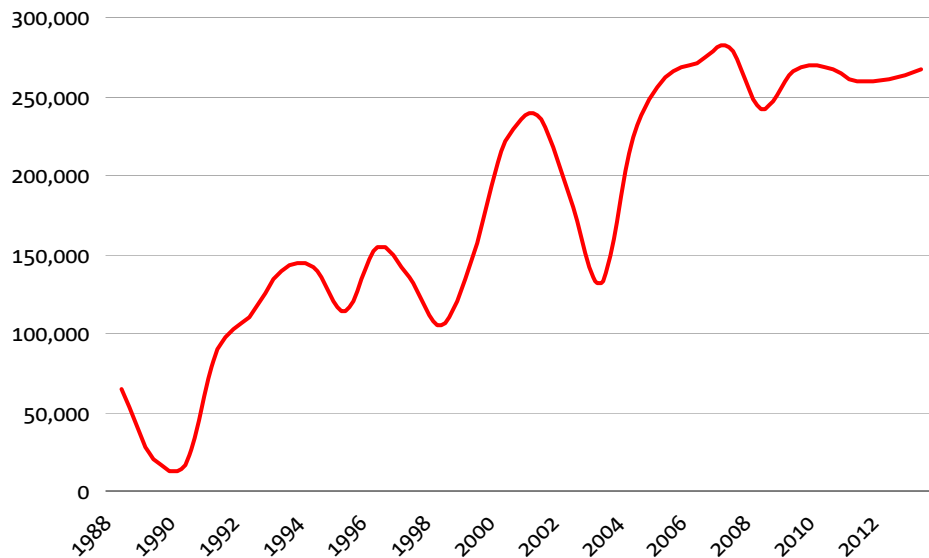
ABARES projected increase in Chinese food demand to 2050 (2009 USD billion)



# Agriculture – discretionary safeguards

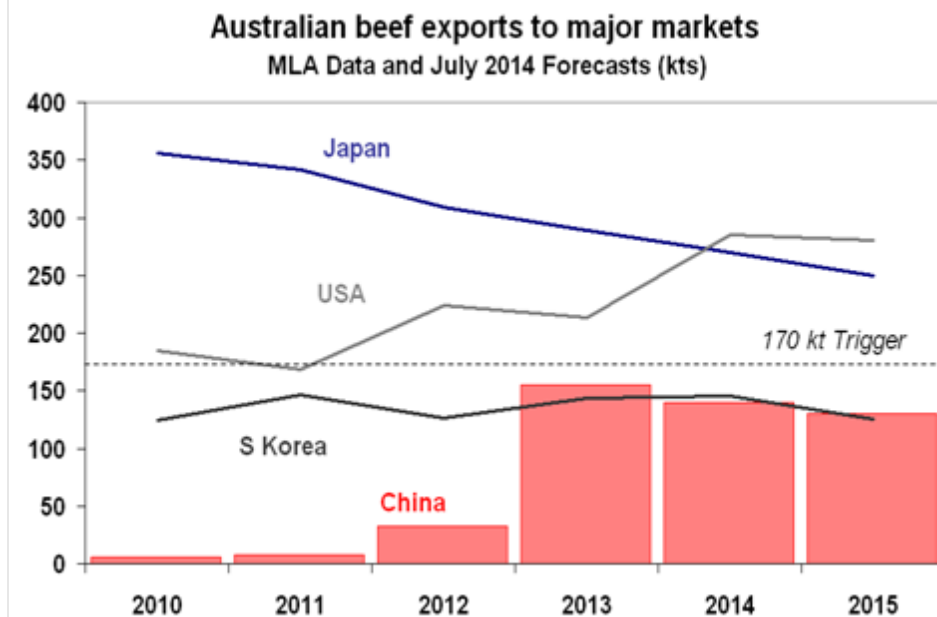
- This FTA is quite ‘clean’ in introducing few limits on the volume of agricultural imports that can be brought in duty free. Nevertheless China retains a few discretionary safeguards for beef and whole milk powder imports.
- The FTA imposes discretionary safeguards for Australian beef and whole milk powder above trigger points of 170,000 tonnes and an unpublished rate above current levels respectively. Australian beef exports to China stood at 154,294 tonnes in 2013, but have fallen in 2014. Nonetheless, the beef safeguard will allow China a trigger to impose tariffs should exports to China grow much beyond current levels.
- For wool, China already provides a WTO tariff rate quota of 287,000 tonnes, in which tariffs are 1%. The FTA will provide Australia with an additional quota of 30,000 tonnes (clean wool) that scales up over time. While China may impose a tariff of 38% beyond the 287,000 tonne quota, it generally declines to do so and the additional clean wool quota may not be used much.

Australian annual wool exports to China (tonnes)



Source: UN Comtrade Note: chart shows wool, not combed or carded

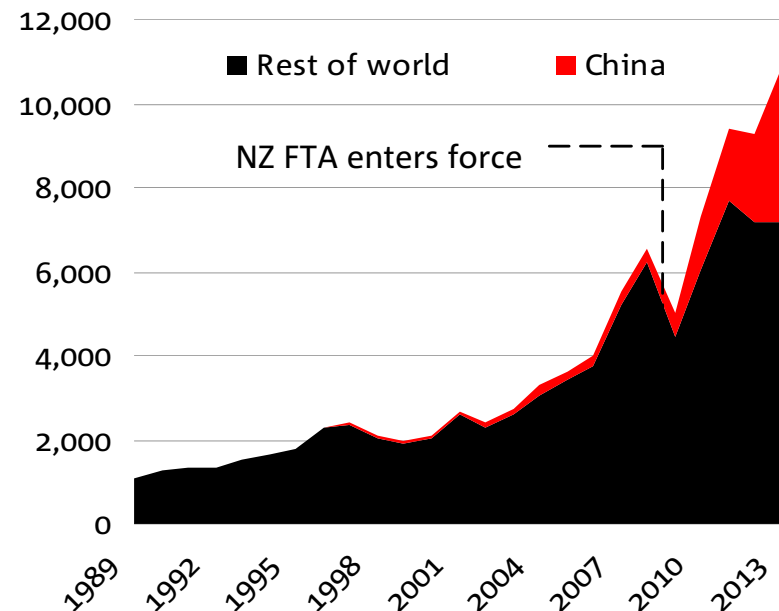
Australian beef exports



# Agriculture – dairy sector

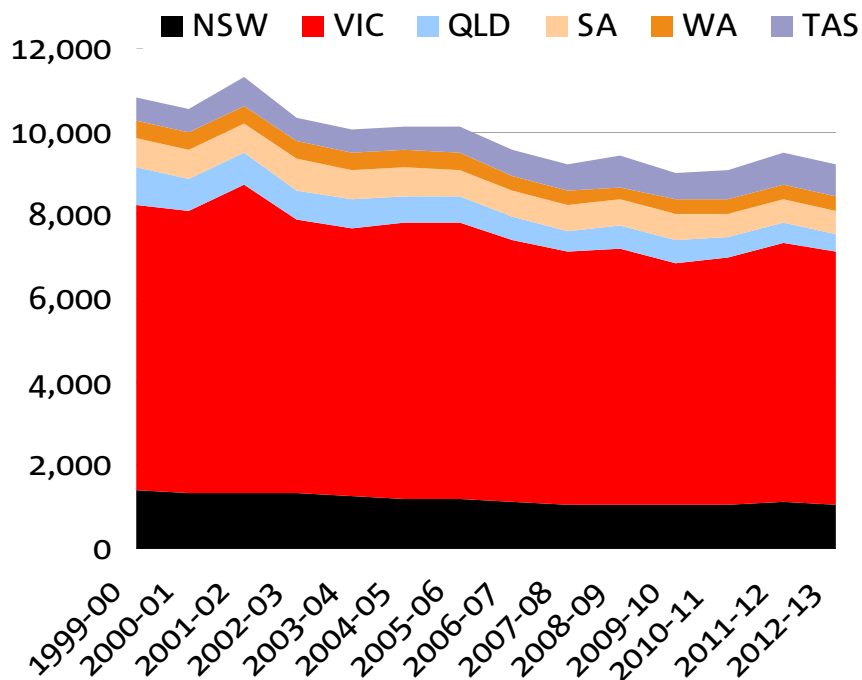
- The New Zealand-China FTA is often credited with boosting NZ's dairy exports since coming into force in October 2008. There has been a substantial increase in NZ dairy exports to China since 2008.
- Longer term trends for Australian dairy have been less favourable and characterised by industry consolidation and lower milk production. Total Australian milk production fell 15.2% between 1999-00 and 2012-13.
- To fully capitalise on the FTA, Australian dairy producers require further economies of scale in farming and investment in processing capacity, as well as strategies to mitigate the effects of future droughts.

## New Zealand dairy exports (USD million)



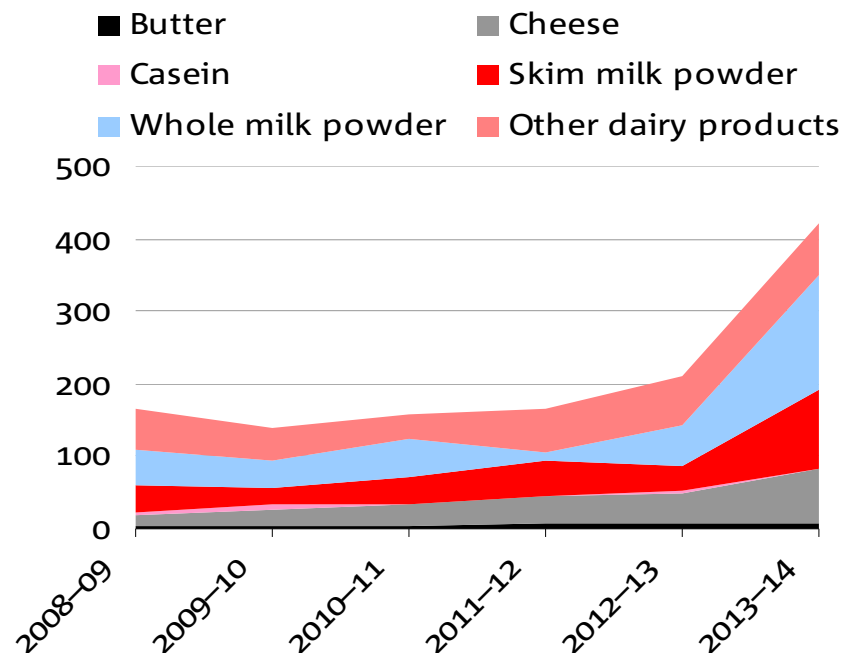
Source: UN Comtrade, NAB Group Economics

## Australian milk production (million litres per year)



Source: Dairy Australia

## Australian dairy exports to China by type (AUD million)



Source: ABARES, NAB Group Economics

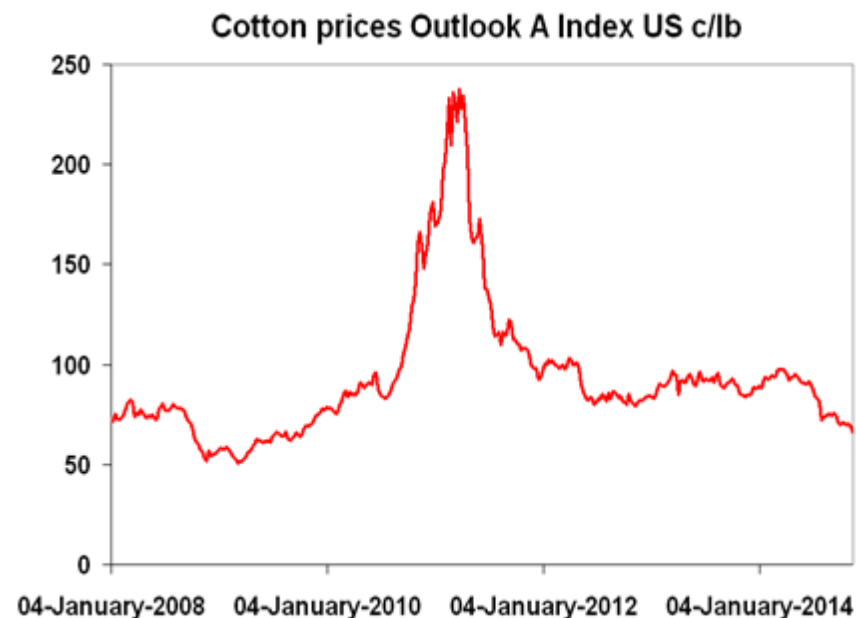
# Agriculture – cotton sector

- Cotton is one of Australia’s biggest agricultural export earners in China but the FTA delivered no improvement in market access. This reflected the sensitivity of the sector; China has already accumulated a very big stockpile of cotton because of industry support arrangements.
- This price support system entails over \$US5 billion in subsidies annually. The regime of minimum support acquisition prices and stock accumulation is to be replaced in 2014/15 by a direct subsidy to Xinjiang farmers.
- Facing this high cost policy that has created a big overhang of stocks, the Chinese will restrict cotton imports to the 894 kt specified in their WTO commitments, signalling zero allocation for the sliding scale discretionary quota that exceeds that amount and leaving importers of additional cotton facing a 40% tariff.
- This is not a favourable environment for Australian growers to get improved market access in China.

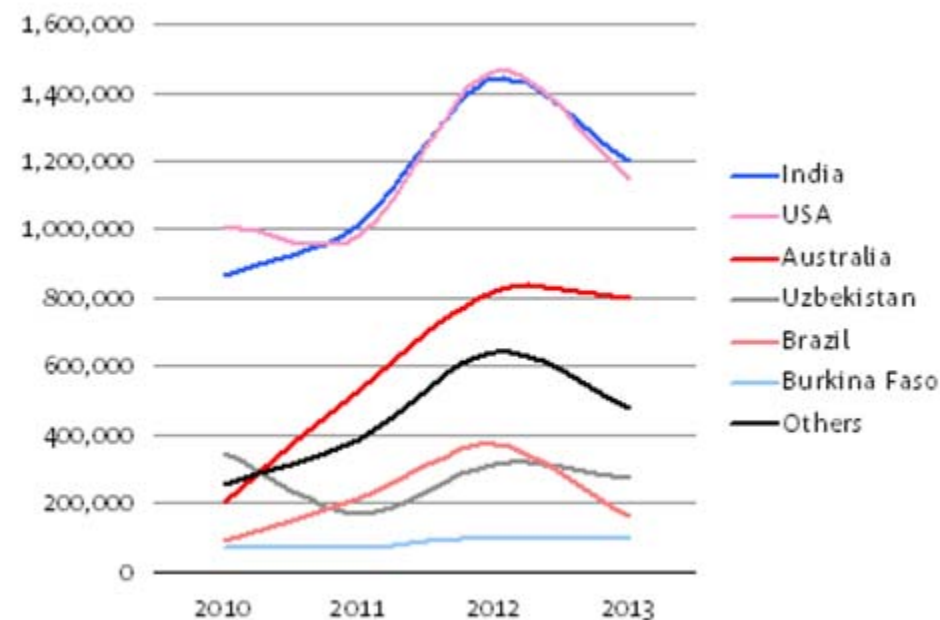
## Chinese cotton situation Million Bales (USDA)

	2012/13	2013/14	2014/15 (f)
Production	35	32.75	30
Consumption	36	34.5	37.5
Imports	20.3	14.12	7
Start stocks	<b>31.08</b>	<b>50.36</b>	<b>62.71</b>
End stocks	50.36	62.71	62.16

## World cotton prices



## China’s cotton imports by source (tonnes)



Source: UN Comtrade, NAB Group Economics

# Resources & Energy

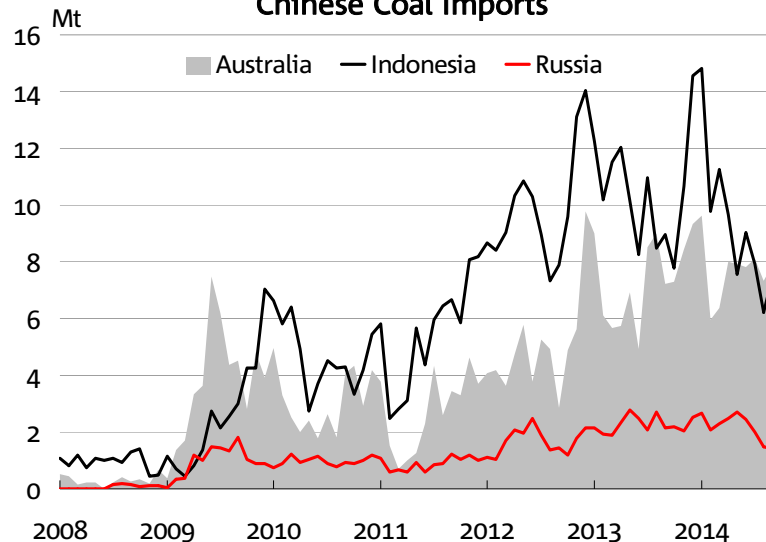
- The FTA includes the removal of tariffs on resource and energy products (e.g. coal) and transformed resource & energy products (refined metals).
- The most significant of these relate to tariffs on coal exports – Australia’s second largest export behind iron ore. A 3% tariff on coking coal is to be removed immediately, while the 6% tariff on thermal coal will be phased out over 2 years.
- The impact of China’s coal tariffs is not easy to see in the export data since they were only reintroduced in October of this year (trade data are only available to September). The tariffs affect Australia and Russia (China’s 2<sup>nd</sup> and 3<sup>rd</sup> largest coal sources) disproportionately as Indonesia (China’s largest source of coal imports) was already exempt under an FTA between China and ASEAN.
- Australian coal producers face a softening demand environment in China, so the removal of these (short-lived) tariffs will help to buffer some of the weakness. However, this is more true for Australian coking coal producers which tend to have a production cost advantage. Australian thermal coal on the other hand tends to be further up the cost curve and will continue to face difficulties with competitiveness regardless.

## Sample of tariff reductions for minerals

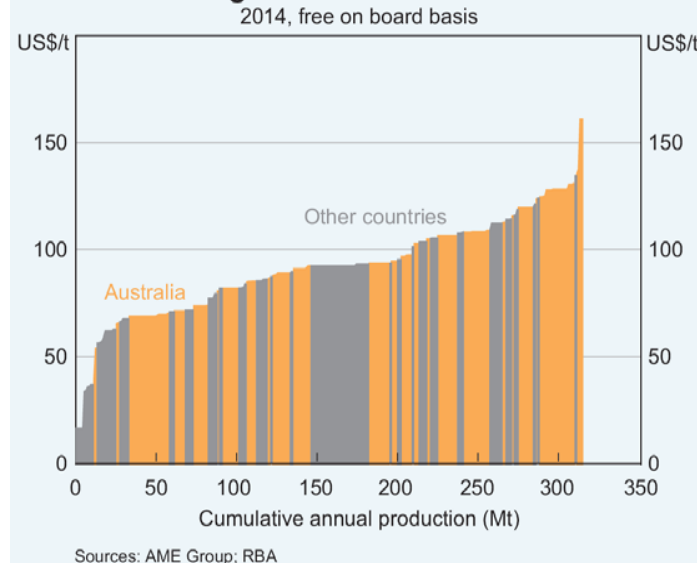
Commodity	Current tariff	New tariff	Timeline	% of Min. exp.
Coking coal	3%	0%	Immediately	12%
Thermal coal	6%	0%	<2 years	8½%
Refined copper & alloy	1% & 2%	0%	Immediately	4½%
Aluminium	5% & 7%	0%	Immediately	3%
Alumina	8%	0%	Immediately	2%
Nickels	3%	0%	Immediately	<2%
Zinc	3%	0%	Immediately	<2%

Source: DFAT; BREE

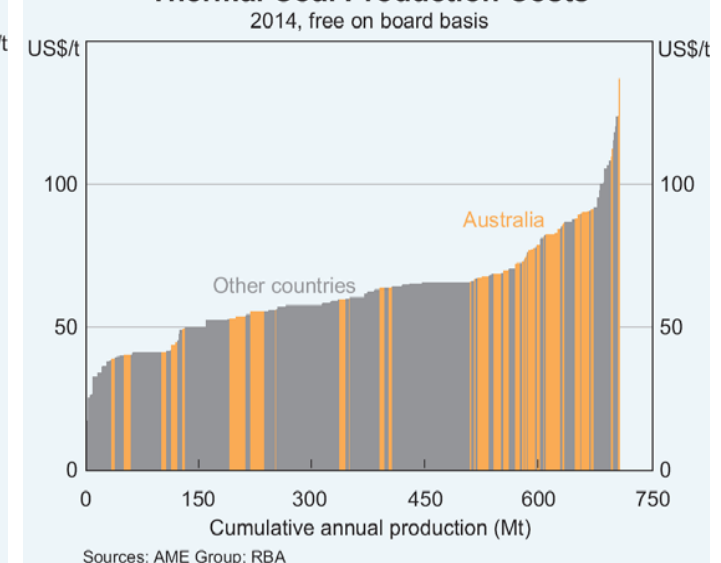
### Chinese Coal Imports



### Coking Coal Production Costs



### Thermal Coal Production Costs



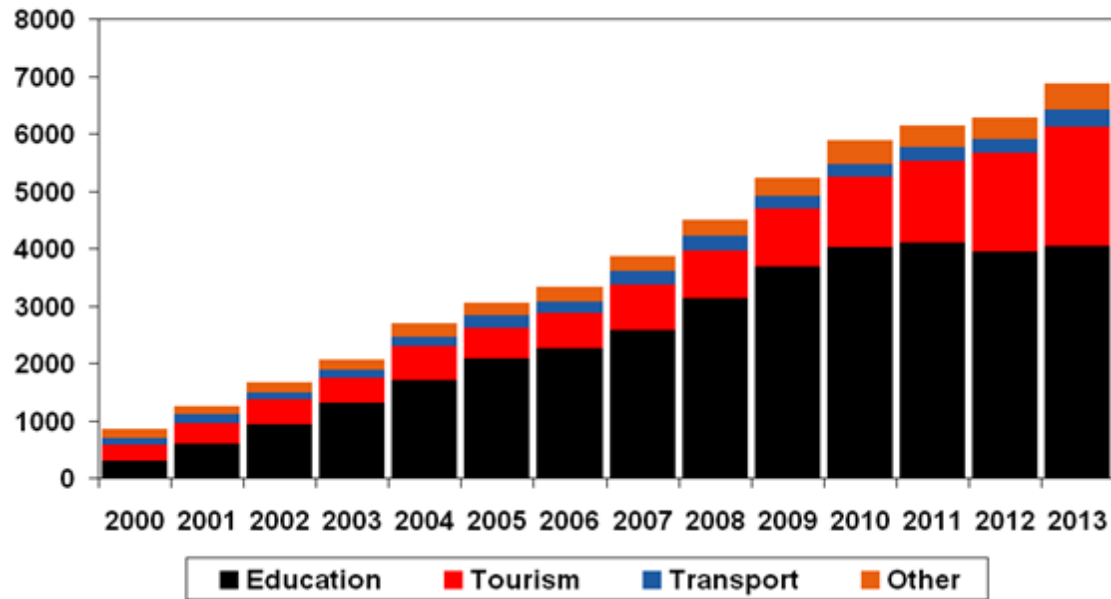
# Trade liberalised across many areas of services

Market access for many Australian service providers could improve significantly

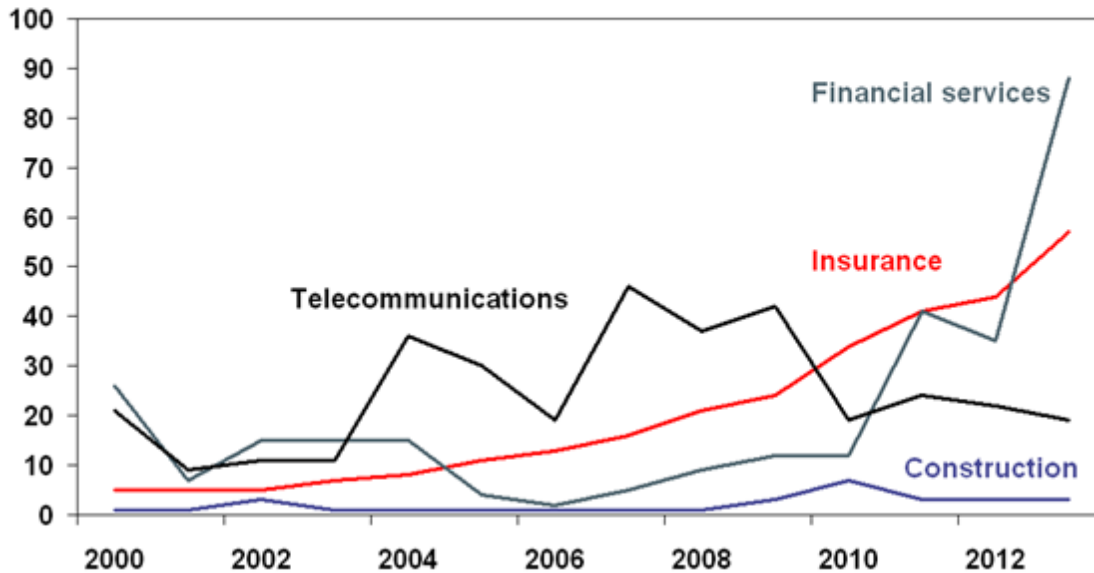
Industry	Proposed liberalisation
Medical services	can establish wholly owned hospitals and aged care facilities – opportunity for firms like Ramsay Health Care
Law firms	allowed to link in with Chinese law firms in Shanghai Free Trade Zone “without restrictions on where clients may be located”
Telecom firms	guaranteed new market access to specific telecom services in Shanghai Free Trade Zone
Banks	More liberal access through shorter waiting times, streamlined approvals for pre-existing Australian banks and removal of minimum working capital requirements for Australian branches operating as subsidiaries in China
Fund managers	able to invest offshore RMB in Chinese onshore financial assets under the RQFII program (50 Billion RMB initial quota)
Insurers	allowed to access China’s statutory 3rd party car insurance market
Currency traders	Official RMB clearing bank to be established in Sydney, giving a more direct way for cross-border RMB transactions than was available before (already announced)

# Services exports – dominated by education and tourism

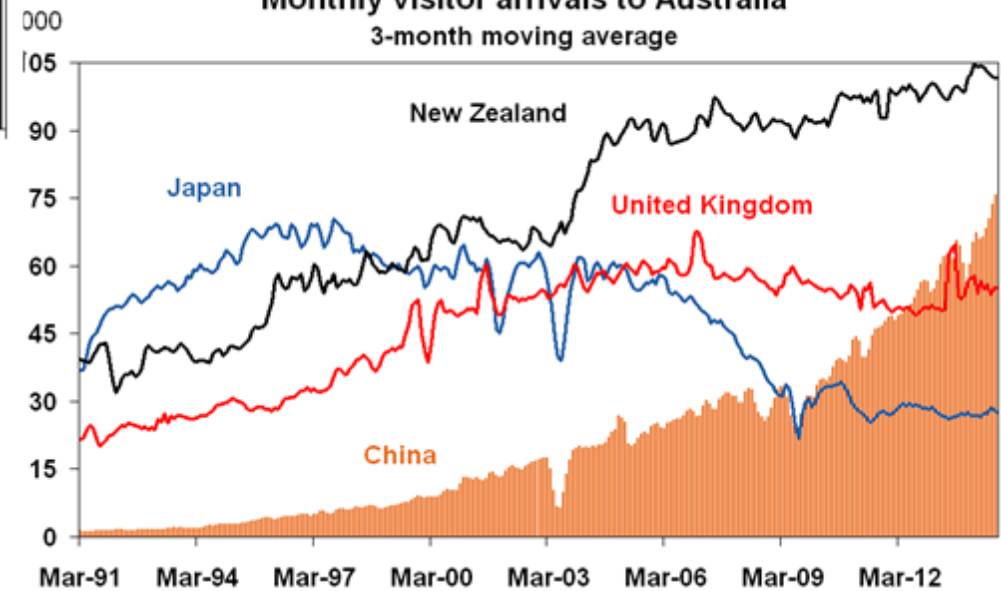
Australian Services Exports to China \$ Million



Australian Business Services Exports to China Selected Sectors Annual \$ Million



Monthly visitor arrivals to Australia 3-month moving average

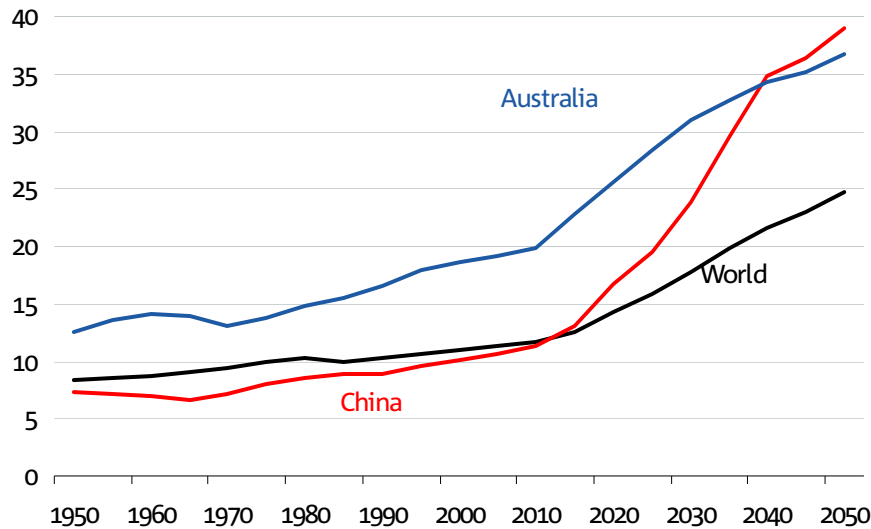




# Healthcare

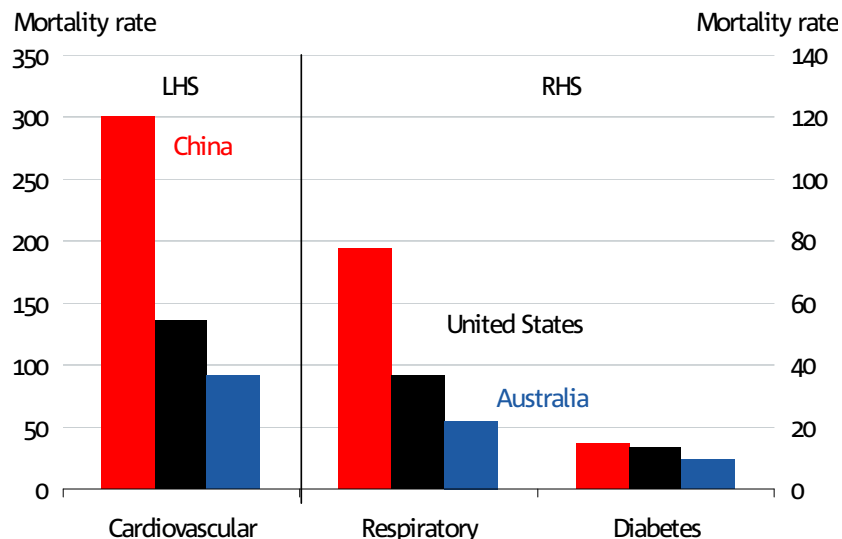
## China's ageing population a driver of health demand

% (ratio of older age to working age population)



Source: UN population database, NAB Economics

## Higher mortality rates from non-communicable diseases

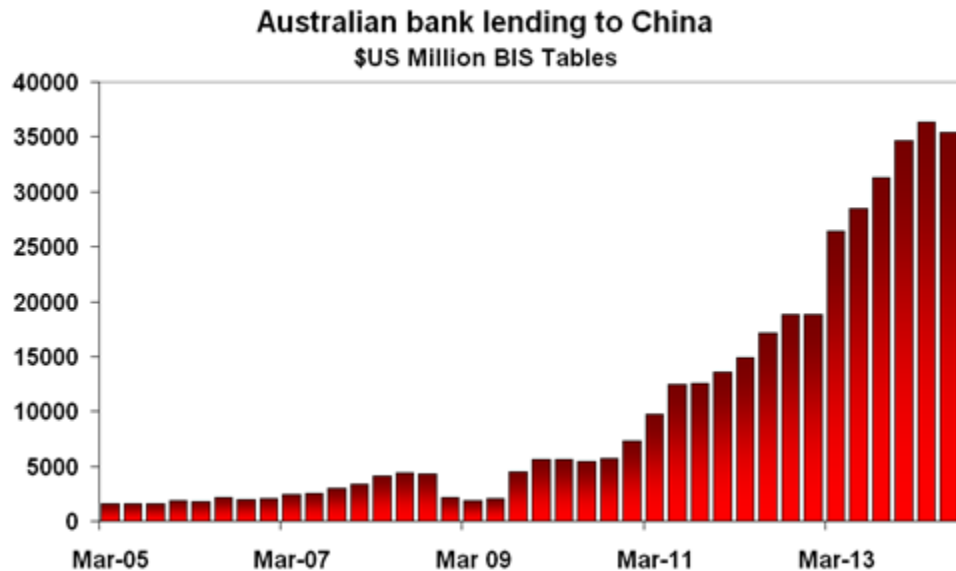


Age standardised deaths per 100 000 of population  
Source: World Health Organisation, NAB Economics

- **China's population is ageing and life expectancy is rising** - demand for healthcare is set to increase in coming years.
- **Current private hospital system** - Mostly joint-ventures with domestic investors, and tends to serve foreign workers and high wealth Chinese – comparatively high costs are not covered by basic medical insurance schemes.
- **Recent changes** - In August, China's government announced it will allow overseas-owned private hospitals to open in major developed cities. Aim is to encourage the development of high-end medical services and encourage public hospitals to lift standards.
- **Challenges remain, and must be overcome for wider growth** – High cost could remain a constraint on the sector
- In most cities, China's doctors require permission from state-owned hospitals in order to practice in the private sector – many public hospitals are reluctant to let their better doctors go.
- In August, Beijing became the first municipality to allow doctors to work in multiple locations without permission from their public employer.
- **Impact of FTA** - China will allow Australian health service suppliers to establish wholly owned hospitals and aged care institutions in China.
- **Ramsay Health Care** has signed a memorandum of understanding to take a 50% share of Jinxin Group's healthcare assets in Chengdu (the fourth most populous city in mainland China (2010 census)).

# Finance

## Ramping up of bank lending to Chinese borrowers



## Australian finance sector earnings in China



## Banking

- Reduction in waiting time for Australian banks conducting RMB business from 3 to 1 year.
- Ending of 2-year profit-making requirement before banks can provide RMB services.
- Streamlined approval process for RMB business for additional branches of an already approved Australian bank already operating in China .
- Removal of RMB 100 million working capital needed by branches of Australian banks.

## Insurance

- Access to statutory third-party liability car insurance market.

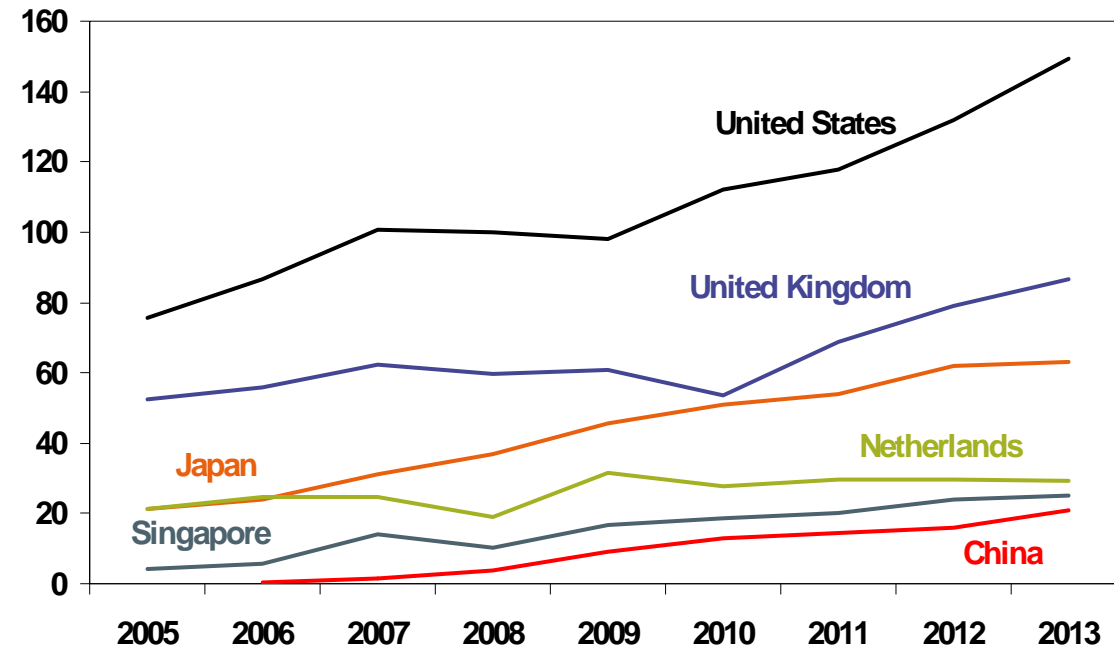
## Fund managers and securities firms

- Australian financial institutions allowed to invest offshore RMB in Chinese onshore financial assets (bonds, equity) under RQFII program.
- Australian securities firms benefit from increased foreign equity participation limits when underwriting Chinese domestic shares.
- Australian securities brokerage and advisory firms to provide cross-border securities trading accounts, custody, advice and portfolio management services to selected Chinese investors who are approved to invest offshore.

# Chinese Investment in Australia

- Chinese direct investment in Australia has been growing strongly in recent years, reaching around \$20 billion in 2013.
- Although this is still quite small relative to our biggest foreign investors in the United States and United Kingdom, China has been quickly closing the gap with countries such as Singapore and the Netherlands.
- According to the most recent data published by the FIRB (for 2012-13), most of China's direct investment is concentrated in the mining sector as well as property – which aligns with the dominance of resources in Australia's export mix to China.
- The main outcome for investment from the FTA is the raising of the threshold at which investments in non-sensitive sectors by private sector entities from China are considered by the Foreign Investment Review Board (FIRB) from \$248 million to \$1,078 million.

Direct Investment in Australia \$ billion  
ABS Data (stock)

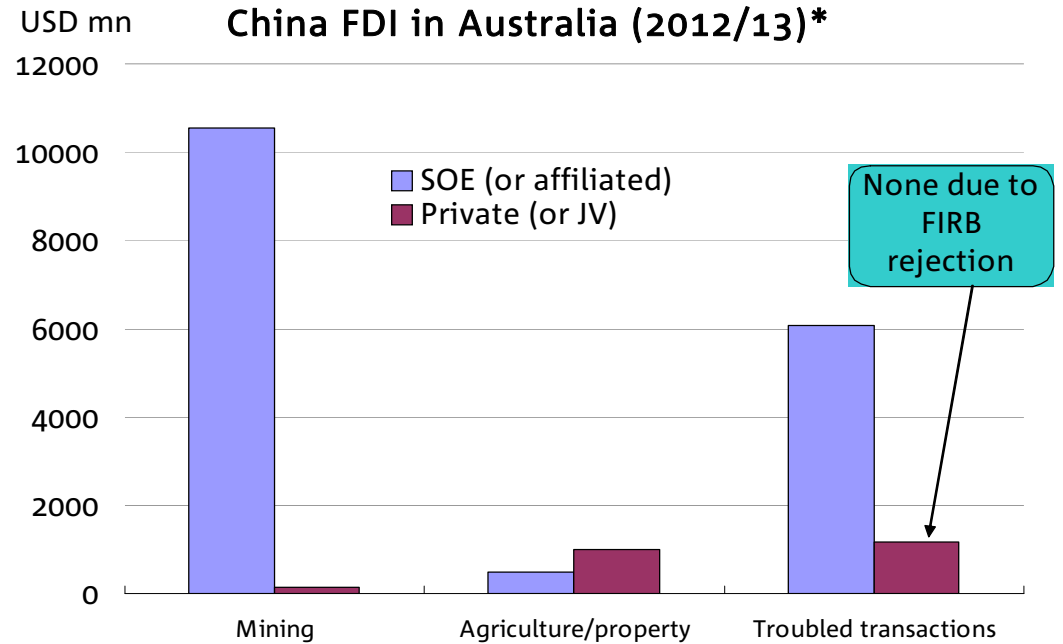


## Major countries investing in Australia 2012-13 (\$m)

Country	No. of approvals	Agri	Finance & insurance	Manuf.	Mining	Real Estate	Resource process	Services	Tourism	Total
USA	264	880	1,647	1,563	5,381	4,406	60	6,666	25	20,627
Switzerland	51	-	-	12	15,763	346	-	2,266	-	18,387
<b>China</b>	<b>6,102</b>	<b>328</b>	<b>23</b>	<b>957</b>	<b>8,273</b>	<b>5,932</b>	-	<b>291</b>	-	<b>15,803</b>
Canada	218	553	-	355	1,545	4,926	25	6,987	-	14,392
UK	1,197	-	159	494	3,198	1,671	-	1,318	-	6,849
Japan	111	-	129	-	2,906	895	-	654	-	4,589
<b>Total</b>	<b>13,421</b>	<b>2,858</b>	<b>2,924</b>	<b>6,509</b>	<b>45,142</b>	<b>51,907</b>	<b>422</b>	<b>25,909</b>	<b>25</b>	<b>135,699</b>

# More to be done on investment

- Most of the benefit should come from shorter planning times due to the reduction of 'red tape' – 80% of all foreign investment in Australia comes from arrangements valued more than \$100 million. Heritage Foundation data also suggests that the majority of Chinese investment projects in Australia are above US\$100 million.
- The FIRB has not been a major hurdle to (private) foreign investment. Only a small number of applications have been rejected since 2007 – despite some high profile exclusions based on national interest/national security grounds.
- The FTA does not appear to abolish the 'national interest test' and in fact re-enforces it for industries such as media, telecommunications and defence-related industries (as well as maintaining additional safeguards in agriculture). Most importantly, the FTA does not increase the threshold for SOEs.
- Third party data provided by The Heritage Foundation (which tracks Chinese foreign investments valued over US\$100 million) shows that in 2012/13 most Chinese investment in Australia was undertaken by SOEs (the bulk of which occurred in the mining sector).
- Only 3 proposed Chinese projects in Australia in 2012/13 did not proceed (only one involved a private Chinese investor) – the failure of the project was not a direct result of red tape.



\* Valued over \$100 million  
Source: Heritage Foundation; NAB Economics

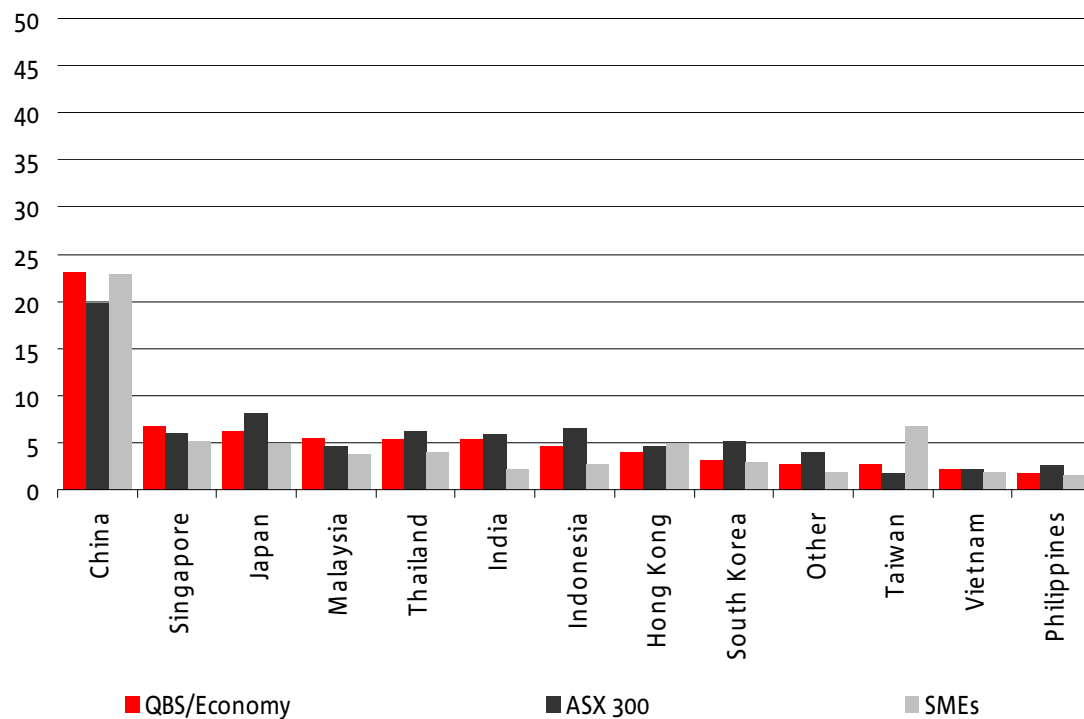
### Number of FIRB applications considered (all global investors)

	2008/09	2009/10	2010/11	2011/12	2012/13
Approved:					
Unconditional	2,266	2,672	4,606	4,900	5,535
Conditions	3,086	1,729	5,687	5,803	7,196
Rejected	3	3	43	13	-
Withdrawn	341	167	390	534	446
Exempt	125	132	139	170	145
Total	5,821	4,703	10,865	11,420	13,322

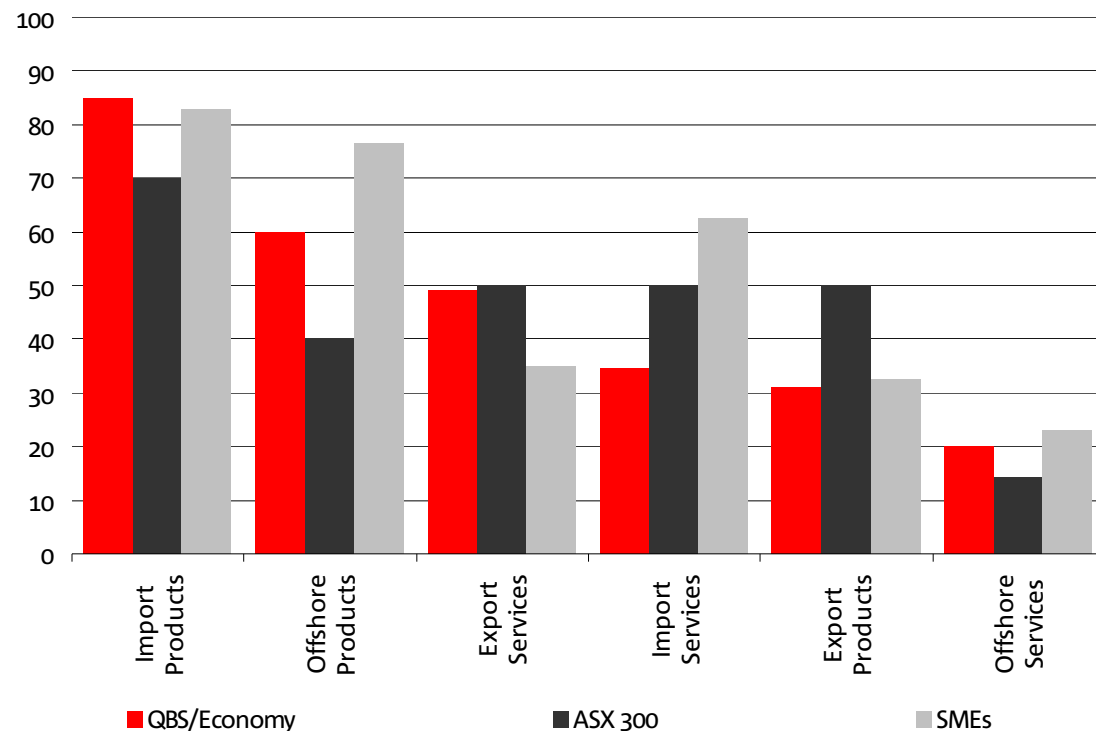
# Variation in Business Engagement with China across firm types

- The NAB Australia-Asia Business Engagement Index asks Australian businesses about their trade engagement. The index differs from other measures of trade by capturing engagement at the business level rather than at the output level and it looks at business overall (QBS) as well as small (SME) and large (ASX300) firms.
- Business engagement is clearly strongest with China (versus other economies) across all firm size ranges.
- The level of engagement also varies by business activity. For example, engagement with China is strongest in product imports followed by off-shoring of product. Consequently, although most of the attention has focussed on farm exporters, the largest single group of businesses impacted by the China FTA are firms bringing products into Australia.

Engagement by Country:  
Weighted by Type of Engagement



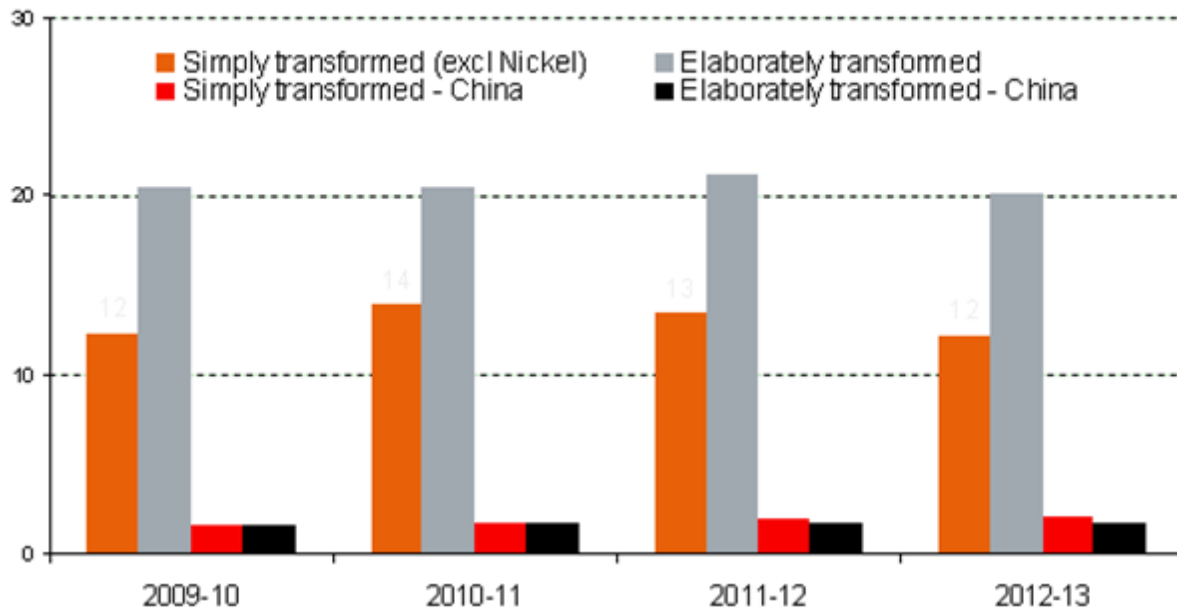
Business Engagement by Type - China



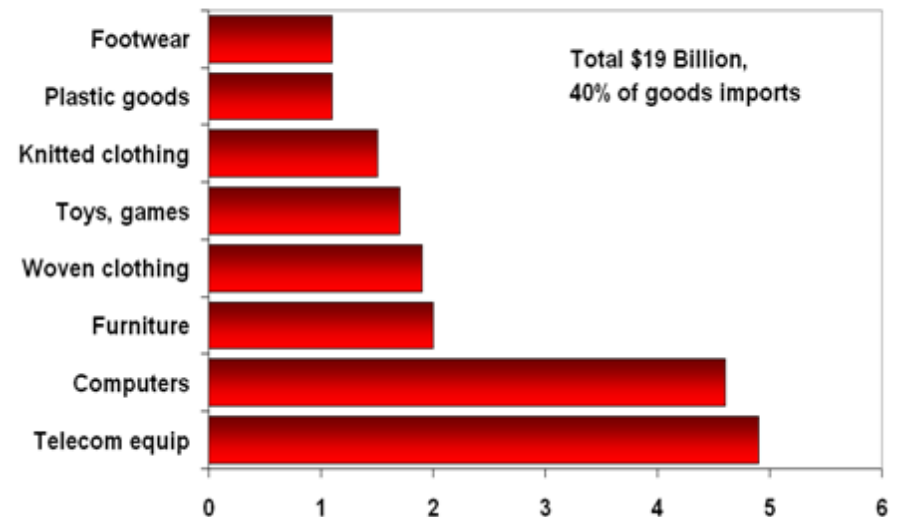
# Manufacturing to face more pressure

- Manufacturing output has been trending down as high cost domestic producers face rising competition from offshore competitors. China is a key supplier of low cost manufactured goods and Australian imports from China are dominated by a wide range of manufactured goods with light manufactured consumer articles like textiles clothing and footwear plus electronic and electrical goods featuring strongly. The high \$A has hit Australian manufactured exporters.
- The FTA contains provisions that cushion its impact on Australian manufacturers
  1. Trade remedies under the WTO such as Anti-dumping and Countervailing measures are still available
  2. The China FTA has an additional temporary safeguard measure in case an Australian industry faces “serious injury” due to a surge in imports following the tariff cuts it contains
  3. Although all Australian tariffs on manufactured imports from China will be removed, 2 to 4 year phase out periods are included for sensitive sectors like steel, aluminium, canned fruit, carpets, clothing and footwear. Industry lobby groups intend to explore just how extensive these phase out provisions are across sectors with the Government.

Australian manufacturing exports (A\$ billion)



Major import items from China 2013 \$A Billion



Source: DFAT.

STM: simply transformed manufactures; ETM: elaborately transformed manufactures

# Conclusion

- The FTA offers considerable potential for Australian agricultural and services firms as a result of their improved market access
- Market access being improved in sectors where growth outlook strong (protein demand, fresh fruit, services) as Chinese growth model re-balances toward consumption and with less focus on investment and less metal intensive activity
- FTAs usually involve winners and losers with Governments focusing attention on the former, we need to see the details to establish the balance more precisely
- Dairy, meat and horticulture stand to gain significantly but little is on offer to the wool and cotton industries that account for a large share of rural exports
- This FTA helps levels the playing field for market for Australian industries facing rival producers who already have FTAs (NZ dairy, Chilean horticulture)
- Lower tariffs are a big help in boosting market position of Australian exporters but other things also very important (eg lifting Victorian dairy output, good record on phytosanitary for horticulture exports from Sunraysia)
- Almost all resource exports will end up having duty free access but the tariff reductions on coal just ending new restrictions recently introduced
- Improved access for Australian services providers could end up delivering sizeable benefits eventually, although current trade flows are relatively small
- The FTA aims to lift inward investment by cutting red tape but key controls remain covering SOEs as well as ongoing national interest tests, special controls for sensitive sectors and the close screening of farm land and agri-business investment over threshold values



## Important information

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