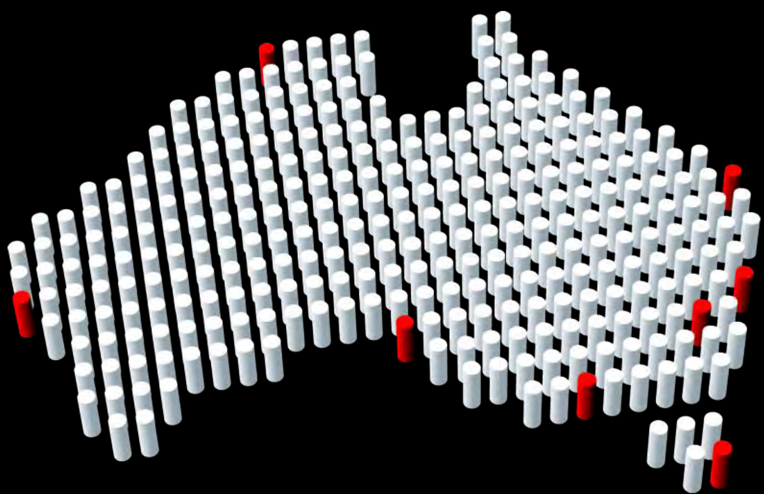
National Australia Bank

Australian States Handbook

August 2014



The material in this report was finalised on 20 August 2014

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A note from Peter

I am very pleased to introduce National Australia Bank's latest handbook on Australia's States.

Australia's Federal system of Government makes State Governments a critical part of the overall fiscal and economic performance of Australia.

State Governments are also significant issuers of debt in their own right. The most recent ABS data to March 2014 showed State Governments had outstanding bonds totalling $251bn – not far behind the Commonwealth Governments issuance of $340bn. State or Semi Government bonds have a broad range of owners with 29% owned by offshore investors, 42% by Authorised Deposit-taking institutions (ADIs) and the remainder by domestic investors.

Our handbook is intended to provide investors with a comprehensive update on both the economies and fiscal finances for each State – the last update was in August 2013.

The handbook is the work of our interest rate strategy and economic research teams.

The fiscal outlook comes from our Interest Rate Strategy team of Skye Masters and Rodrigo Catril and uses the recent State Budgets for 2014-15 as background – the Tasmanian 2014-15 Budget is due on 28 August.

The economic outlook has been expanded this year and comes from our economics team of Rob Brooker and James Glenn. Uniquely, Rob and James are able to leverage off NAB's proprietary survey data which, for example, allows a more granular look at business conditions within each State.

I am sure you will find the handbook both a useful reference tool as well as insightful when making investment decisions.

Best regards

Peter Jolly
Global Head of Research

20 August 2014

Contents

Overview

- Economic profile – The Australian economy has exhibited some positive trends outside of the mining sector over the past 12 months, particularly via strength in residential markets. While strength in residential construction is assisting growth and limiting additional deterioration in the labour market, the long anticipated challenges stemming from the end of the mining investment boom are still playing out. As a result, GDP growth for 2013-14 is forecast to remain below trend, at 2.9%, with weak business investment and softening consumption offsetting strong exports growth and improving building activity. Over the longer term, GDP growth will gradually lift towards trend, reaching 3.1% in 2014-15 and 3.2% in 2015-16. Modest growth in domestic demand will keep the labour market soft. The unemployment rate is expected to remain close to 6½% over the coming months – slightly above previous forecasts.
- Budget positions – improving but focus remains on reducing expenditure as Commonwealth terminates/modifies some payments to states. The Commonwealth has announced a White Paper on Reform of the Federation and White Paper on Tax Reform.
- Credit ratings are seen to be stable.
- Semi issuance – as budgets move into surplus demand on the market for funds is declining. This is happening at a time when demand from bank balance sheets is moderating.
- Semi bond performance – the big macro compression trade is all but complete. For now though the domestic backdrop does not point to catalyst for significantly wider spreads. Spread curves can flatten further.

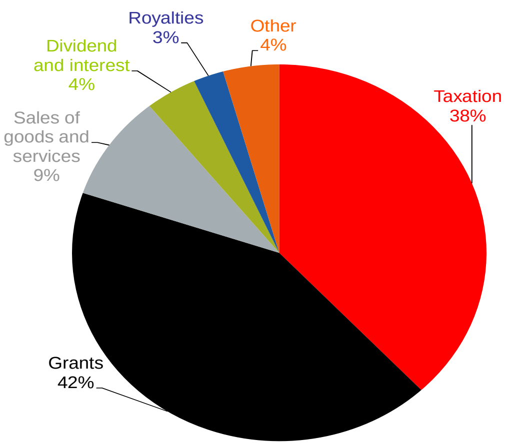
Economic profile of States

Economic growth across the states diverged significantly over much of the past decade, with the resource rich states outperforming significantly during this period. The divergence is now narrowing as growth in resource states slows in line with the completion of major mining investments projects. In contrast, growth in some other states has started to improve, driven by the strong performance in residential property markets and (to a lesser extent) better consumption, although the latter softened in Q2 2014. Low interest rates and an undersupply of housing has helped to drive these results and have encouraged a surge of residential construction approvals that should contribute notably to growth this year – particularly in NSW and Victoria. While there are very few signs of a broader improvement in other sectors, the RBA is expected to keep interest rates low for a while yet, giving these sectors more opportunity to recover. As a result of less mining investment, GSP growth in WA and Qld is expected to be slower this year and next, than in 2012-13 – growth in exports will be partly offsetting, implying even softer domestic demand. Growth in NSW and Victoria on the other hand will pick up due largely to stronger residential construction, although consumption and business investment will gradually start to improve as well. South Australia and Tasmania on the other hand are expected to continue to lag behind, constrained by an uncomfortably high AUD – that will hinder local industries – and less favourable residential market fundamentals.

Exhibit 1: State credit ratings and outlook

State	S&P	Moody's
NSW	AAA/Negative	Aaa/Stable
Vic	AAA/Stable	Aaa/Stable
Qld	AA+/Stable	Aa1/Negative
WA	AA+/Stable	Aaa/Negative
SA	AA/Stable	Aa1/Stable
Tas	AA+/Stable	Aa1/Negative
NT	-	Aa1/Negative
ACT	AAA/Stable	

Exhibit 2: NSW revenue breakdown

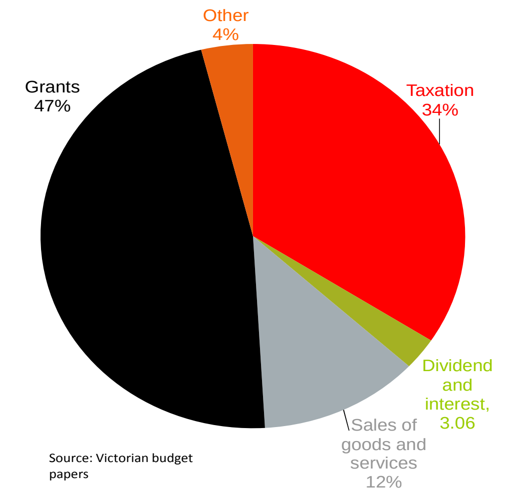


Source: NSW Budget

Exhibit 3: NAB growth and unemployment rate forecasts for the states

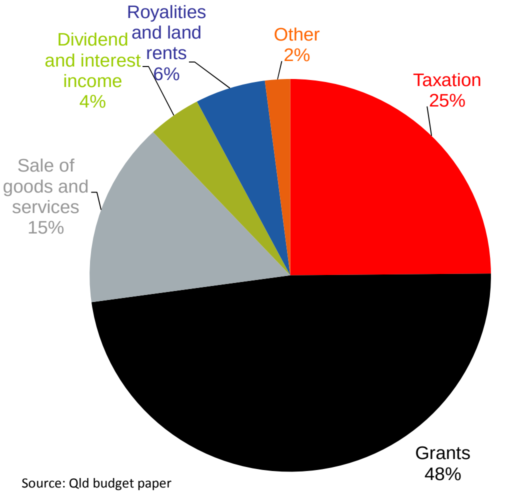
	Gross State Product YoY			Unemployment rate		
	13/14e	14/15f	15/16f	13/14e	14/15f	15/16f
NSW	2.9	3.3	2.6	5.7	5.7	5.4
Vic	2.0	2.8	2.7	6.2	6.4	6.0
Qld	3.0	3.5	5.6	6.0	6.8	6.8
SA	1.8	2.0	2.0	6.7	7.0	7.0
WA	3.8	3.5	2.8	4.8	5.8	6.0
Tas	1.8	1.8	1.0	7.7	8.0	8.4
Australia	2.9	3.1	3.2	5.8	6.4	6.2

Exhibit 4: Vic revenue breakdown



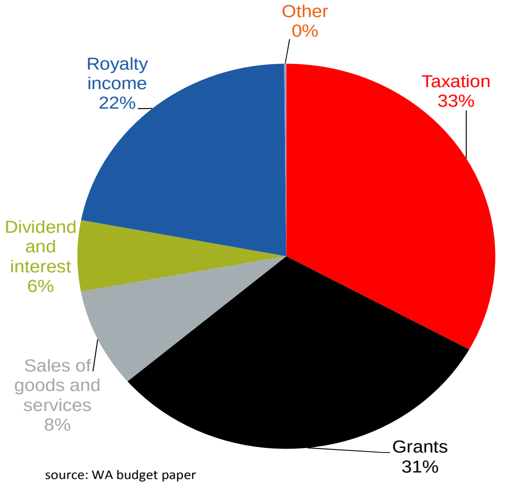
Source: Victorian budget papers

Exhibit 5: Qld revenue breakdown



Source: Qld budget paper

Exhibit 6: WA revenue breakdown



source: WA budget paper

State budgetary positions show good improvement for eastern states

To accurately compare each States budget position we use the Uniform Presentation Framework (UPF) and focus on the non-financial public sector. This covers both the general government sector (ie ‘core’ public administration and service delivery agencies funded largely by taxations and grants from the Commonwealth) and non-financial public enterprises. This allows for a more ‘like for like’ comparison and is consistent with S&P’s approach when evaluating the credit rating of the states and territories.

Based on current projections, all state budget positions (ex NSW) were in deficit in 2013-14. There was a significant turnaround in NSW’s budget position driven by an increase in revenue of AUD2.9bn from original estimates (predominantly driven by increased stamp duty and GST revenues as well as re-profiled and new grants from the Commonwealth). In the forward estimates, all states except for WA and ACT are forecast to be in surplus by 2017-18.

Surpluses are generally achieved via a combination of revenue and expenditure measures. However, revenue is also reliant on expectations for increases in consumer spending and property prices (contributing to land taxes), while mining states are anticipating a boost to revenue from increased commodity production in the out years. While the uncertainty behind these expectations varies, they all carry budgetary risks. For example, a significant share of state revenue is still heavily reliant on Commonwealth grants (see next page for more detail), limiting the control states have on revenue from taxes such as the GST (further exacerbated by economic uncertainties). The GST is collected by the Commonwealth and distributed entirely to the states via a complex formula intended to equalise their fiscal capacities. South Australia, Victoria and particularly WA are expected to receive a lower share of the GST over the forward estimates period. Further to this, tied grants have been staging something of a retreat lately. The 2014-15 Commonwealth Budget sees lower indexation arrangements for public hospital and schools payments and the cessation of a number of other payments. Finally, land taxes also make up a significant share of state revenue (eg. around half of Victoria’s own sourced tax revenue). However, these are susceptible to large fluctuations due to price and volume trends in property markets.

Exhibit 7: Operating balance - non financial public sector

AUDbn	2012-13	2013-14	2014-15f	2015-16f	2016-17f	2017-18f
NSW	1.0	1.9	0.1	1.5	3.3	3.3
Vic	-1.4	-0.5	0.7	5.4	2.3	2.5
SA	-1.3	-1.5	-0.7	0.2	0.6	0.8
Qld	-4.9	-2.2	0.3	3.3	3.8	3.4
Tas*	-0.1	-0.1	-0.1	-0.1	0.1	
WA	-0.4	-0.6	-0.3	-0.5	-0.5	-0.2
NT	-0.1	-0.1	0.1	0.1	0.1	0.1
ACT	-0.1	-0.3	-0.4	-0.2	-0.2	-0.1

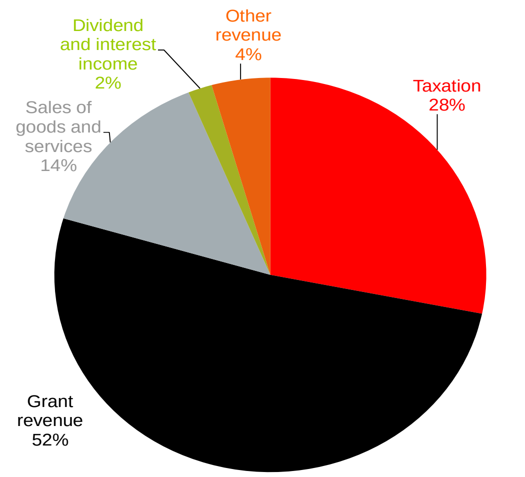
* estimates are from mid-year budget review for 2013-14

A focus for the larger states this year was asset sales to help fund proposed infrastructure projects. With close to half of state revenues coming from Commonwealth grants there was also a focus on reducing expenditure.

Credit rating

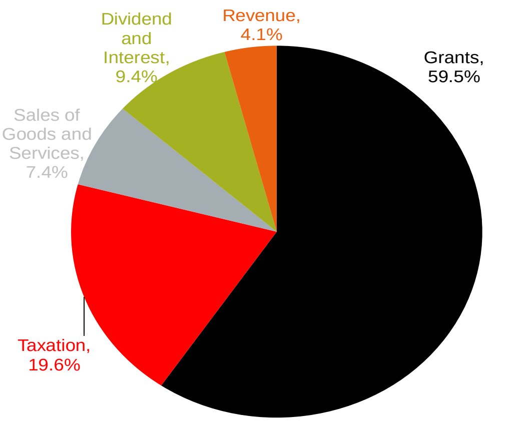
State credit ratings are seen to be stable. The only potential near-term move could be S&P returning NSW’s credit rating outlook to stable from negative but it is likely to want to see a successful asset sale process before this is done.

Exhibit 8: SA revenue breakdown



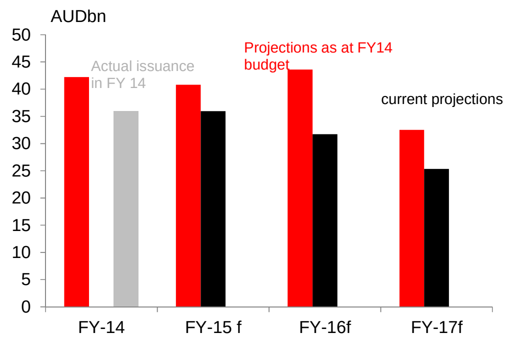
source: SA budget papers

Exhibit 9: Tasmanian revenue breakdown



Source: Tasmanian budget papers

Exhibit 10: Projected semi issuance



source: various state authorities

Commonwealth funding to the states

Commonwealth funding/grants make up a large proportion of state revenues. In 2014-15, commonwealth funding to the states is estimated to total AUD101.1bn (a AUD3.3bn increase from 2013-14). This comprises AUD46.3bn in payments for specific purposes while general revenue assistance is expected to total AUD54.9bn (of which GST payment is AUD53.7bn).

In terms of Commonwealth funding to the states the latest budget includes decisions to terminate or modify some payments to states that the Commonwealth Government sees as ineffective. For example, the Australian Government will amend funding arrangements for public hospitals (from 1 July 2017) and schools (from 1 January 2018) to generate savings across all states totalling over AUD80bn in the period to 2024-25. Alternatively the Australian Government is focused on 'improving infrastructure development and increasing job opportunities'. It has established an Infrastructure Growth Package worth AUD11.6bn – including AUD5bn Asset Recycling Initiative.

To overcome 'duplication and overlap' the Australian Government has announced that with the states and territories a White Paper on reform of the Federation will be produced. This will be co-ordinated with the White Paper on the Reform of Australia's Tax System. A Green Paper will be released in H1-15 and the White Paper will be delivered by end 2015.

The Federal Government is looking to limit commonwealth funding to the 'core national interest matters identified in section 51 of the Constitution'. Note that health and education do not fall within this. As to tax reform, the focus will be on 'addressing the issue of the state governments raising insufficient revenues from their own sources to finance their spending responsibilities' and the 'most appropriate approach to ensuring the horizontal fiscal equalisation does not result in individual jurisdictions being disadvantaged in terms of quality of services'.

Australia's tax system is seen to be unsustainable with Martin Parkinson (Department secretary of the Treasury) suggesting that there is an excessive reliance on direct tax (ie corporate and personal incomes). At the time of writing there remains uncertainty around the White Paper on Tax Reform and the Government's commitment to tax reform. Speculation amongst the market is that GST should be increased (currently at 10%) to potentially as high as 17% and/or a broadening the items subject to GST.

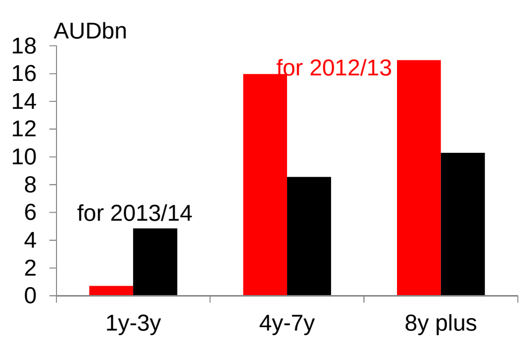
The GST is collected by the Commonwealth under a Commonwealth head of power and is distributed entirely to the states via a complex formula intended to equalise their fiscal capacities. This Horizontal Fiscal Equalisation is administered by the Commonwealth Grants Commission such that: *State Governments should receive funding from the pool of goods and services such that, after allowing for material factors affecting revenues and expenditures, each would have the fiscal capacity to provide services and the associated infrastructure at the same standard, if each made the same effort to raise revenue from its own source and operated at the same level of efficiency.* The methods used to derive recommended GST distribution are reviewed around every five years and between reviews the GST distribution is updated annually to reflect changes in the circumstances of the states and territories.

South Australia, Tasmania, the Australian Capital Territory, the Northern Territory and recently Queensland receive more than their population share of the GST, whereas New South Wales, Victoria and Western Australia receive less than their population share. Western Australia's share has fallen since the mining boom but is likely to stabilise near 0.36.

Forecast profile for semi-government issuance

For 2013-14, total semi issuance was AUD36bn (around AUD6bn below initial estimates). In line with the improvement in budget profiles, projected semi-government bond issuance in forward estimates is slightly lower than previous estimates (see Exhibit 10). In our view the bias will be for issuance intentions to be revised lower, particularly given the prospect of asset sales.

Exhibit 11: Maturity structure of semi issuance



Source: various state aithorities, NAB

Exhibit 12: Ownership of semi bonds

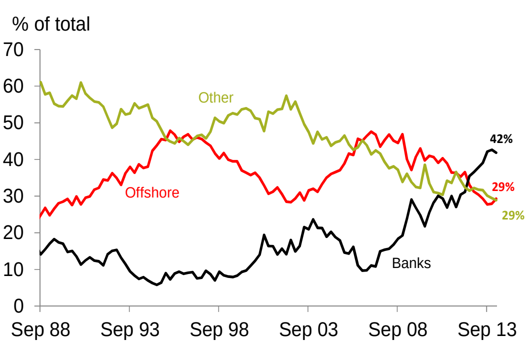
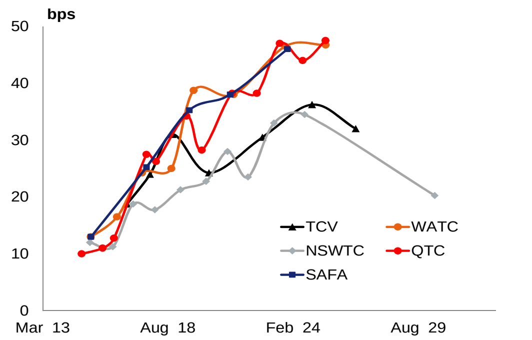
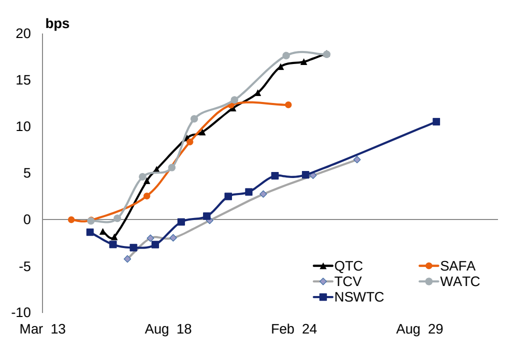


Exhibit 13: Semi to benchmark curves



Source: NAB

Exhibit 14: Semi ASM curves



Source: NAB

Total semi government bond issuance is expected to be around AUD36bn in 2014-15. While this is in line with issuance for 2013-14, new issuance is lower (at AUD16bn vs AUD21bn in 2013-14) and is expected to drop to a mere AUD5bn over the forward estimates.

Trends in semi-government issuance

Looking at the maturity profile of semi-issuance in 2013-14 there remained a clear preference to issue in the 5y plus part of the curve but compared with 2013-14 there was a little more issuance in the front of the curve. A key change last year in terms of semi issuance was an increased interest in floating rate notes with a total of AUD12bn issued. This issuance is being driven by client need but also investor demand as smaller bank balance sheets were eager to buy these bonds to meet Liquid Coverage Ratio (LCR) standards which come into play in Australia on 1st January 2015. The state of Victoria is the only issuer (amongst the larger states) to abstain from issuing FRNs. The biggest issuers of FRNs in 2013-14 were Queensland and Western Australia. Historically South Australia has been a relatively keen issuer of FRNs but due to regearing of SA Water this demand is expected to decline over the forward estimates.

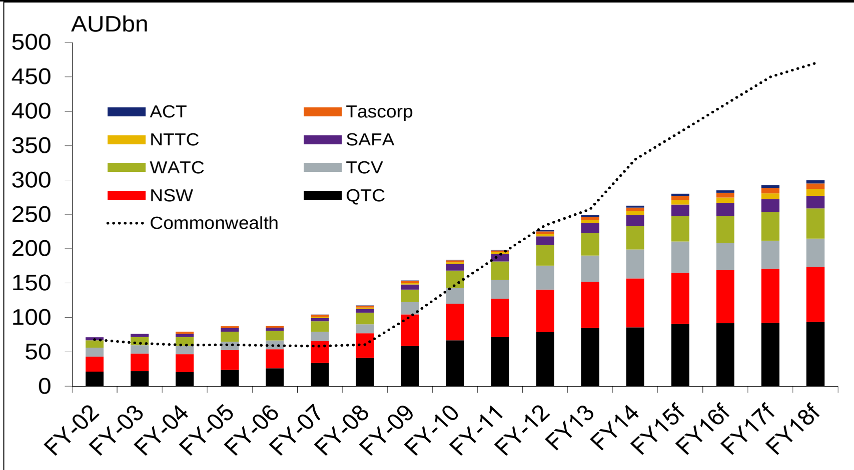
Ownership of semi-government bonds

Official data on holdings of semi-government bonds is lagged by around 3-4 months but latest data (for Q1-14) shows that offshore investors own 29% of semi-government bonds outstanding and Australian Banks hold 42%. As Exhibit 12 illustrates, the trend decline in offshore ownership as a proportion of total may be coming to an end while Bank ownership may be stabilising. We see Bank ownership settling at around 45% of total outstandings.

Growth in bonds outstanding

Total semi-government bond outstandings are forecast to increase to around AUD300bn by 2017-18, from AUD265bn currently. Note that in 2005-06 outstandings stood at a mere AUD88bn. As Exhibit 15 illustrates there is a clear divergence projected to develop between semi-government bonds outstandings and Commonwealth bonds outstandings. This is likely to have an influence on performance of semi bonds relative to bond and swap.

Exhibit 15: Commonwealth and semi-governemnt bonds outstanding

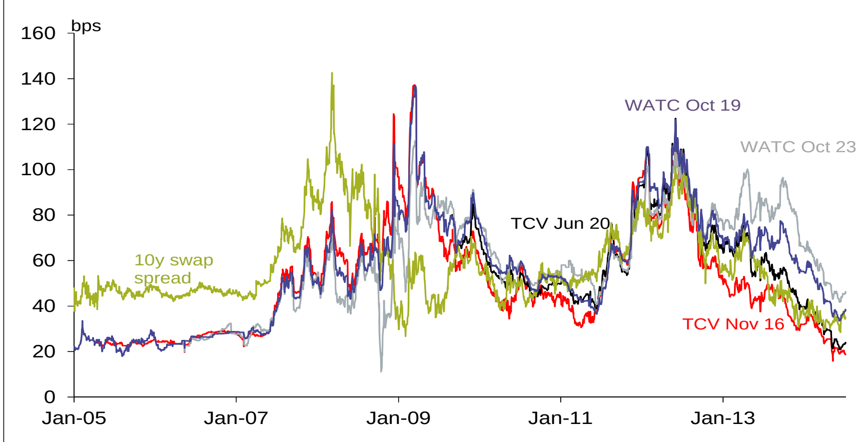


Source: AOFM, various state authorities and NAB

Performance of semi-government bonds

In the year to 30 June 2014 semi-government to benchmark spreads have narrowed by 20-60bps. The larger moves coming from longer dated maturity bonds and lower rated credit which reflects the improvement in risk appetite. While we see scope for some further out-performance in longer dated semi-government bonds, the big macro trade has already been seen. That being said, we see little reason for semi-government bond spreads to widen significantly in the near future. Note from Exhibit 16 the relationship between semi-government to benchmark spreads and swap spreads. As to the later, we see 10y swap spread trading in a range of 25-50bps over the next six months.

Exhibit 16: Semi to benchmark spreads vs swap spread



Source: Bloomberg, NAB

Against swap we would expect to see a flattening in the semi ASM curves. We are likely to see continued selling pressure (or lack of buying) from bank balance sheets when semis are flat to sub swap.

Looking at semi curves, zero coupon analysis shows that the spread between AAA and AA rated semi bonds has narrowed from close to 50bps two years ago to around 15bps currently. While spreads in shorter dated maturities can/will trade sub 10bps, for 10y AA rated semi bond, less than 10bps above AAA looks tight and offers little value. For now we see this spread trading in a range of 10-20bps.

Exhibit: 17 AAA vs AA rated semi spreads using zero coupon analysis

bps	3y	5y	10y
24 months ago	19	41	50
12 months ago	7	15	29
6 months ago	11	11	17
3 months ago	7	10	12
current	5	8	15

State of New South Wales

Capital city	Sydney
Government	Liberal-National coalition
Next election	March 2015
Rating and outlook	Moody' s Aaa/Stable S&P AAA/Negative
Website	www.nsw.gov.au

Overview

In recent years, Australia's largest state economy has lagged behind the pack in terms of growth as the mining rich states prospered from a once in a generation mining boom. However, the state is now starting to reap the rewards of its diverse economy, insulating it from the difficult structural changes that are starting to weigh on the mining states in particular. Low interest rates and strong population growth have been very supportive for the NSW economy, helping to drive a residential markets boom that is bolstering household wealth and the residential construction pipeline. Public infrastructure will lend support to the local economy in coming years, helping to soak up some of the capacity overhang from the end of the mining boom and offset conservative public spending elsewhere. NAB's forecast is for Gross State Product (GSP) to lift to above trend at around 3% in 2013-14 and 2014-15. This is consistent with forecasts provided in the 2014-15 state budget. Further out there is a risk that rising interest rates will weigh on NSW given its relative debt level.

Stronger state growth and an asset recycling strategy has resulted in an improvement in the state's budget position in 2013-14. Further expansion in the economy should support revenue growth while slower expenditure growth and further asset recycling will benefit the budget position in the forward estimates. A key factor which has the potential to constrain fiscal consolidation is the impending adjustments to state-commonwealth financing arrangements. NSW's AAA credit rating is seen to be sound but a move back to stable outlook is unlikely to be made this year given the uncertainty around the impact of changes to state-commonwealth financing and the proposed asset recycling.

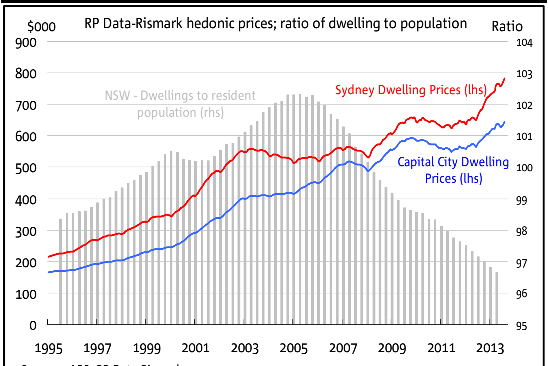
In line with the improved budget position, NSW Treasury Corporation's (Tcorp) demand on the market is reduced with new funding in 2014-15 estimated to be AUD 2.5bn (vs AUD3.5bn in 2013-14). New funding is forecast to decline to AUD1.9bn by 2017-18. While Tcorp bonds are a safe asset to hold (and should out-perform non AAA assets in any credit event induced widening) further performance against benchmark and swap (for now) is seen as limited.

Economic Profile

Residential property/dwelling investment to lead

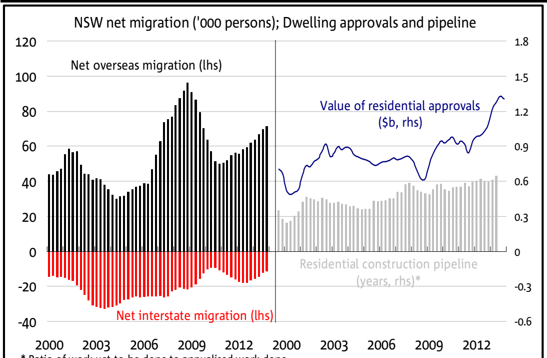
The main source of momentum in NSW is the emerging "residential construction boom", underpinned by the underinvestment in housing supply that has occurred over the past 5-10 years (Exhibit 18). Population growth in NSW has been incredibly strong, driven by overseas immigration, with interstate immigration actually in decline. New housing supply has failed to keep pace with this growth, demonstrated by the consistent decline in the ratio of dwellings per resident population, which has fallen to its lowest level in well over a decade. Consequently, house prices growth in Sydney has been the strongest of the capital cities, encouraging a flood of housing investment. Residential building approvals rose by about a third over 2013 and remained elevated during 2014 (the value of residential buildings approved in June was 8½% higher than a year earlier). These high levels are contributing to a hefty pipeline of residential construction work to be done, increasing about 40% over the past 2 years to about AUD9bn – or almost 2% of GSP. Given current rates of construction in NSW, this pipeline is enough to support construction activity for more than 8 months with no new projects approved (an unlikely negative outcome given the current momentum). NAB are forecasting Sydney residential property prices to rise further, albeit at a softer pace (6.1% over 2014 and 4.8% over 2015), helping to underpin solid residential construction activity ahead.

Exhibit 18: Residential property sector



Sources: ABS; RP Data-Rismark

Exhibit 19: Net migration + dwelling approvals



* Ratio of work-yet-to-be-done to annualised work done
Source: ABS; NAB

Exhibit 20: Retail spending and wages

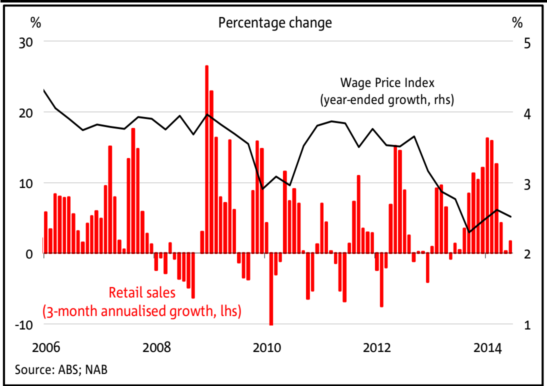


Exhibit 21: Non residential approvals

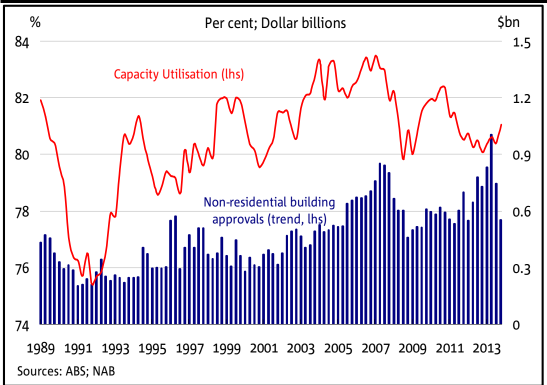


Exhibit 22: Public infrastucture spending

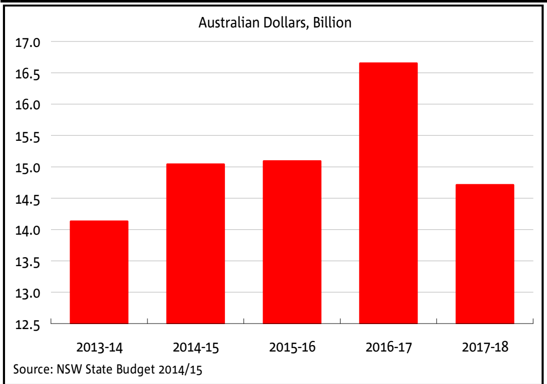
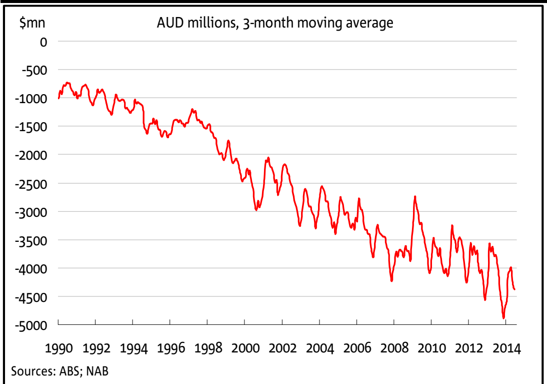


Exhibit 23: Net merchandise trade, smoothed



Consumers respond to rising wealth but headwinds remain

Higher asset prices over the past 12 months or so (particularly in real estate) helped to drive solid rates of consumption in NSW over 2013, despite ongoing deterioration in the labour market (the unemployment rate in NSW peaked at 5.9% in late 2013). According to the state accounts, household final consumption rose 3.5% over the year to March quarter 2014, its fastest pace since early 2011 and its third fastest pace post-GFC. This outcome also occurred despite wages growth in NSW (as measured by the Wage Price Index) easing last year to its lowest rate in at least a decade – picking up only modestly in early 2014.

However, with some of the heat starting to come out of the property market and wages growth remaining soft, consumers have again started to pull back on spending; retail spending declined for two of the past three months. However, much of the recent slowdown could be a reflection of a sharp deterioration in consumer confidence that followed the Federal government's 'tough' budget in May. How persistent the budget impact on consumer behaviour is likely to be is unclear, especially given the political situation at the moment. Putting that issue aside, NAB economics forecast labour markets to remain soft nationally as the labour intensive mining boom winds down and workers return to non-mining states in search of employment. Although the residential construction sector will help to soak up the employment overhang (assisted by public infrastructure investments in later years), the unemployment rate is forecast to stay above 5½% (worse than the state treasury forecast of 5¼-5½%).

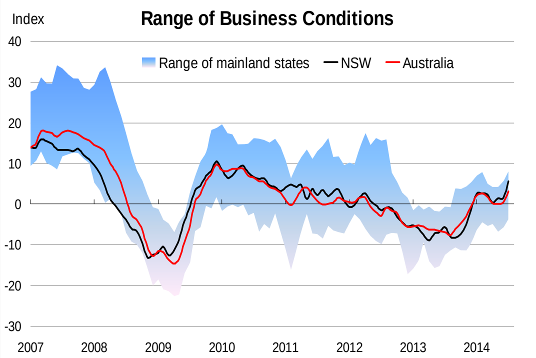
Investment and net trade are taking a back seat

Privatisation of public assets has helped to inflate private investment growth over the past 12 months, with underlying business investment (excluding second hand asset sales) remaining relatively weak due to plentiful spare capacity, sharp declines in mining investment and sluggish domestic demand. Annual average growth in private investment in the year to March quarter 2014 was 6%, as opposed to an underlying decline of 2½%. There were, however, some positive signs in the March quarter, with non-residential building construction lifting notably, and machinery and equipment investment rising as well. Nevertheless, non-residential building approvals in NSW have dropped notably from recent highs, and capacity utilisation rates remain low as well (Exhibit 21). These trends suggest a slow rebalancing of business investment away from the mining sector and toward the non-mining sectors – something that has been suggested by the ABS Capital Expenditure Survey.

Finally, despite a general push towards fiscal consolidation across the Australian public sector, underlying public investment has picked up in recent quarters to be about 14% higher over the year – but still below previous peaks. The state budget anticipates some AUD61.5bn to be spent on public infrastructure projects over 4 years (AUD25bn earmarked for road and rail projects), which is a little less than 3% of GSP. The main boost to growth from this spending is to come in 2014-15 and 2016-17 (growing 6.4% and 10.3% respectively), but will decline from 2017-18. However, the overall impact on the economy from public demand is expected to be neutral as infrastructure spending is offset by other cost saving measures.

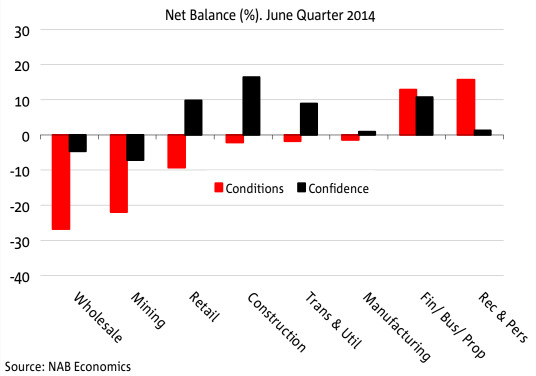
The export sector has provided little to no impetus to growth in NSW for some time now and this trend is unlikely to change significantly in the near term. Manufacturing exports have been in decline, while rural exports have been affected by drought. Fewer capital imports by the mining sector and some assistance from an anticipated depreciation of the AUD (forecast to drop close to USD 0.80 by end 2015) will provide some assistance to the state's exporting industries, but is unlikely to significantly reverse the trend. Net exports have consistently detracted from NSW GSP growth, largely due to a heavy reliance on goods imports. Timely data on merchandise trade suggest that the trade deficit may have improved going into 2014, but much of this is likely to have been seasonal (Exhibit 23).

Exhibit 24: Conditions up but sub trend



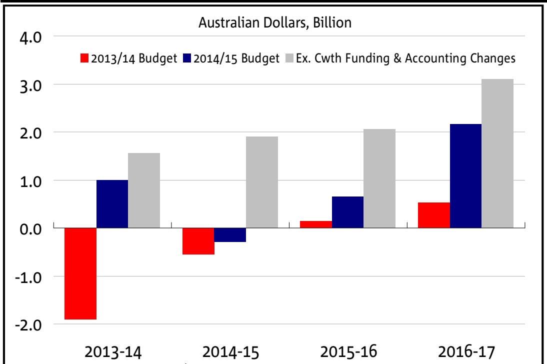
Source: NAB Economics

Exhibit 25: Conditions/confidence by industry



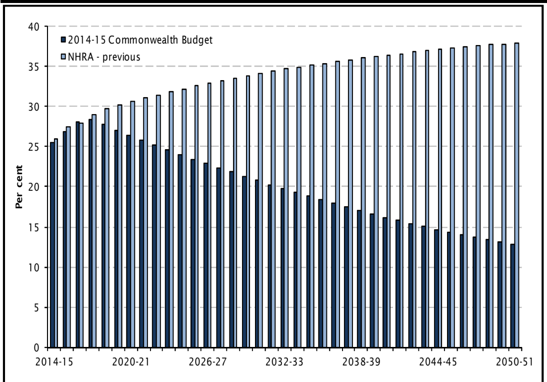
Source: NAB Economics

Exhibit 26: Budget to support AAA rating



Source: NSW State Budget 2014/15

Exhibit 27: Commonwealth health funding



NAB Survey

Results from the NAB Business Survey generally support the notion that the NSW economy is heading into a construction (and consumer) led recovery, despite firm's responses on actual activity remaining relatively subdued – especially outside of the service sectors. Nevertheless, the business conditions index (a summary of trading conditions, profitability and employment) has lifted from last year and has remained in mildly positive territory this year and is also above the national average.

However, some of the leading indicators from the business survey are mixed for the NSW economy. Forward orders continue to be very soft, having been negative for four of the last five months. The wholesale sector – often considered a bellwether industry for the broader economy – is also showing very weak conditions and soft confidence levels (see Exhibit 25). In contrast, confidence levels reported by firms in NSW have been relatively positive, holding above long-run average levels since the Federal election last year (although confidence in NSW is only fourth highest among the mainland states). Capacity utilisation is holding up reasonably well at 80.5%, but this is below the long run average. Nevertheless, firm's capital expenditure has started to lift, partly supported by slightly better borrowing conditions facing business.

By industry, business conditions are generally looking best in the services industries, which are particularly prominent industries in NSW. Nevertheless, in spite of soft conditions, retail and construction firms in NSW are becoming more confident (see Exhibit 25) – a trend that is even more apparent in the more timely monthly survey. This is consistent with expectations for a construction led recovery in the state.

State budget and finances

Budget position

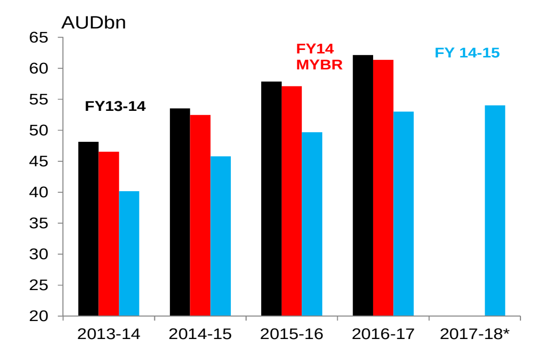
Stronger state growth combined with an asset recycling strategy has assisted the state government's bottom line. The Budget balance for 2013-14 is expected to come in at a AUD988mn surplus, much better than the AUD1.89bn dollar deficit given at the time of the 2013-14 Budget (Exhibit 26). Strength in the housing market and private consumption both contributed to better than expected tax revenues, and with the NSW Treasury forecasting a further pick-up in the NSW economy, reasonably solid revenue growth is expected to persist. In combination with slower expenditure growth and an asset recycling program (that will reduce the financial burden of increased infrastructure spending, but only in the short term), the budget surplus is expected to grow to almost AUD1.7bn by 2016-17.

The 2014-15 state budget pledges to "effectively manage" expenditure growth over the forecast period, with average nominal expenditure growth to slow to 3.4% in the years to 2017-18 from close to 5% in 2012-13.

In terms of funding, asset sales contribute around AUD2.5bn to the state infrastructure program, the Commonwealth contribution will be AUD8.8bn, while Public Trading Enterprises will contribute AUD17.3bn.

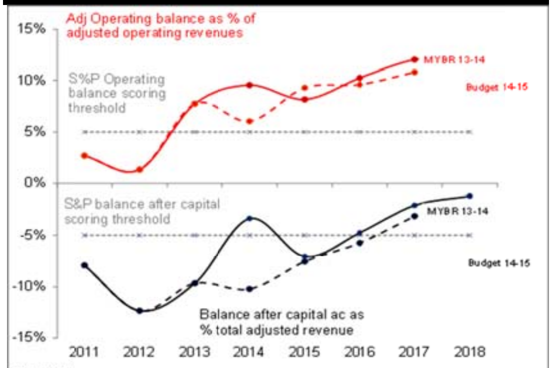
A factor constraining the state's fiscal consolidation is the impending adjustments to state-commonwealth financing arrangements, which will have a fairly significant impact on budget balances over the forward estimates. Unsurprisingly, the state budget makes special note of concerns over Commonwealth changes to health and education funding. For health alone, the Budget estimates the loss of funding to be around 1.3% of GSP by 2015, with Commonwealth funding growth to fall from 7.2% to 4% per annum, although most of these changes do not impact until after the budget projection period (Exhibit 27). In the near term however, changes to financing arrangements (and accounting standards) are having a significant impact on budget balances (Exhibit 26, blue and grey bars).

Exhibit 28: NFPS net debt levels



Source: NSW State Budgets

Exhibit 29: Budget performance



Government Debt levels

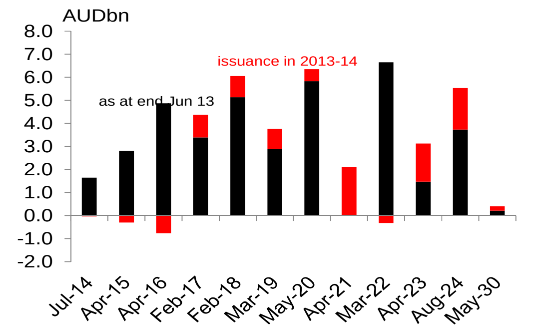
The improvement in the fiscal position of the state means that net debt is now lower. At an estimated AUD40bn for 2013-14 net debt is some AUD7bn below estimates provided at the mid-year budget review.
The estimates in the 2014-15 Budget do not include any proceeds from potential asset sales or leasing's which are contingent on the government wining a new mandate in next year's election. The completion of these could potentially release as much as AUD20bn in new funds.

Credit Rating

While S&P has acknowledged an improvement in NSW's budget it still sees downside risk to the state's operating position, driven by weak budgetary performance and debt burden. Credit risks are seen to come from the Commonwealth cuts to health and education funding (which have the potential to exert long term budget pressures on the state) and the implementation of NSW's sizable capital programme. While the 2014-15 budget shows a small improvement on NSW budget performance, S&P remains concerned about NSW's ability to sustain these improvements over the forecast period.

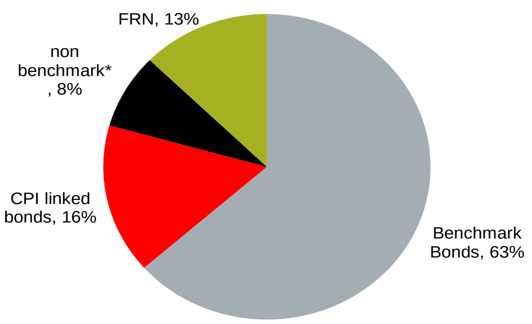
Bloomberg ticker	NSWTC
Website	www.tcorp.nsw.gov.au

Exhibit 30: Benchmark bond issuance in FY14



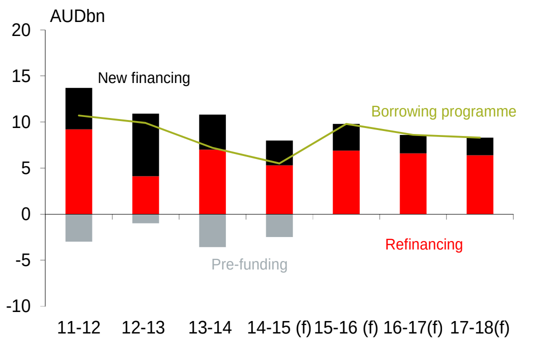
Source: NSWTcorp, NAB

Exhibit 31: Issuance profile for FY15



Source: NSWTcorp FY15 funding programme

Exhibit 32: NSW funding programme



Source: NSWTcorp

New South Wales Treasury Corporation

Function

New South Wales Treasury Corporation (known as Tcorp) is the central financing authority for the state of New South Wales (NSW). A core function of Tcorp is the provision of financing to the NSW Government Sector and all NSW Government Agencies. Tcorp issues bonds in both domestic and offshore markets, although the majority of bonds are issued domestically.

Debt Outstanding

Tcorp's funding policy is to: i) match the duration of borrowing clients loans – medium dated issuance dominates as steep curve is reducing longer dated issuance; ii) maintain liquidity through large benchmark lines; and iii) diversity of funding – index linked and FRN.

Total debt outstanding (which includes domestic bonds, linkers, global, EMTN and ECP) is currently around AUD69.2bn (face value) with benchmark bonds at AUD52.5bn. Outstandings are expected to grow to just under AUD80bn by 2017-18. The majority of borrowings are funded through benchmark bond lines which currently account for around 76% of total borrowings.

Tcorp took up the Commonwealth Government guarantee of state debt in 2009. The Commonwealth ceased offering the guarantee at the end of 2010 and Tcorp is transitioning away from the scheme (currently there are AUD4.798bn outstanding).

Tcorp clients

Tcorp's biggest clients are the crown and both the electricity and water sectors. The electricity sector borrowings are currently at AUD22bn with the majority of borrowings coming from Ausgrid and Endeavour.

Ownerships of Tcorp bonds

Tcorp estimates that Australian Banks are their largest bond holders at 39% of total outstandings. Central Banks and Australian investment managers are the next largest holders at 18% and 17% respectively. Japanese investment managers are estimated to own 11% while offshore investment managers (ex Japan) own 15%.

Liquid Assets

Tcorp currently has AUD12.9bn of liquid assets. These are held for prudential requirements to fund upcoming client requirements and to prefund maturities.

Issuance

Two months into the current financial year Tcorp has revised down its funding requirements for 2014-15, following the announcement of the sale of Macquarie Generation. Total funding has been revised from AUD6.3bn to AUD5.5bn with Tcorp having already issued around AUD1.1bn of this. The majority of the funding is expected to come from term funding. Tcorp is likely to issue a new FRN and nominal bond line in 2014-15. As for linkers, Tcorp will cease commitment to quarterly tenders. Under the new regulatory requirements utility clients are reviewing debt benchmarks. Tcorp will update their inflation needs once this is complete.

View

While Tcorp bonds are a safe asset to hold (and should out-perform non AAA assets in any credit induced widening) further performance against benchmark is seen as limited. Over time we could see continued out-performance relative to swap but for now bank balance sheet domination in the semi sector will limit performance as buying subsides, when bonds are sub swap.

Capital city	Melbourne
Government	Liberal-National coalition
Next election	November 2014
Rating and outlook	Moody' s Aaa/Stable S&P AAA/Stable
Website	www.vic.gov.au

State of Victoria

Overview

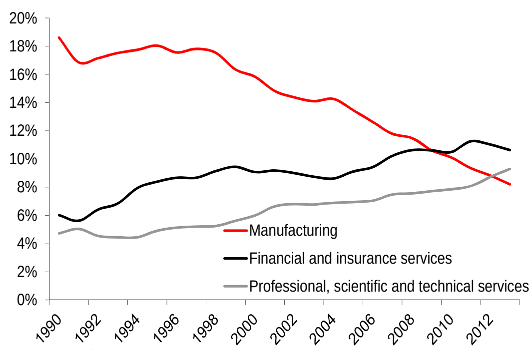
Victoria is Australia's second most populous state and likewise has the nation's second largest economy. Victoria's economy is relatively diversified, with manufacturing declining and services increasing over recent decades.

The Victorian economy has generally performed below the national average since the mid-2000s, as strong growth in mining in Western Australia and Queensland began to drive Australian GDP growth. Nonetheless, Victorian economic growth has remained in positive territory, although sub-trend growth persists. Unemployment has been increasing since 2011 and now stands at 6.6% (trend) and 7% (seasonally adjusted) – the third highest in Australia.

Victoria holds a AAA credit rating with a stable outlook. In the 2014-15 Budget the Victorian Government forecasts budget surpluses over the forward estimates. Short term risks to Victoria's fiscal position include a withdrawal of Commonwealth payments and a dependence on volatile transfer based taxes. The Victorian Government has recently committed to constructing a number of large infrastructure projects, although construction is not slated to begin for some time.

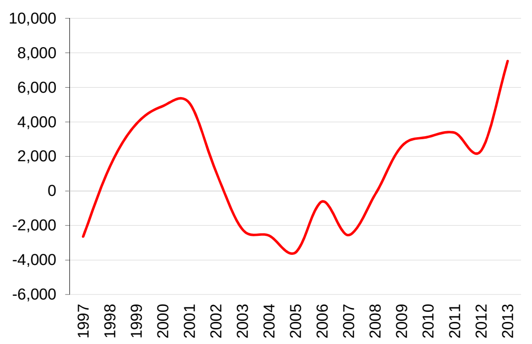
In line with the improved budget position, Victoria's demand on the market for funding is in decline. This is most notable in 2015-16 when funding is estimated to be –AUD2.9bn as privatisation receipts will be used to repay maturing liabilities and fund new borrowing. In preparation for privatisation receipts TCV will have a greater focus in 2014-15 on short-term funding (in contrast to previous years).

Exhibit 33: Share of industry gross value added



source: ABS

Exhibit 34: Surge in net interstate migration



source: ABS

Economic Profile

Services sector becoming more important. Interstate migration surges

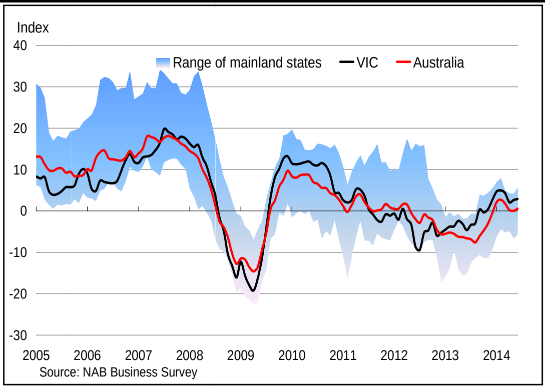
Victorian economic growth remains below the national average, reflecting the relatively small role mining plays in the Victorian economy. Growth remains positive, but has been generally sub-trend since the Global Financial Crisis (GFC).

Traditionally reliant on manufacturing, Victoria's economy has diversified over recent decades. Manufacturing's share of the Victorian economy has fallen from almost 20% in 1990 to 8% today and services (particularly professional, scientific, financial and insurance services) have become more important. This trend is likely to continue as car manufacturing and aluminium smelting wind down over coming years.

Despite the economic headwinds, Victoria has experienced an increase in population, with net interstate migration surging in 2013. Melbourne is now growing faster than Sydney and is on track to be Australia's largest city by the middle of the century if current trends continue.

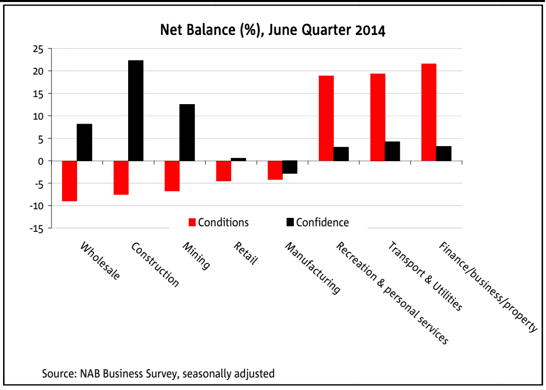
Unemployment is on the rise in Victoria and now stands at 6.6% (trend) – the third highest in Australia. The rise in unemployment has been accompanied by a falling participation rate, which has now sunk below 65%.

Exhibit 35: Conditions above national average



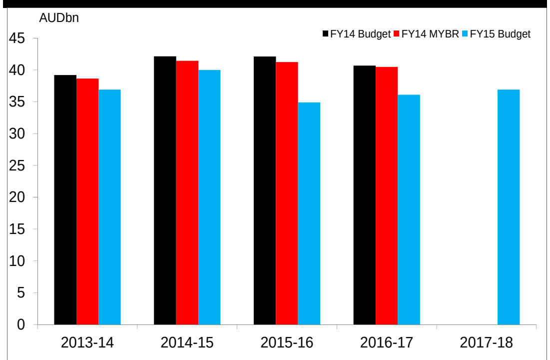
Source: NAB Business Survey

Exhibit 36: Conditions/confidence by industry



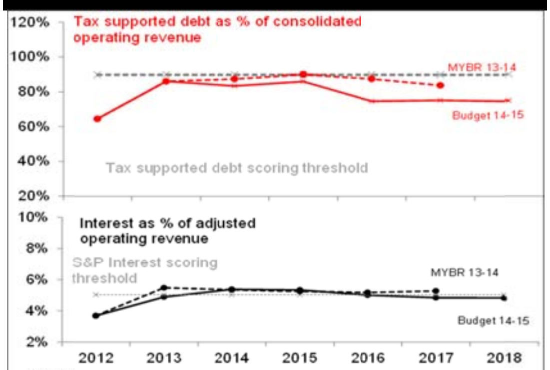
Source: NAB Business Survey, seasonally adjusted

Exhibit 37: NFPS net debt levels



Source: Victoria State Budgets

Exhibit 38: Victoria's debt burden



Source: Victoria's budget papers, NAB

NAB Survey

Results from the NAB Business Survey show that while Victorian business conditions for the last three months are in line with the national average, Victorian businesses are generally less optimistic for the next three months than their interstate counterparts.

At an industry level, businesses report strong conditions in finance, business and property, transport and utilities and recreation and personal services. As Exhibit 36 illustrates, conditions in these sectors well outstrip reported confidence for the next three months. Conversely, wholesale and construction businesses report lacklustre conditions, but are more optimistic about the next three months. The construction industry in particular reports confidence at +22 (seasonally adjusted), probably reflecting a strong increase in residential building approvals in late 2013 that has since abated.

State budget and finances

Budget position

The 2014-15 Victorian Budget boasts that "Victoria is the only Australian state forecasting consistent budget surpluses over the next four years, and holds a triple-A credit rating from both major credit rating agencies" and forecasts an operating surplus of AUD1.3bn in 2014-15.

The 2014-15 Victorian Budget saw the announcement of a number of high profile infrastructure projects, including the full East West Link toll road and the Melbourne Rail Link. The combined value of these two projects is currently estimated at AUD24.5-29bn. As of August 2014, there are no comprehensive, publicly available business cases available for either East West Link or Melbourne Rail Link. As such, it is difficult to establish whether these projects are viable. With such large sums slated to be directed towards these projects, there is a risk that infrastructure investment may not be directed towards its highest value use.

Government Debt levels

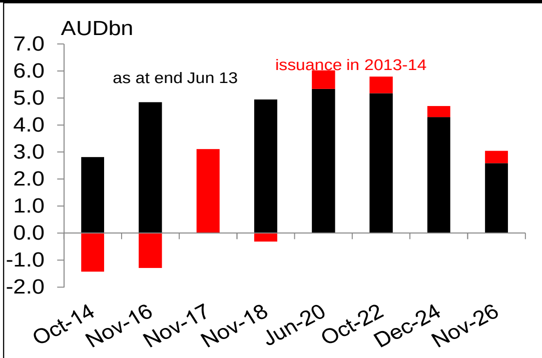
A solid fiscal outlook along with upfront Commonwealth grants receipts and planned asset sales and leases means that Victoria's net debt is projected to decline from a peak of 6.3% of GSP in June 2015 to 4.5% in June 2018. Net debt could to be lower than current estimates if infrastructure projects proceed as public private partnerships. Current accounting policy practices in Australia for public private partnerships recognise liabilities later than if the projects are state financed. This is only a timing effect with liabilities fully recognised at a later stage.

Credit Rating

Following the release of the 2014-15 budget, S&P confirmed Victoria's AAA credit rating with stable outlook. The stabilisation of its own source revenue as well as the state's solid budgetary performance have been highlighted as factors supporting the state's credit rating. In addition, the stabilisation and projected levels of Victoria's tax-supported debt have also been noted as being consistent with the 'AAA' credit rating of the state. Consistent with budget estimates, S&P has said that it expects Victoria's total tax-supported debt to remain relatively stable at under 90% of adjusted operating revenues over the forward estimates (see Exhibit 38).

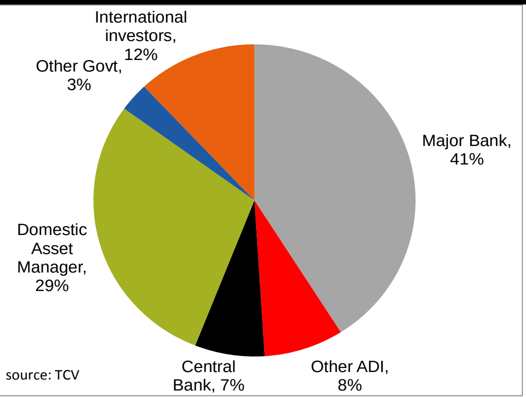
Bloomberg ticker	TCV
Website	www.tcv.vic.gov.au

Exhibit 39: Benchmark bond issuance in FY14



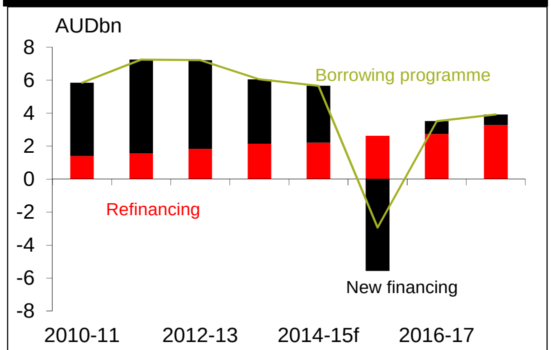
Source: TCV, NAB

Exhibit 40: Ownership details



source: TCV

Exhibit 41: TCV funding programme



Source: TCV

Treasury Corporation of Victoria

Function

Treasury Corporation of Victoria (TCV) is the central financing authority for the state. TCV provides loans, financing, investment and advisory services to the state and state entities. Loans are funded through the issuance of state government guaranteed bonds in the domestic and international financial markets as well as deposits received from public authorities.

TCV clients

TCV services the state of Victoria (treasury), water companies, ports and transport as well as education and health.

Debt Outstanding

TCV has four funding programmes. The domestic inscribed stock programme is the principal source of funding with currently AUD30.6bn of outstandings across 8 benchmark bond lines (maturities fall between 2014 and 2026). The minimum outstanding targeted for each bond line is AUD4-5bn. There are 4 non-benchmark lines totalling AUD2.6bn. Funding is supplemented by a European Medium Term Note Programme (outstanding currently at AUD95mn but programme is USD3bn); AUD Promissory Note (outstanding at AUD375mn but programme is AUD5bn) and Euro Commercial Paper Program (outstanding at AUD617mn and programme is USD5bn).

Ownerships and turnover of TCV bonds

TCV estimates that Australian Banks are their largest bond holder at 49% of total outstandings. Australian investment managers are the next largest holders at 29%. International investors are estimated to hold 12% while Central Banks hold 7%. TCV estimates that of the international holdings, turnover is greatest out of Europe (60%) with Japan accounting for 26%. The remainder is split between non-Japan Asia and North America.

Issuance

Following the release of the 2014-15 Budget, TCV announced a funding program of AUD5.7bn, slightly lower than the AUD6.1bn program for 2013-14. In contrast to previous years, there will be a greater focus on short-term funding given the state governments decision to privatise the Port of Melbourne's operations in 2015-16. The funding program will be split roughly 50/50 between short term debt (either Euro Commercial Paper and Domestic Pnotes or short term fixed rate issuance) and longer term benchmark lines. Previously TCV has sourced around 90% of funding from long term debt. Given these funding needs TCV has said that is is unlikely that it will issue a new benchmark bond line in 2014-15. TCV has also suggested that it is unlikely that it will access non AUD issuance. TCV will assess floating rate debt in terms of risk and value benefits for their clients.

With privatisation receipts used to repay maturing liabilities and fund any new borrowing, TCV's funding program for 2015-16 is estimated to be –AUD2.9bn. Funding thereafter is estimated to be around AUD3.5bn with the majority of this being refinancing.

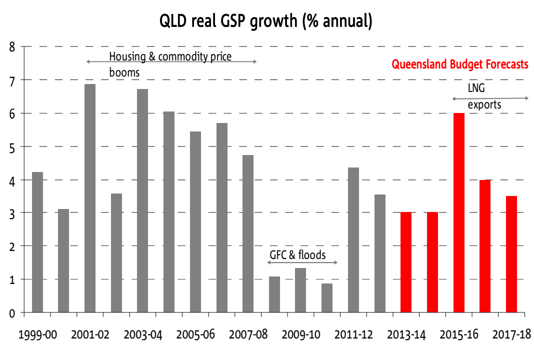
View

With Victoria a sound AAA rated state, TCV bonds are a safe asset to hold and will out-perform non AAA assets in any credit event induced widening. Further performance against benchmark is, however seen as limited. Over time we could see continued out-performance relative to swap but for now bank balance sheet domination in the semi sector will limit performance as buying subsides and selling appears when bonds are sub swap. Given TCV's funding programme, sourcing bonds may eventually become an issue.

State of Queensland

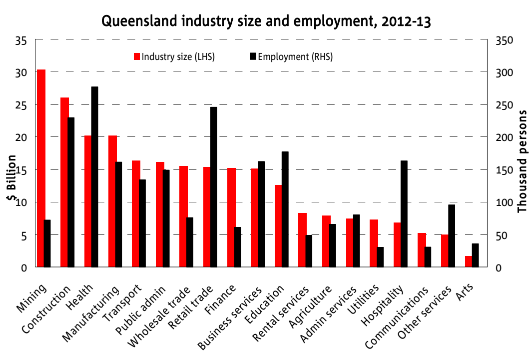
Capital city	Brisbane
Government	Liberal-National coalition
Next election	By June 2015
Rating and outlook	Moody' s Aa1/Negative S&P AA+/Stable
Website	www.qld.gov.au

Exhibit 42: Real GSP growth (% annual)



Sources: ABS, Queensland 2014-15 Budget

Exhibit 43: Industry size vs employment



Sources: ABS

Overview

The state of Queensland has enjoyed unprecedented economic growth in recent years, benefiting from high commodity prices and a mining investment boom. From 2000, the annual economic growth in Queensland has averaged a healthy 4.1%, exceeding Australia's average economic growth of 3%. Strong commodity prices and mining investment have contributed significantly to the state's economic prosperity.

In 2012-13, business investment alone accounted for 1.9 percentage points of the state's total 3.6% GSP growth. However, as the construction of the LNG projects near completion, overall business investment is expected to decline, falling sharply in 2014-15. This will contribute to sub-trend economic growth. By 2015-16 growth will be boosted by LNG exports. The state budget expects export growth to surge to 22.5%, leading to a post GFC peak in economic growth.

Downward revisions in royalty and taxation revenues as well as a change in the timing of disaster recovery funding from the Australian Government has resulted in a deterioration in Queensland's budget position for 2014-15. The forward estimates show a greater improvement relative to previous projections with operating balance in 2015-16 and 2016-17 expected to average surpluses of AUD3.5bn. While debt levels remain elevated, assets proposed for divestment could potentially deliver AUD33.6bn in funds of which three quarters would be used to reduce debt. S&P has reaffirmed Queensland's AA+ credit rating with stable outlook but has noted that downward revisions in royalty revenue is a credit hindering factor.

On funding, QTC's demand on the market for new money continues to decline – averaging AUD2bn over the next four years vs an average of AUD8bn in four years to 2013-14. Total funding in the forward estimates is projected to average AUD9.5bn.

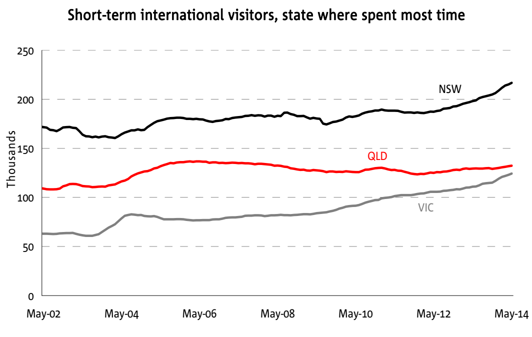
Economic Profile

Mining produced the most output but health was biggest employer

In 2012-13, mining contributed the most to the state's economy (10% of GSP), followed by construction (9%), health (7%) and manufacturing (7%). Despite its sizeable economic contribution, mining was a small employer, only employing 3% of the state's total workforce. Service industries were the largest employers, with health, retail trade, construction, education, hospitality and business services providing over half of the jobs in the state (55% of total employment). While labour market conditions in Queensland have recently shown signs of improvement, employment growth is expected to remain subdued.

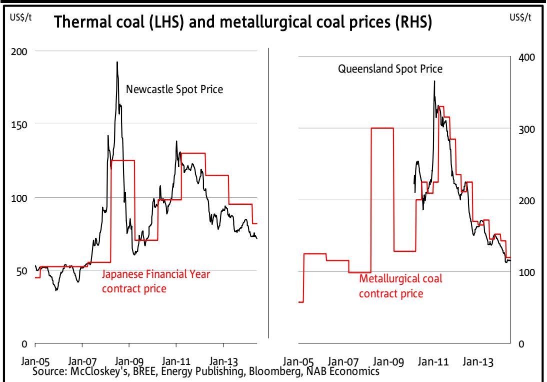
One of the biggest employers, construction, will see demand from mining and related infrastructure fall, as large projects near completion. Providing some offset is dwelling investment but this has been slow to recover and pick up the spare capacity. Retail trade and hospitality remain weak as cautious consumers anticipate the impacts from a tough Federal Budget. Jobs growth in other labour intensive sectors including Health, Education and Public administration will also be limited by fiscal tightening at the Federal and state levels.

Exhibit 44: Spending by international visitors



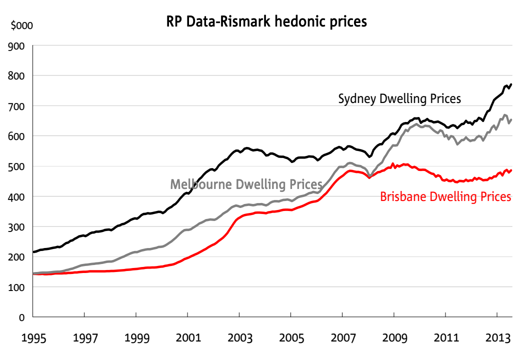
Sources: ABS 3401.0. Original, 12-month moving average

Exhibit 45: Coal prices



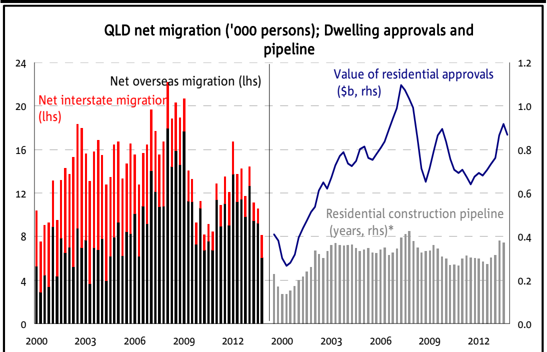
Source: McCloskey's, BREE, Energy Publishing, Bloomberg, NAB Economics

Exhibit 46: RP data-rismark hedonic prices



Sources: RP Data-Rismark

Exhibit 47: Migration and dwelling approvals



* Ratio of work-yet-to-be-done to annualised work done
Source: ABS; NAB

Sunshine state tourism losing some of its shine

In 2012-13, tourism contributed AUD11bn to the Queensland economy, accounting for 3.8% of the state's gross state product. While the sunshine state has been a favoured domestic holiday destination, in the past year the number of domestic visitors to Queensland has declined by 1.8% (spending declining by 1.1%) compared to an overall increase in domestic tourism in Australia.

Queensland's warmer climate and beaches also failed to attract its fair share of international visitors. With the number of international visitors to Australia reaching new highs, Queensland's share has been on the decline, reaching a low of 23% when it had previously reached 30% in 2006. This probably reflects competition from south-east Asian countries on the back of the strength of the Australian dollar.

Agriculture adversely affected by drought

Agricultural output was 2.7% of the state's total economic output in 2012-13, employing 2.9% of its workforce. Cattle was the most important agricultural commodity, accounting for 34% of total value of agricultural production, followed by sugar cane (11%), cotton (10%) and vegetables (9%). Since October 2012, most of Queensland has been affected by serious drought conditions. This caused farmers to reduce herd sizes, which led to strong growth in beef exports. As weather conditions improve, exports growth should slow as producers rebuild their herds.

Resources sluggish outside of LNG

Coal export volumes are expected to increase as production ramps up at a number of new mines. However prices will remain subdued due to adequate global supplies and comparatively soft demand. Lower prices are also keeping new mining investment outside LNG subdued.

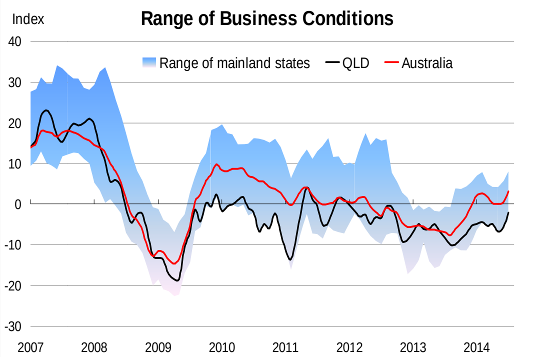
On LNG projects, The three large-scale LNG projects on Curtis Island off the coast of Gladstone have combined construction costs of over AUD60bn. Construction of these large projects has also provided many employment opportunities. For example, the QCLNG project employed on average 5,000 workers during construction. As the investment phase starts to wind down and the operation phase begins, fewer workers will be required. For instance, only around 1,000 permanent staff are required for the operation of the QCLNG project (company estimates). Local commerce and property markets in regions which boomed with the impetus of mining construction will also be heavily impacted.

Dwelling investment to contribute to state's economic growth

Due to its warmer climate, Queensland has historically attracted large inflows of interstate migrants. This trend is likely to continue into the future, with the state government predicting net interstate migration will contribute 14% to its population growth over the next 50 years. As property price growth in Sydney and Melbourne accelerated over the past few years, price growth in Brisbane seems moderate in comparison and might prove a more affordable alternative.

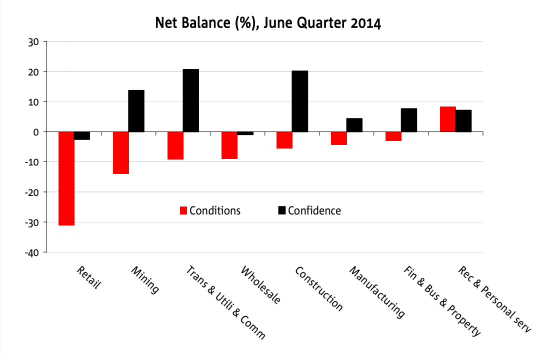
The low interest rate environment and improved property price outlook are expected to support growth in dwelling investment, which will contribute positively to the state's economic growth over the next few years.

Exhibit 48: Conditions lagging since GFC



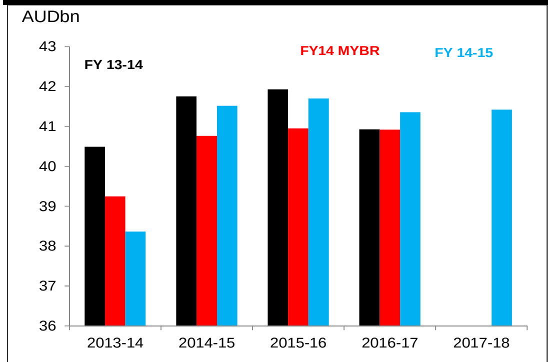
Source: NAB Economics

Exhibit 49: Conditions/confidence by industry



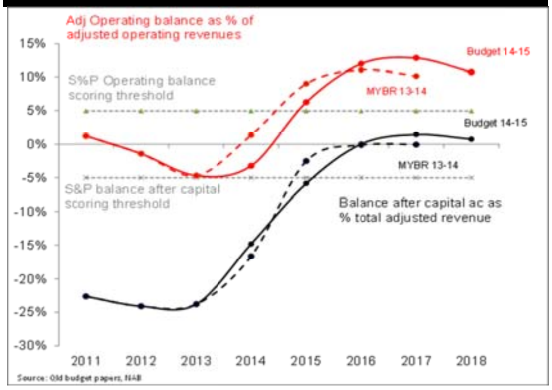
Source: NAB Business Survey, seasonally adjusted

Exhibit 50: NFPS net debt levels



Source: Qld State Budgets

Exhibit 51: Budget performance



Source: Qld budget papers, NAB

NAB Survey

The NAB Business Survey indicates business conditions in Queensland have been lagging behind the national average since the Global Financial Crisis (GFC). Prior to the GFC, businesses in Queensland reported strong conditions as the state enjoyed high commodity prices, rising house prices and household consumption. From early 2010, a series of natural disasters including floods and cyclones hit the state, which shut down mines and affected a wide range of businesses. More recently, coal prices have been on a steady decline and the high Australian dollar is not helping the state's tourism operators, which in combination kept the conditions reading below zero for the majority of the time since the GFC.

The June 2014 survey results show business conditions remained weak across industries, with higher confidence levels as businesses expect things to pick up. Conditions were particularly weak in the retail sector, as cautious consumers cut discretionary spending, especially after a tough Federal Budget. Mining was on the decline, so were related transport, wholesale and construction sectors, however miners were feeling more optimistic about the future.

State budget and finances

Budget position

The Queensland government has been running a fiscal deficit since 2005-06 and its debt burden remains high compared to other states. The debt-to-revenue ratio for the non-financial public sector in Queensland is expected to peak at 146% in 2013-14 and fall gradually afterward. However this will still be substantially higher than other jurisdictions.

Recent natural disasters have hit the state's budget with significant rebuilding bills. The combined cost of all disasters was estimated to be AUD5.63bn over the 2013-14 to 2015-16 period. Federal funding is also going to be impacted with the 2014-15 Federal Budget introducing increases in infrastructure funding to the states but with cuts in other areas, especially health and education. The Federal Budget indicated the Australian Government will amend funding arrangements for public hospitals (from 1 July 2017) and schools (from 1 January 2018) to generate savings across all states totalling over AUD80bn in the period to 2024-25.

The Queensland government is projecting a budget surplus of AUD862mn (or 1.6% of General Government revenue) in 2015-16, and continues to pursue a surplus beyond then as a policy objective. It identifies tourism, agriculture, resources and construction as the four pillars of its economy and is committed to supporting the industries and the community through reforms and red tape reduction.

Government Debt levels

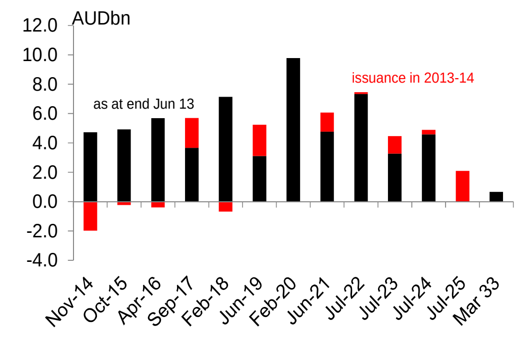
Net debt is expected to remain elevated but steady (around AUD41.5bn over the coming years). After extensive consultation and public feedback the government will issue a final plan for debt reduction and infrastructure investment in September 2014. The assets proposed for divestment in the 2014-15 Budget could potentially deliver AUD33.6bn in funds out of which three quarters (AUD25bn) would be used to reduce the state's debt.

Credit Rating

Following the release of Queensland's 2014-15 budget, S&P reaffirmed the state's AA+ credit rating with stable outlook. While the budget projections show an improvement in the fiscal position of the state (albeit at a more moderate pace than previous forecast), further progress is still required before a credit upgrade can be expected. S&P's key ratios for measuring budget performance are adjusted operating balance as a percent of adjusted operating revenue and balance after capital as a percent of total adjusted revenue. As Exhibit 51 shows, although Queensland's budget projections show an improvement of these ratios over the coming years, they are still expected to remain below S&P's ratings thresholds.

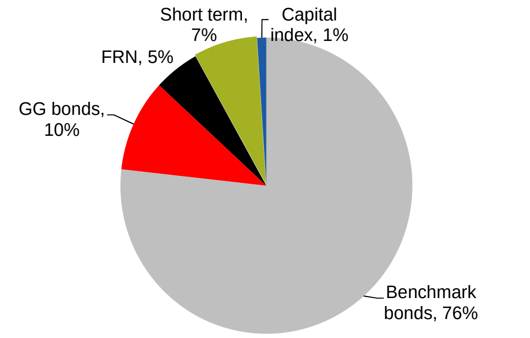
Bloomberg ticker	QTC
Website	www.qtc.qld.gov.au

Exhibit 52: Benchmark bond issuance in FY14



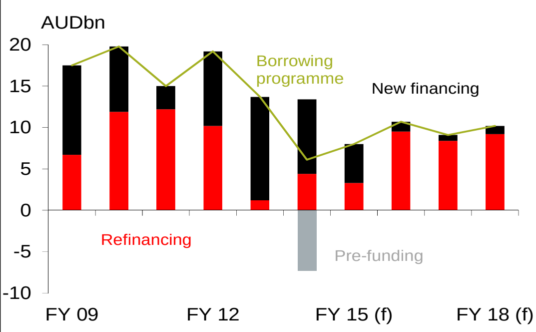
source: QTC, NAB

Exhibit 53: Funding sources by facility



Source: QTC

Exhibit 54: QTC funding programme



Source: QTC

Queensland Treasury Corporation

Function

Queensland Treasury Corporation (QTC) funds the Queensland government public sector. With more than 20 years in operation, QTC issues more debt than any other Australian semi government issuer. QTC issues debt obligation fully guaranteed by the state of Queensland. During the GFC, QTC made use of the Commonwealth voluntary guarantee borrowing schemes.

QTC clients

QTC's main client is Qld's public sector including entities guaranteed, supported and approved by the state. QTC has almost 175 borrowing clients ranging from government owned corporations, government departments and local governments. QTC's loans to clients currently totals AUD87bn with the Treasury department accounting for 50% of this. The next biggest borrower is Government owned corporations at 22%.

Debt Outstanding

QTC maintains a diversified global focus for its funding requirements. It has a funding strategy with up to 10% in short term securities (Domestic T notes, ECP and US CP), AUD domestic benchmark and non-benchmark bonds, domestic retail and MTN (Euro and US). QTC's total debt is currently at AUD86bn. At 76%, AUD Benchmark bond lines are the main funding source. AUD Commonwealth guaranteed (CG) bonds currently represent 10% of the total debt (down from 19% a year ago) with FRNs accounting for 5% and short term taking up 7%.

QTC has 12 benchmark bond lines outstanding (total outstanding at AUD65bn) with an average of AUD5bn outstanding in each line. In 2013-14, QTC issued a new 2025 bond and two new FRN lines (ie. Sep 2016 and Mar 2017).

Ownerships and turnover of QTC bonds

QTC estimates around 55% of its funding is owned by domestic investors and 45% by offshore.

Issuance

QTC has a funding task of AUD8bn of term debt for 2014-15 comprising AUD4.7bn of new borrowings and AUD3.3bn of refinancing. It will maintain around AUD5bn of commercial paper outstandings. QTC's indicative borrowing program in the forward estimates does not include any potential proceeds from the Government's proposed asset sales. As at the time of writing QTC has already issued AUD 1.5bn.

Benchmark bonds will remain the principal source of funding but this will be complemented by floating rate notes and other instruments. QTC has said that it will consider cancelling shorter-dated bonds to help manage refinancing task in the forward estimates.

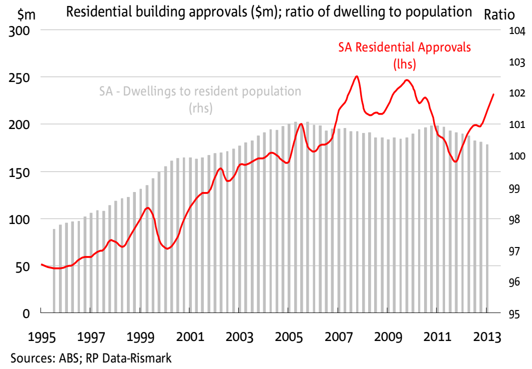
View

While there has been some re-pricing more recently, for the year as a whole QTC bonds have been an out-performer as improved credit appetite and search for yield resulted in good buying of QTC bonds. There is scope for some further compression in spreads (relative to benchmark and swap) but the big macro spread compression trade is nearing its end. On a relative basis, the QTC yield curve traded as tight as 7-11bps over the AAA equivalent. While in the front of the curve credit risk dissipates, sub 10bps out in 10y maturity starts to look tight. For the 10y the differential (using zero coupon analysis) is currently at around 15bps and in the absence of a major credit crisis we see it in a range of around 10-20bps over the year ahead.

State of South Australia

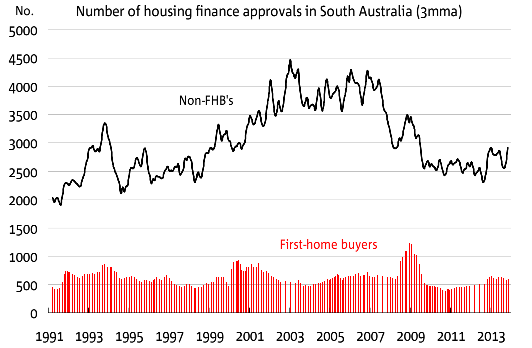
Capital city	Adelaide
Government	Labour Party
Next election	March 2018
Rating and outlook	Moody' s Aa1/Stable S&P AA/Stable
Website	www.sa.gov.au

Exhibit 55: Residential property sector



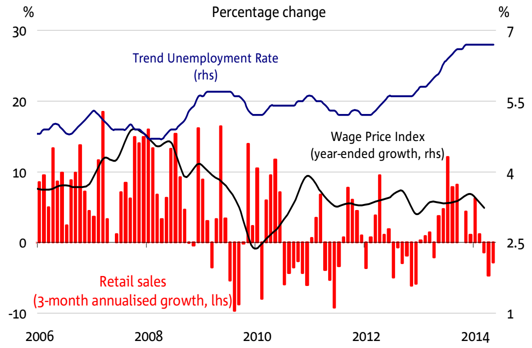
Sources: ABS; RP Data-Rismark

Exhibit 56: Demand from first home buyers low



Sources: ABS; NAB Economics

Exhibit 57: Retail spending and wages



Source: ABS; NAB

Overview

The South Australian (SA) economy has consistently underperformed in recent years, failing to benefit significantly from the mining boom, while simultaneously lacking the right industry mix to weather the headwinds from an elevated AUD and rising input costs. With the AUD expected to depreciate – in line with commodity prices and a strengthening global economy – and wages growth very subdued, the state's outlook is starting to look more positive. The impact from low interest rates has not been as stark as in some of the major eastern states, but sensitive sectors of the economy (particularly residential property) are starting to turn around.
If property markets in SA manage to regain some ground in the near-term, the positive impetus for both dwelling investment and consumption will help to offset the winding down of public and private investment. A lift in rural and mining exports is providing some additional support to Gross State Product (GSP). However, the state faces a number of significant challenges over coming years, the most confronting being the closure of local manufacturing operations by GMH and Toyota. Weighing up these factors, we expect that GSP growth in SA will lift in 2014-15 to a sub-trend rate of around 2% – from an anticipated rate of 1¾% in 2013-14. This is slightly less than that forecast in the 2014-15 state budget. Sub-trend growth and the contraction of the manufacturing industry will keep spare capacity and the unemployment rate elevated.

The continuation of soft economic conditions, election promises and budget decisions resulted in 2013-14 Budget coming in slightly worse than previously forecast (at deficit of AUD1.2bn). In the forward estimates the budget position is forecast to improve, driven by cuts to expenditure and an improvement in growth. Sustainability remains a key focus for the SA Government. S&P has affirmed SA's AA rating with stable outlook. Credit concerns remain on the states elevated net debt level (expected to peak in 2015-16).

SA's demand on the market for funding is expected to remain at around AUD6bn over the next two years, dipping to AUD2bn by 2016-17.
The majority of borrowing requirement continues to come from refinancing. The regearing of SA Water means that over-time South Australian Financing Authority (SAFA) will reduce its FRN issuance.

Economic Profile

Residential property one of the bright spots emerging, but needs more traction

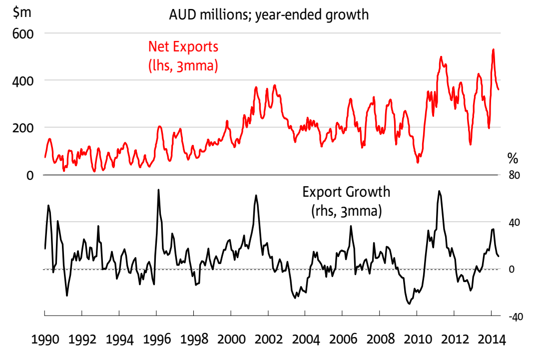
In terms of any potential bright spots for the SA economy, construction appears to be the main standout, with the state experiencing a solid lift in residential building approvals since late 2012. However, the value of approvals has only returned to the peaks seen back in 2010 – significantly softer than what we are seeing in some other states. This is stemming from the fact that underlying fundamentals in the property market are somewhat softer in SA.

On a positive note, net overseas migration has stabilised, and has even started to lift again, while outward interstate migration has begun to slow. Nevertheless, aggregate net migration remains well below the peaks of 2009 and is unlikely to strengthen significantly in light of the coming job losses in manufacturing and limited scope for job gains outside of the mining and rural sector. With population growth being somewhat sluggish, dwelling construction has managed to keep pace, meaning that pent up demand has been relatively contained. Adelaide is yet to experience the same degree of growth in dwelling prices that have been seen in other capital cities, and our forecasts do not envisage prices closing the gap to any great extent (Adelaide dwelling prices are forecast to be relatively flat over 2014 and 2015). While this is good for affordability, first-home buyers (FHB) remain notably absent from the market, with the number of approvals for housing finance by FHB's easing slightly over the past 12 months.

Exhibit 58: Retail spending still weak

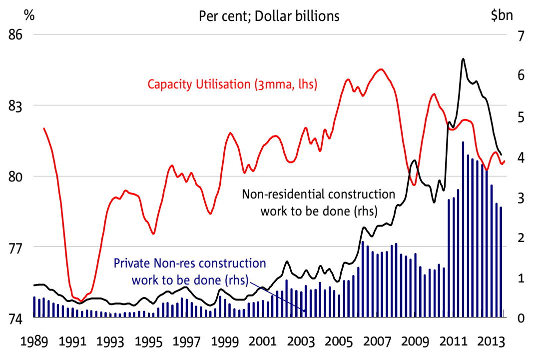
Sources: ABS; NAB Economics

Exhibit 59: Merchandise trade



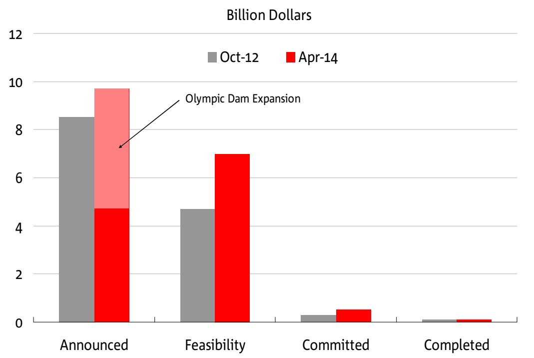
Sources: ABS; NAB

Exhibit 60: Non-residential construction



Sources: ABS; NAB

Exhibit 61: Mineral & energy project pipeline



Sources: BREE Major Projects Reports; NAB Economics

Consumption contributed to growth, but relative performance still poor

SA is yet to experience the degree of strength in residential prices – and household wealth – that helped to underpin solid consumer spending in other states over 2013 (and early 2014). Nevertheless, a moderate improvement in dwelling prices and very low interest rates helped to lift consumer spending in SA. Household consumption made the largest contribution to nominal state final demand over the year to the March quarter. This was a particularly good outcome in light of the upward trend in the unemployment rate, which is currently the highest of the mainland states. Wages growth in SA – as measured by the ABS Wage Price Index – has also been relatively subdued, although well up from the lows recorded during the GFC.

With the state's labour market remaining loose – and a tough adjustment from the auto industry still to come (see below) – it is not surprising that more timely data on retail sales has shown a contraction. Nominal retail sales in June were around 0.2% lower than they were at their peak early in the year. It is possible that some of the more recent weakness in retail sales is reflecting the volatility in consumer confidence that we have seen since the 'tough' Commonwealth Budget was handed down in May – potentially exacerbated in SA, where consolidation of public spending is already underway.

Mining and agriculture helped to drive solid export growth, but slowing

The state's exports have picked up since early 2013 – a good result given the difficulties still facing South Australian exporters from an elevated AUD and the somewhat soft global demand environment. Good crop outcomes and completed mining projects have helped to drive this outcome. Unfortunately, trend export growth has started to slow again, but with expectations for the global economy to improve and the AUD to depreciate, export sectors should start to see more support. The completion of mining projects will also boost minerals exports a little further (see below).

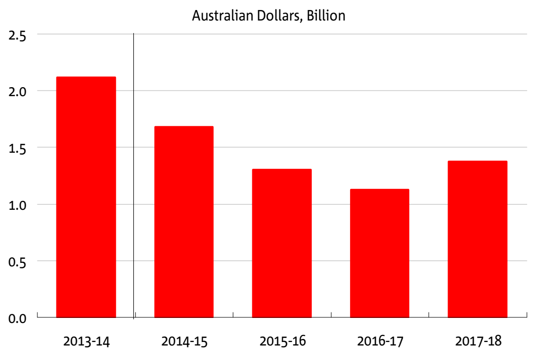
AUD and commodity prices dampening investment opportunities

Underlying private business investment (excluding second hand asset sales) remains relatively soft in real terms for SA, due to plentiful spare capacity and a less favourable investment environment. Underlying private business investment is down around 5% over the year to the March quarter 2014, with growth soft for all investment types (building, engineering and machinery & equipment).

Firms in South Australia have generally responded to pressures from the elevated AUD and lower commodity prices by refraining from announcing new investment projects. This has also been the case for public investment, which is expected to ease over coming years now that major projects (such as the South Road Superway, Southern Expressway Duplication, Adelaide Oval Redevelopment and Seaford rail electrification projects) near completion. The state government is simultaneously looking to restrict investment expenditure to 'more sustainable levels' following significant infrastructure stimulus in recent years (see below). In terms of private investment, ABS statistics show that the pipeline of projects (in current value terms) has steadily declined from its peak in 2011 (but remains relatively elevated – sustaining 6 months of construction activity), and capacity utilisation remains quite soft (limiting new investment).

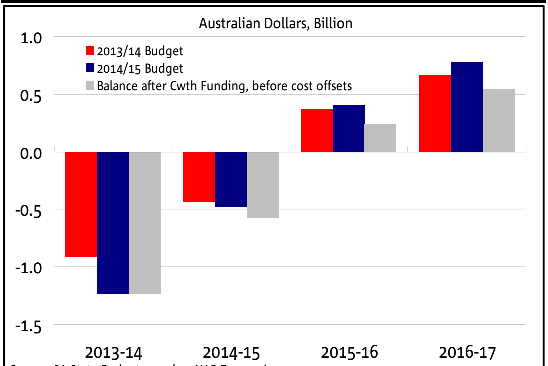
Resource investment projects have been somewhat supportive of private capital expenditure, while recently completed projects have also helped to drive an increase in SA's mineral exports. The pipeline of mining projects remains relatively large for South Australia (around $7.2bn according to the April report on major projects from BREE), but most of these are still at the early stages of development (many of which might never go ahead) and mineral exploration has dropped. However, there have been some positive developments more recently in relation to the large Olympic Dam expansion project that was shelved in 2012 due to rising costs, falling

Exhibit 62: General Government Investment



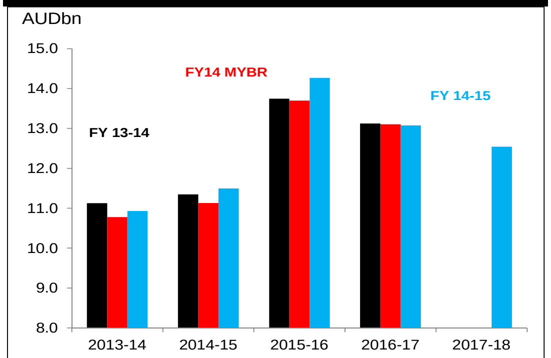
Source: SA State Budget 2014/15

Exhibit 63: Aiming for sustainable budget



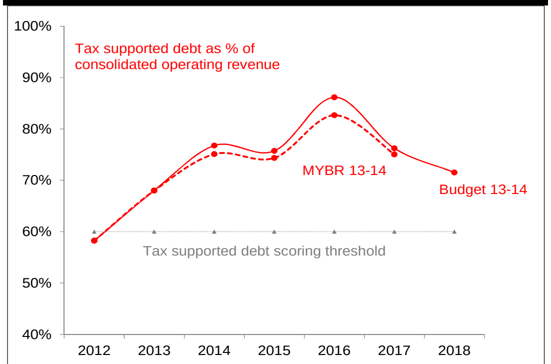
Source: SA State Budget 2014/15; NAB Economics

Exhibit 64: NFPS net debt levels



Source: SA budget papers

Exhibit 65: Budget performance



Source: NAB, SA budget papers

prices and a push by mining companies to return capital to shareholders. BHP has apparently put the project back on the agenda due to the potential deployment of more cost-effective ore processing methods. Nevertheless, this project is a long way from commencement and is not likely to impact our forecast horizon.

Finally, underlying public investment has started to ease back, falling 9% over the year to the March quarter (in real terms), following strong growth in previous quarters. The state budget anticipates a significant winding down of public capital expenditure, easing from AUD2.1bn in 2013-14 to around AUD1.1bn in 2016-17 (after adjusting for public-private arrangements to finance the new Royal Adelaide Hospital).

State budget and finances

Budget position

Sustainability remains a major focus in the South Australian state budget. Nevertheless, the Budget balance for 2013-14 is expected to come in at a AUD1.2bn deficit, somewhat worse than the AUD955m dollar deficit given at the time of the 2013-14 mid-year budget. The deterioration in the net balance has been put down to the continuation of soft economic conditions, commitments made during the state election and new budget initiatives. While the government expects the economic environment to improve (more than our own forecasts), they have had to respond to the above factors in order to 'ensure that the budget remains sustainable'. This includes actions to offset anticipated cuts to funding stemming from the recent Commonwealth Budget (see below). A combination of cuts to expenditure and stronger growth in revenues, is expected to see the budget deficit shrink in 2014-15 and shift into surplus thereafter (reaching AUD883mn by 2017-18).

Growth in revenues primarily reflects projected increases in SA's share of the national GST pool in response to changes in state shares of Commonwealth Government non-GST payments, and an expected continued recovery in revenues from property taxes – two tax measures (relating to Emergency Services Levy remissions) and a raft of non-tax measures were imposed to help the budget position and address Commonwealth funding cuts. Lower growth in operating revenues in the out years reflects a decline in Commonwealth Government grant funding (excluding GST) in real terms in those years. This will keep revenues as a share of GSP relatively stable (15-16% of GSP), while expenditure declines around 2ppts over the forecast period.

Government Debt levels

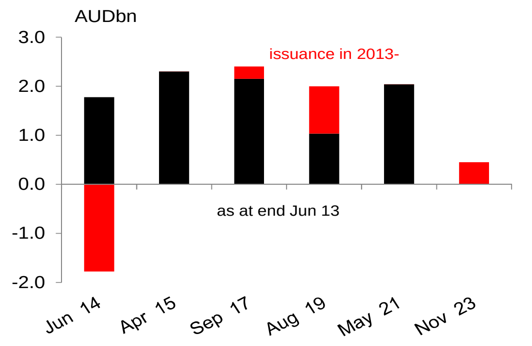
South Australia's net debt for the total public sector is now projected to reach AUD11.5bn in 2014-15 - AUD400m higher than previous estimates. Consistent with previous figures, 2015-16 still marks the peak in net debt over the forecast period, largely representing the debt required for the Royal Adelaide Hospital. Net debt is projected to decline in 2016-17 with a new estimate for 2017-18 also showing a further improvement on the net debt position of the state.

Credit Rating

Following the release of the 2014-15 Budget, S&P reaffirmed SA's AA credit rating with stable outlook. The credit agency noted that while there had been some improvement in the fiscal position of the state, SA is still estimating lower own sources of revenue. Credit concerns also remain on the elevated net debt, and as Exhibit 65 illustrates, the tax supported debt as a percent of consolidated operating revenue (one of S&P preferred measure of debt burden) is now projected to peak at a higher level than previously forecast.

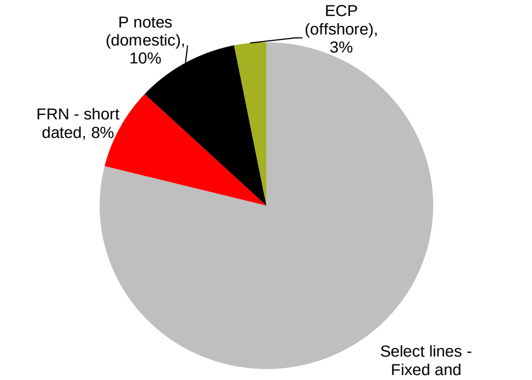
Bloomberg ticker	SAFA
Website	www.safa.sa.gov.au

Exhibit 66: Benchmark bond issuance in FY14



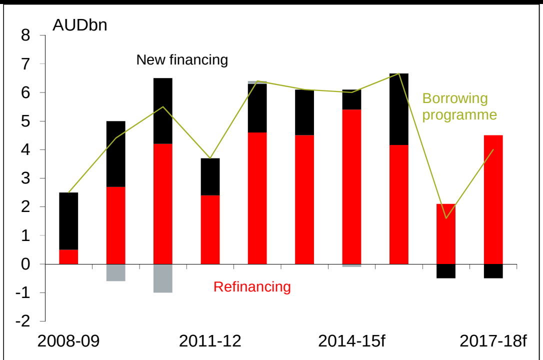
Source: SAFA

Exhibit 67: Funding sources by facility



Source: SAFA

Exhibit 68: SAFA funding programme



Source: SAFA

South Australian Financing Authority

Function

South Australian Government Financing Authority (SAFA) plays an integral role in the overall management of the state government's finances. SAFA is able to provide a range of treasury, insurance and vehicle fleet management to public sector clients. Treasury services provided by SAFA include raising funds from domestic and international financial markets and on-lending the proceeds to clients as well as providing clients with investment, portfolio management and financial and risk advisory services.

SAFA's clients

South Australia's loans distribution can be broken down into three main sectors, the general government sector represents 59%, public non financial corporations sector comprise 27% and public financial corporations make up the remaining 14% of total loans.

Debt Outstanding

SAFA's main source of funding comes from its domestic bond programme (select lines) with an amount outstanding of AUD14bn as at 30 June 2014 – includes Floating Rate Note (FRN). SAFA also has around AUD0.5bn of ECP outstanding and AUD1.6bn of P-notes. Total debt outstanding was AUD16.1bn at 30 June 2014 and SAFA forecasts this will be at AUD16.4bn at 30 June 2015.

Regearing of SA Water

To better align SA Water's capital structure with interstate-owned water utilities SA Water's gearing is being increased from 27% to 45%. Total government debt level will not change but SA Water debt will increase by AUD2.7bn and general government debt will fall by AUD2.7bn. This will put the debt duration of Treasurers portfolio at 1.0-1.5 years while SA Water portfolio's debt duration is 3.0-4.0 years. The debt transfer will mean that over-time SAFA will reduce its FRN issuance.

Issuance

SAFA's funding program for 2014-15 remains focused on fixed and floating select lines, promissory notes and ECP. Total funding requirement is AUD6.0bn, comprising AUD0.7bn of new funding and AUD5.3bn of maturities. SAFA intends to refinance the Dec 14 FRN (AUD1bn outstanding) and the Apr 2015 bond (outstanding at AUD2.3bn) with a new 4 year FRN and also adding to the existing Nov 2023 bond line. Depending on market conditions SAFA may increase the 2020 FRN to AUD2bn in outstanding (currently at AUD1.5bn). Maximum amount in a select line will remain capped at AUD2.5bn. Following the debt transfer from Treasurer's portfolio to SA Water SAFA is likely to issue a new 2018 select line.

View

Liquidity and credit rating should keep SAFA longer dated bonds around 10bps above equivalent AAA rated semi. Against larger AA rated semis SAFA bonds are likely to continue to trade in a range of around -4/+4bps. While SA is not expected to be downgraded there is limited prospect of an upgrade in the foreseeable future.

State of Western Australia

Capital city	Perth
Government	Liberal-National coalition
Next election	March 2017
Rating and outlook	Moody's Aaa/Negative S&P AA+/Stable
Website	www.wa.gov.au

Exhibit 69: WA economy driven by mining

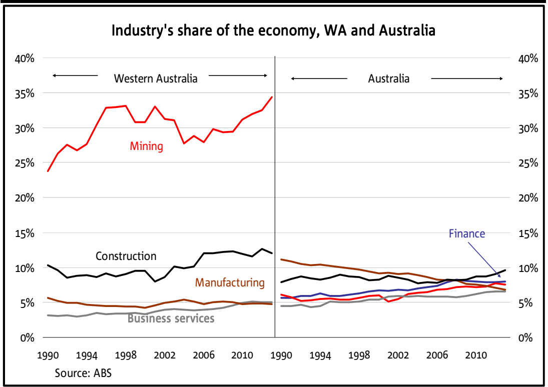


Exhibit 70: Business investment contracting

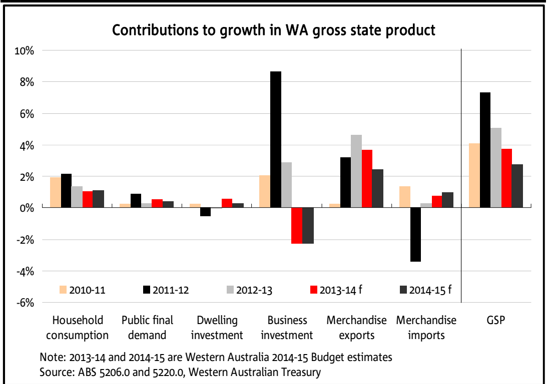
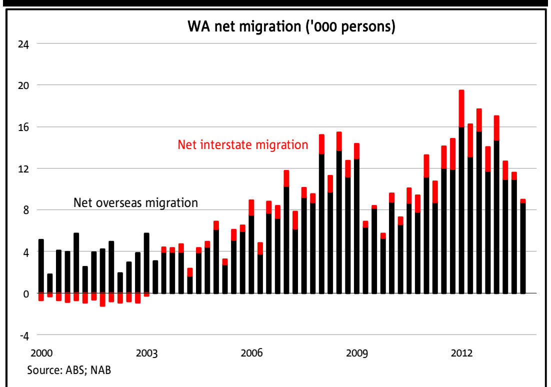


Exhibit 71: Population high but likely to slow



Overview

The Western Australian (WA) economy has significantly outperformed other states thanks to the once in a generation mining boom and its heavy endowment of raw commodities (namely iron ore and natural gas). However, with large investments in the sector coming to completion, the tide of new supply is expected to drive commodity prices lower and stifle new (mega) mining investment projects. While a surge in mineral production and exports from the newly completed projects will contribute to the state GSP over coming years, the negative impact on the labour market will constrain domestic demand and more than offset the positive impetus from exports. This is because the construction of a mine tends to be significantly more labour intensive than its operation. Consequently, we expect GSP growth in WA to slow from over 5% in recent years, to around 2¾% in 2015-16. This will also see the unemployment rate lift, but could be partly offset by some outward interstate migration.

In line with the difficult structural transition taking place in the WA economy the general government net operating surplus is forecast to drop considerably in 2014-15. A key drag on revenues has been a deterioration in the state's GST relativity. On the positive side royalty receipts are forecast to rise, driven by increases in mineral and energy exports. For now the state government expects to continue to fund its asset investment program via debt accumulation.

S&P left WA credit rating at AA+ with stable outlook following the release of the 2014-15 Budget. The rating agency believes budget performance remains susceptible to external shocks and debt remains at elevated levels.

With WA relying on debt to fund infrastructure needs its demand on the market for funds in 2014-15 is forecast to be greater than that seen in 2013-14. WA has the largest funding programme amongst the states for 2014-15, with total funding at AUD9.8bn

Economic Profile

Unprecedented resources investment drove Western Australia's superior economic growth

WA is home to only around 10% of Australia's total population, but the resource-rich state is very important economically, contributing around 16% of Australia's total GDP. In 2012-13, WA exported 41% of Australia's total exports and 47% of total goods exports. The top five exports from WA are iron ore and concentrates (AUD 55.7bn), gold (AUD 14.9bn), natural gas (AUD 11.2bn), crude petroleum (AUD 9.3bn) and wheat (AUD 2.7bn).

Clearly, the state's economy is heavily dominated by mining. Over the past two decades, mining's contribution to total state output has increased from 24% in 1990 to 34% in 2013, thanks to strong demand for resources from emerging economies, particularly China. That compares to less than 10% for mining Australia-wide. The once-in-a-generation mining boom also drove growth in related industries including construction and manufacturing (through the downstream processing of minerals), with construction's share of total economic output also rising and manufacturing holding steady despite an unfavourable exchange rate environment and an overall shrinking manufacturing industry nationally.

The construction of the large-scale resource projects has created a significant number of job opportunities, making construction and mining the third and fourth largest employers in the state. Nevertheless, employment is still fairly heavily concentrated in WA's health and personal services sectors. Health and retail trade are the two largest employers in WA, although their GVA is significantly smaller than mining and construction.

Exhibit 72: Engineering pipeline slowing

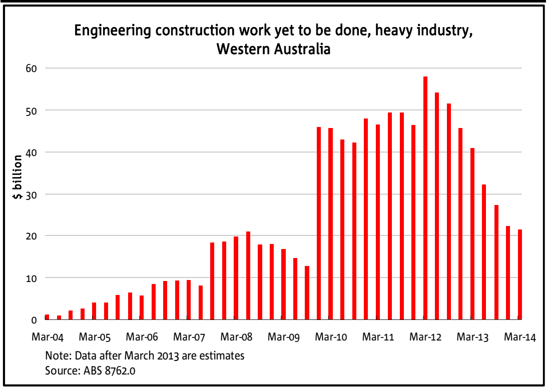


Exhibit 73: Public capital expenditure

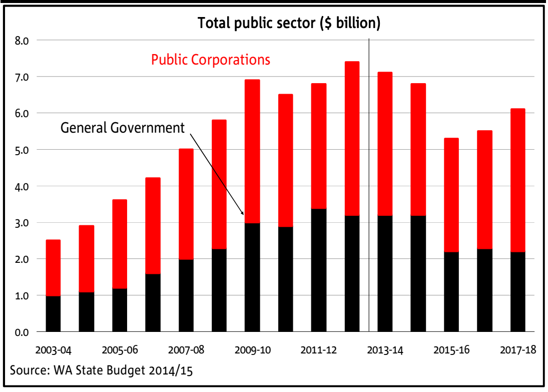


Exhibit 74: Retail sales & wages growth slowing

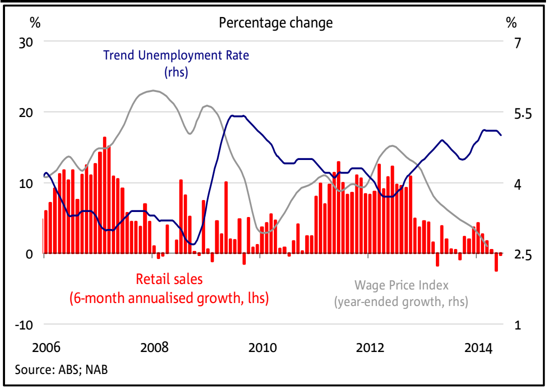
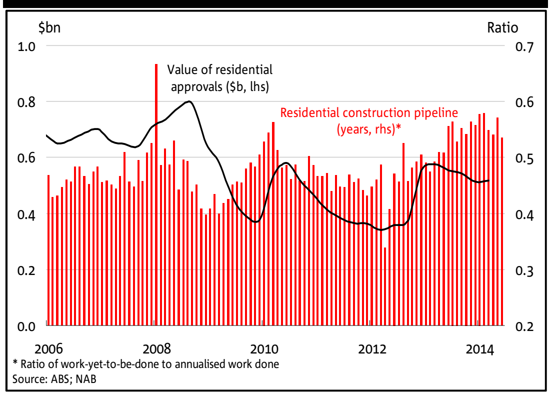


Exhibit 75: Dwelling investment and activity



Recent economic performance

In 2011-12, the state enjoyed its fastest economic growth of 7.3%, driven by a 39% increase in business investment. In 2012-13, economic growth slowed down to 5.1% and is forecast to return to more moderate levels as growth in business investment slows. With many large resource projects approaching completion, business investment has now peaked and the state is entering a transition period from the construction phase of major resource projects to the production and exports phases. As the latter phase is significantly less labour intensive than the construction phase, labour market conditions and wage growth are starting to soften and the strong population growth in WA is slowing down as well.

At the time of the state budget, it was reported that spending at the state's largest ever projects were past their peak; the Gorgon LNG project (AUD55bn) was around 80% complete, while construction at the Wheatstone LNG project (AUD29bn) was 30% complete. As mining investment winds down, population and wages growth is likely to be hit further, having a large impact on non-mining sectors as well and driving a deterioration of the labour market that is much more severe than direct mining employment numbers would suggest. A tighter labour market and slower wage growth will likely weigh on consumer sentiment and household consumption (see below). But while domestic demand growth will be constrained, GSP growth will be supported (higher than most states) by rapid growth in commodity exports. Over the forecast horizon iron ore exports are expected to rise by a third and LNG to more than double.

Regarding public investment, capital expenditure growth slowed notably since the global financial crisis, reflecting minimal growth in both general government and public corporation investment (Exhibit 73). The need to restrain debt levels means that public investment is expected to be pulled-back considerably over coming years, creating yet another drag on the domestic economy. Major spending on health infrastructure is coming to completion, contributing heavily to a drop in general government capex of almost a third in 2015-16. PNFC spending is also expected to be relatively flat over the next couple of years before accelerating in the out years due to new public transport projects (particularly the Forrestfield Airport Link).

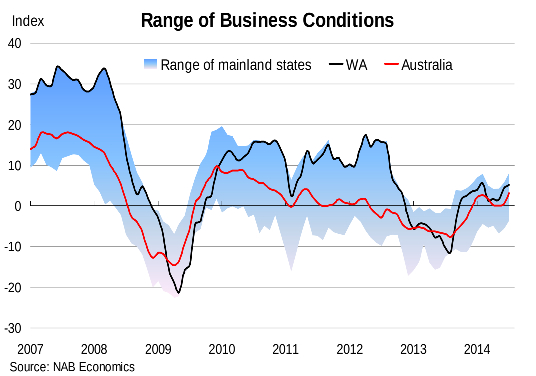
Consumer demand soft, but dwelling investment a key source of support

Retail trade and hospitality, both of which are major employers in the state, are facing their own challenges given the strong Australian dollar and cautious consumer. Recent ABS data has shown negative growth in retail sales since the beginning of the year as households cut discretionary spending in response to heightened uncertainty and a notable deterioration in the states labour market. The trend unemployment rate for WA has risen steadily to around 5%, up from a pre-GFC low of around 2.7%, and only slightly below the GFC high of 5.4%.

The labour market is likely to remain under significant pressure as employment in mining investment drops off significantly – although the precise timing is very difficult to gauge. The impact on population, spending behaviour and asset prices is expected to keep private household consumption's contribution to GSP very subdued.

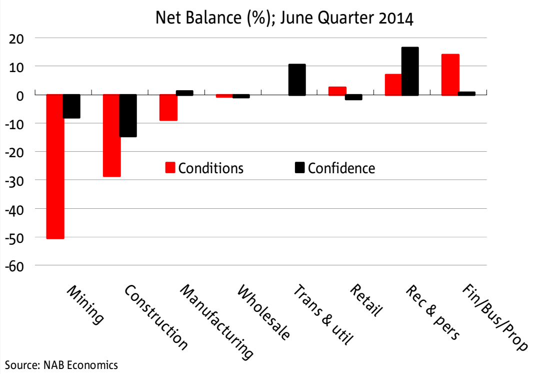
While consumption is not providing much support to domestic demand, WA has experienced a surge in residential building approvals over the past 12 months – similar to what has occurred in some of the major eastern states. Previously strong employment growth, higher rents and low interest rates contributed to higher demand. Demand outstripped investment in new housing, causing prices to rise sharply over 2013. However, demand side fundamentals are now starting to shift (as per above discussion) and supply is also starting to respond. In the medium term, the supply response will be a positive for GSP as dwelling construction helps to offset some of the drag from business investment. However, with vacancy rates on the rise, the positive impetus will not be completely offsetting in the longer term.

Exhibit 76: Business conditions sub trend



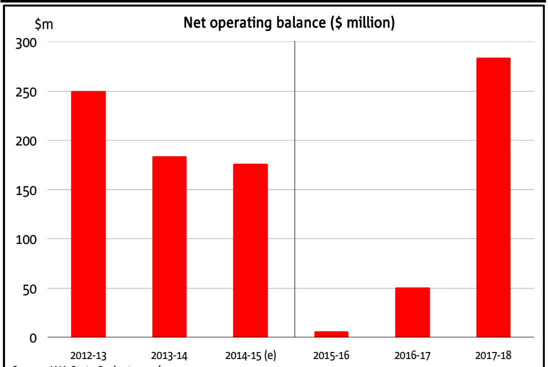
Source: NAB Economics

Exhibit 77: Industry breakdown



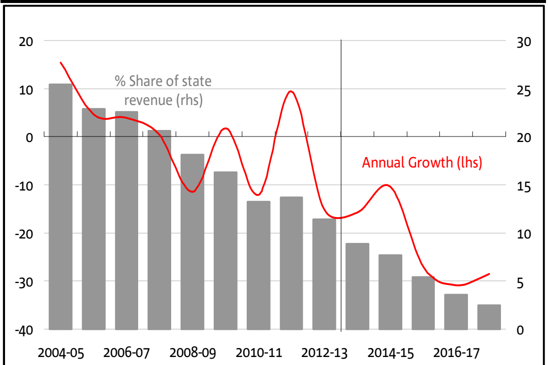
Source: NAB Economics

Exhibit 78: GG operating surplus to shrink



Source: WA State Budget 2014/15

Exhibit 79: GST grants from Commonwealth



Sources: NAB; WA Budget 2014/15

NAB Survey

Results from the NAB Business Survey are showing that most industries in WA are doing it tough, led by a sharp deterioration in mining and construction industries – consistent with the slowing down of the mining investment boom and softening commodity prices. Nevertheless, trend conditions from the recent July survey (a summary of trading conditions, employment and profitability), were equal highest of the mainland states for WA (along with New South Wales). Trend confidence on the other hand is equal lowest (along with South Australia).

Confidence levels remained positive (albeit softer than other mainland states) in July, but some of the leading indicators from the business survey are not so positive. Forward orders softened considerably in the month, although this followed solid levels in the previous two months, while capacity utilisation rates have dipped back below 80%. The wholesale sector – often considered a bellwether industry for the broader economy – is also showing soft conditions and soft confidence levels (see Exhibit 76).

By industry, business conditions are generally looking best in professional services, but the all important mining and construction industries that have driven the WA economy's rapid growth have deteriorated significantly. Confidence levels are also negatively based, with retail and construction firms in WA apparently not as optimistic as their counterparts in some other states.

State budget and finances

Budget position

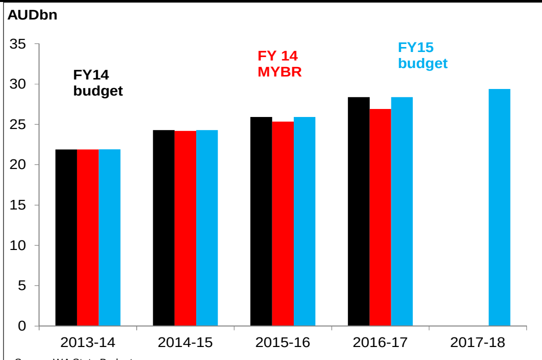
The general government's net operating surplus has been in decline in recent years and is forecast to drop considerably in 2014-15 (despite announced revenue and expense measures). This is in line with the difficult structural transition taking place in the state economy which is limiting state revenue growth. A major drag on WA state revenue has been a deterioration of the state's GST relativity (a complicated calculation that determines how GST grants will be distributed among the states). WA's relativity has dropped from around 1 to 0.38 over the past decade, the lowest of all the states. The state government is projecting GST revenues to drop further over the forecast period from AUD2.5bn in 2013-14 (8.8% of revenue) to AUD799m (2.5% of revenue) by 2017-18, coinciding with a drop in WA's population share of GST to around 11% (much lower than the Commonwealth's projection of WA's GST relativity).

The role of commodity markets is also important, with royalty income accounting for around a fifth of total revenue in 2013-14 (see Exhibit 6, page 2). Royalty revenue jumped considerably in 2013-14 in line with strong increases in iron ore production. Further increases in mineral and energy export volumes is expected to see royalty receipts continue to rise, while anticipated declines in commodity prices are only partly offsetting; although iron ore price assumptions in the budget appear a little on the high side, remaining above US$100 per tonne (FoB) by 2017-18. Every US$1 per tonne change in iron ore prices impacts royalty revenue by AUD49mn – partly offset by changes in GST grants.

Government Debt levels

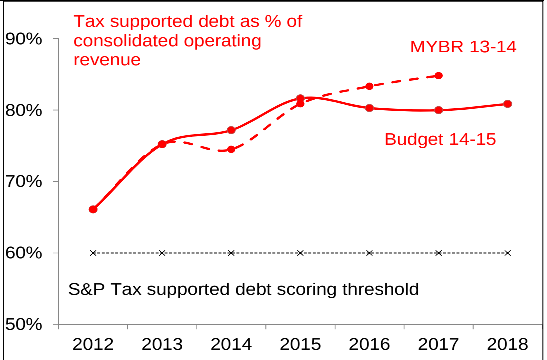
With the operating surplus remaining low, the state government expects to continue to rely on debt accumulation to fund its asset investment program. Total public sector net debt is expected to rise by around a third between 2013-14 and 2017-18 (to AUD29.4bn) – 61.5% of revenue.

Exhibit 80: NFPS net debt levels



Source: WA State Budgets

Exhibit 81: Tax supported debt



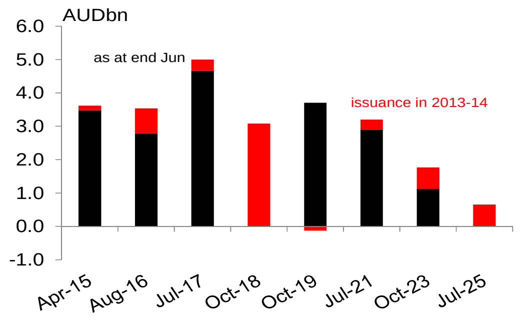
Source: WA Budget papers,

Credit Rating

S&P left Western Australian credit rating at AA+ with stable outlook following the release of the 2014-15 Budget. The rating agency believes budget performance remains susceptible to external shocks and debt remains at elevated levels. As to the later, S&P's preferred measure of debt burden is tax supported debt as a percentage of consolidated operating revenue. As Exhibit 81 illustrates, while there has been an improvement in the forward estimates it remains at an elevated level. Asset sales over the coming years have the potential to improve the debt outlook of the state, but as S&P has noted, "The outcome of any asset sale on the state's credit quality is dependent on how the government uses the proceeds".

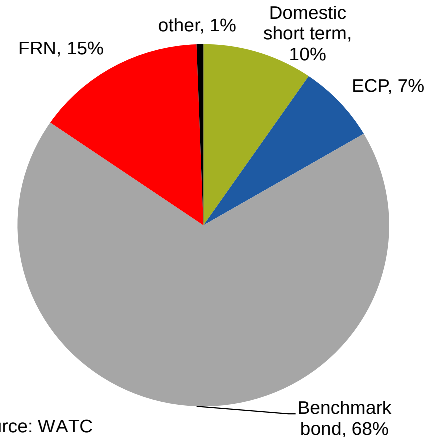
Bloomberg ticker	WATC
Website	www.watc.wa.gov.au

Exhibit 82: Benchmark bond issuance in FY14



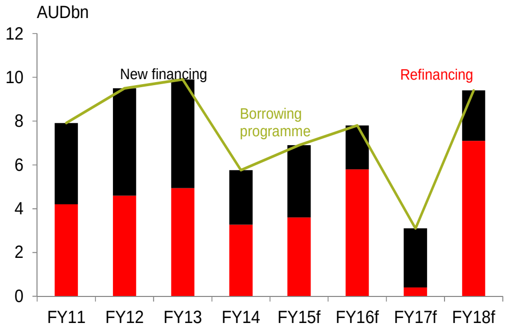
Soure: WATC, NAB

Exhibit 83 Composition of debt



Source: WATC

Exhibit 84: WATC funding programme



Source: WATC

Western Australian Treasury Corporation

Function

Western Australian Treasury Corporation (known as WATC) fulfils the role of the state's corporate treasury services provider. In its role as central financing authority for the Western Australian public sector, WATC is currently responsible for managing debt outstanding of approximately AUD34bn. WATC issues bonds in the domestic markets and while it does have a Euro MTN programme, it currently only uses offshore markets in the form of its multicurrency Euro Commercial programme (ECP).

WATC clients

WATC accesses the domestic and offshore markets on behalf of 160 clients. Its biggest client is the Western Australian public sector. Housing, public transport, port authorities, electricity generation and universities are also debt funded by WATC.

Debt Outstanding

WATC has five borrowing programmes – two short-term and three long-term. Short-term outstandings totalled AUD6.7bn as at April 2014 comprising AUD3.3bn of short-term inscribed stock and AUD2.4bn of euro commercial paper. The long-term outstandings totalled AUD28.5bn with AUD23.4bn in benchmark bond lines and AUD5.1bn in Floating Rate Notes (FRN).

Issuance

WATC's total funding program for 2014-15 is AUD9.8bn with new funding of AUD3.3bn and AUD6.5bn of maturities. It intends to issue between AUD5-6bn of benchmark bonds, AUD3-4bn of FRNs and AUD0.5-1.5bn of short term paper. As at the time of writing WATC has issued up to AUD2bn.

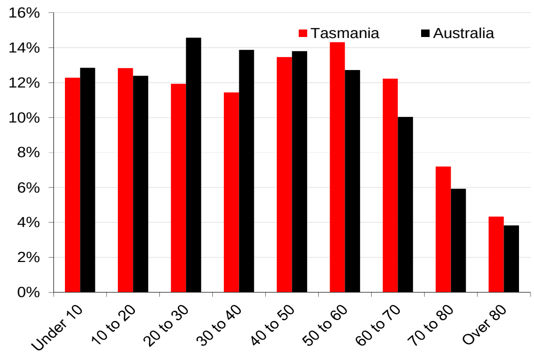
View

While WATC bonds under-performed around the time of rating downgrade, for the past six months spread compression has continued amid improved credit appetite and a search for yield. While there is scope for some further compression in spreads (relative to benchmark and swap) the big macro spread compression trade is nearing its end. On a relative basis, the WATC yield curve traded as tight as 7-11bps over the AAA equivalent. While in the front of the curve credit risk dissipates, sub 10bps in 10y maturity starts to look tight. For the 10y, the differential (using zero coupon analysis) is currently at around 15bps and in the absence of a major credit crisis we see it in a range of around 10-20bps over the year ahead.

State of Tasmania

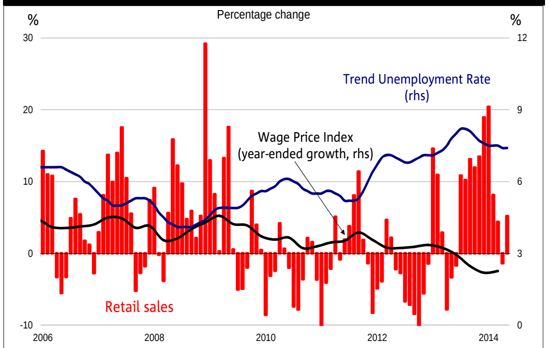
Country	Australia
Capital city	Hobart
Government	Liberal Party
Next election	2018
Rating and outlook	Moody' s Aa1/Negative S&P AA+/Stable
Website	www.tas.gov.au

Exhibit 85: Population distribution by age



source: ABS

Exhibit 86: Unemployment, wages ,retail sales



Source: ABS; NAB

Exhibit 87: Budget flexibility

Source: Tasmania's budget papers, NAB

Economic Profile

Tasmania is an island state located south of the Australian mainland. It is Australia's smallest state, having a population of just over 500,000. This combination of remoteness and low population presents a number of economic challenges. Tasmania has the nation's highest unemployment rate (7.5% trend in July 2014) and lowest GSP per capita ($47,551 in 2012-13, compared to the national average of $66,397). Unlike the mainland capital cities, Hobart house prices have been relatively stable for the last five years, and residential dwelling approvals have been in decline since 2010.

Tasmania's population is older than the national average, with a notably smaller proportion of the population aged 20 to 40. Not only is the Tasmanian resident population ageing, it is growing at the slowest rate for any Australian State or Territory – just 0.3% in 2013.

State budget and finances

Budget position

The 2014-15 Tasmanian Budget is not scheduled for release until late August 2014. The Tasmanian Department of Treasury and Finance's April 2014 Analysis of Budget Risks is the most recent publicly available document on Tasmania's financial position.

The report shows a significant deterioration in the State's financial position since the 2013-14 mid-year update, with a net operating balance of -AUD325.5m forecast for 2014-15. Tasmania has not returned a budget surplus since 2009-10. The Tasmanian Department of Treasury and Finance does not anticipate a return to surplus over the forward estimates and net debt is forecast to exceed AUD400m in 2016-17.

Tasmania has a relatively large number of public sector employees. 17% of Tasmania's workforce was employed by the Tasmanian Government in 2012-13, compared to less than 12% in Victoria. While this partly reflects Tasmania's less extensive privatisation programme, it highlights the dependence of Tasmanians on public sector employment. Aggressive cuts may have a larger impact on employment than cuts of a similar nature on the mainland.

Government Debt levels

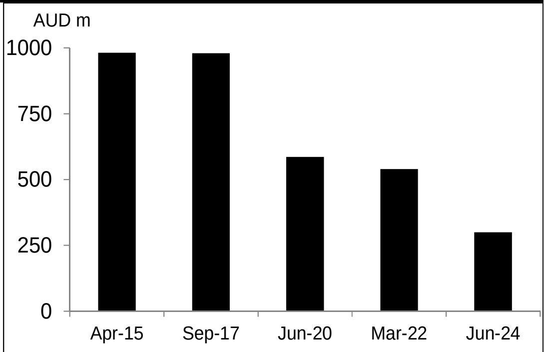
Based on 2014 Mid-Year Budget Review figures, Tasmania's net debt for its Total Public Sector is projected to increase modestly from AUD2.3bn in June 2014 to AUD2.5bn by June 2017. These new projections are lower than those provided in prior budget estimates.

Credit Rating

Tasmania holds a AA+ credit rating with stable outlook from S&P. In the agency's opinion, the state's lack of budget flexibility and high debt burden are the main areas of concern. Budget flexibility is low given that Commonwealth grants account for a large share of revenue. One of S&P measures of budget flexibility is the modifiable revenue as percent of adjusted operating revenue and as Exhibit 87 illustrates Tasmania's ratio remains below S&P's scoring threshold. In terms of the debt burden, while Tasmania has the lowest tax supported debt among Australian state's (less than 50% of revenues), S&P considers Tasmania's debt burden to be moderate once the state's unfunded superannuation liabilities (just over 70% of revenues) are included. On the positive side, S&P notes that the state's budgetary performance remains strong despite some softening in the state's cash operating balance in recent years.

Bloomberg ticker	TASCOR
Website	www.tascorp.com.au

Exhibit 88: Benchmark bond outstanding



Source: Bloomberg

Tasmanian Public Finance Corporation

Function

Tasmanian Public Finance Corporations (TASCOR) main function is to develop and implement borrowing and investment programmes for the benefit of that state's authorities. Given this function and with the approval from the Treasurer, TASCOR is able to issue government guaranteed bonds in the domestic and international financial markets as well as deposits received from public authorities.

TASCOR clients

TASCOR services the state's ministerial departments, authorities and councils.

Debt Outstanding

TASCOR has three funding programmes. The domestic bond programme is the principal source of funding with currently AAUD3.4bn outstanding in five benchmark bonds. A European Commercial Paper and Domestic Promissory Note programmes each with a facility of AUD2.5bn provide short term funding support to TASCOR's funding strategy.

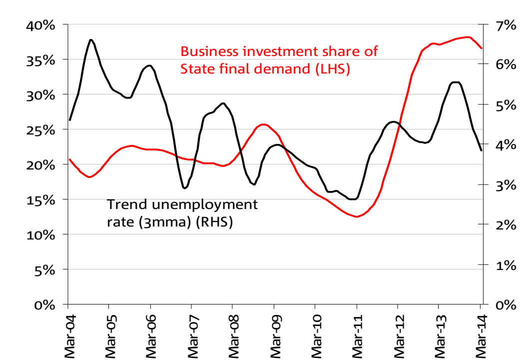
Issuance

TASCORP's funding requirement for the financial year 2014-15 is estimated to be AUD900m. This estimate will be updated once the State Budget is delivered on 28 August. Tascorp estimates that the funding will be raised via taps of existing hotstock lines.

Northern Territory

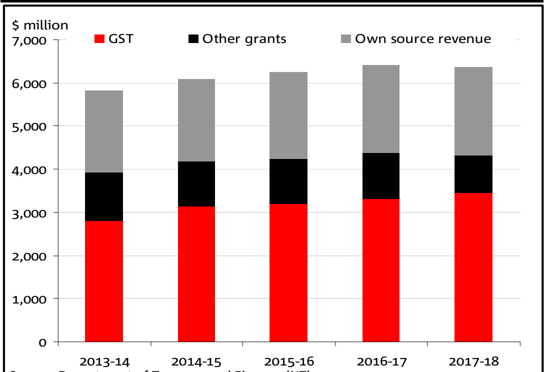
Capital city	Darwin
Government	Country-Liberal Party
Next election	August 2016
Rating and outlook	Moody' s Aa1/Negative
Website	www.nt.gov.au

Exhibit 89: Business Investment



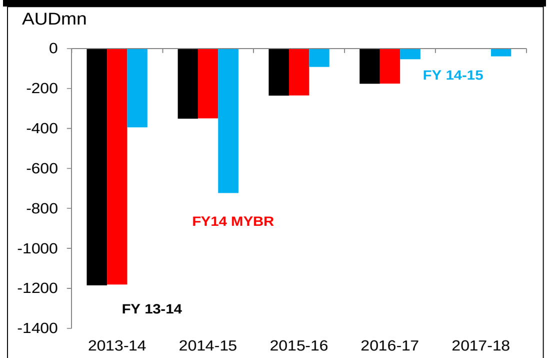
Source: ABS

Exhibit 90: NT Gov revenue sources



Source: Department of Treasury and Finance (NT)

Exhibit 91: NFPS Budget balance



Source: NT budgets papers

Economic Profile

Growth boosted by LNG project

The shadow of the Ichthys LNG project looms large over the Northern Territory (NT) economy. Currently under construction, the project will bring gas from the Browse Basin off the Kimberley coast onshore to an LNG processing facility in Darwin. Since construction began in 2012, business investment has skyrocketed from an average of 15% of state final demand in 2011 to 38% in 2013 and 37% in the March quarter 2014.

In part as a result of this investment, unemployment rate is the second lowest rate in the nation (at 4.8% on trend basis). While this is certainly positive for Territorians, unemployment may rise again as Ichthys nears completion over the next two years.

State budget and finances

Budget position

Although the NT general government sector net operating balance is forecast to move to surplus in 2014-15, the total fiscal balance remains in deficit and net debt is high (surpassing 15% of GSP) and is forecast to increase over the forward estimates.

Commonwealth grants dominate the NT's revenue base. Around half of the NT Government's revenue comes from GST, compared to less than a quarter for Victoria. The NT is the only state or Territory not to levy land tax.

The GST distribution system is designed to give states the same capacity to deliver services. The NT's high proportion of the population living in remote indigenous communities sees it receive more than 5 times its population share of GST, with indigenous and remote factors causing a redistribution of AUD1.5bn to the NT in 2014-15.

The NT's dependence on GST leaves it exposed to fluctuations in GST pool growth and its share of the pool. Should the Commonwealth Grants Commission change the GST allocation rules, the NT could stand to lose more than other jurisdictions.

Government Debt levels

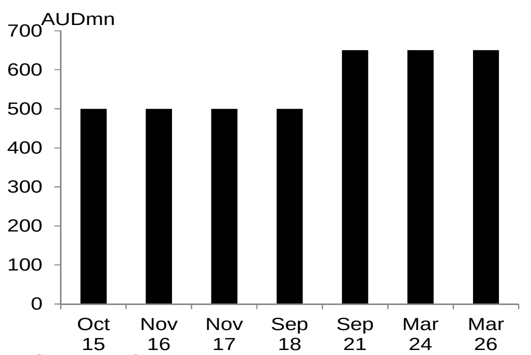
The territory's non-financial public sector net debt was estimated at AUD3.4bn in 2013-14 and it is projected to rise to AUD4.2bn by 2017-18. As a ratio to revenue, net debt for the territory is anticipated to decrease from 67% in 2014-15 to 65% in 2017-18. This improvement is reflective of the expected additional own source revenue and improving position of the Power and Water Corporation (PWC).

Credit Rating

Following the release of the 2014-15 Budget, Moody's reaffirmed NT's Aa1 credit rating with negative outlook. While the agency has acknowledged the territory's plan to narrow its fiscal deficit, a balanced budget is not expected to be achieved over the medium term. The government's commitment to meet lower spending targets as well as achieving a successful reform of the PWC operations is of paramount importance to the territory's credit outlook.

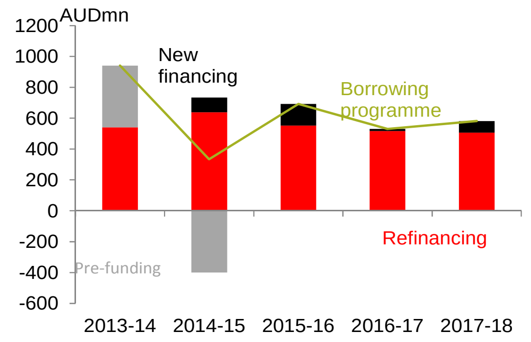
Bloomberg ticker	NTTC
Website	www.treasury.nt.gov.au

Exhibit 92: Benchmark bond outstanding



Source: NTTC

Exhibit 93: NTTC funding programme



Source: NTTC, NAB

Northern Territory Treasury Corporation

Function

The Northern Territory Treasury Corporation (NTTC) manages NT's exposure to funding risk by ensuring the Government is not exposed to a significant refinancing risk in any financial year.

The Corporation's approach to minimising funding risk involves the diversification of borrowing and investment activities across the maturity spectrum and utilising a variety of funding sources to meet the Corporation's requirements.

NTTC clients

The Corporation lends funds to the Northern Territory Government, government business divisions, the government owned corporation, local authorities and other government organisations. Loans are issued in accordance with commercially based guidelines and practices.

Debt Outstanding

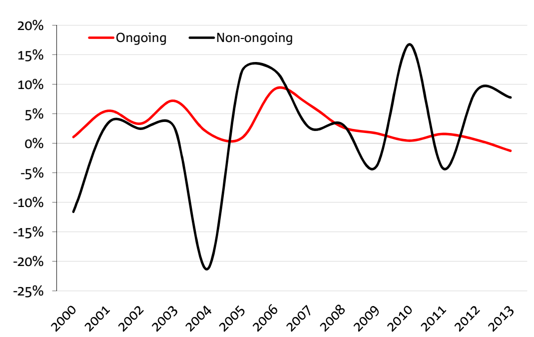
NTTC borrows funds from the domestic and international financial markets by offering a range of financial products. The funds raised by the Corporation assist to finance NT's infrastructure requirements such as housing, transport, health and education services. The corporation has 8 bond lines with an aggregate amount outstanding currently at AUD4.48bn. Short-term funding needs are met via promissory note facility.

Issuance

The Corporation currently estimates its funding requirements for 2014-15 at AUD334mn. This comprises AUD638mn of refinancing, AUD96mn of new money and AUD400m of pre-funding. Over the forward estimates NTTC funding requirement is expected to average around AUD550mn with the majority of this refinancing.

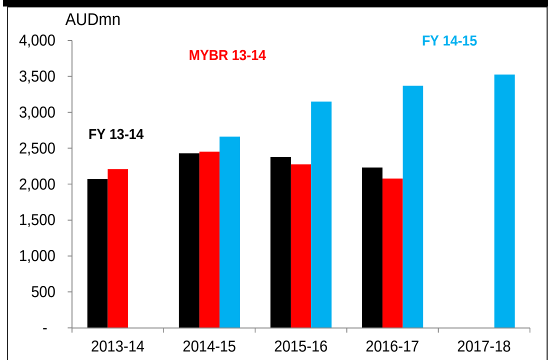
Capital city	Canberra
Government	Labour Party
Next election	October 2016
Rating and outlook	S&Ps AAA/Stable
Website	www.act.gov.au

Exhibit 94: Change in APS staff numbers



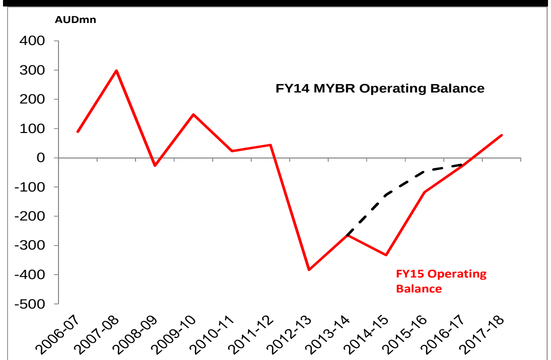
source: APSED

Exhibit 95: NFPS net debt levels



Source: ACT budgets papers

Exhibit 96: GG operating balance



Source: ACT budget papers

Australian Capital Territory

Economic Profile

The Australian Capital Territory (ACT) is a territory within New South Wales consisting of Canberra and a small rural surrounding area. The ACT has Australia's lowest unemployment rate (3.8% trend in July 2014) but growth has been slowing, with state Final Demand falling 0.2% in the March quarter 2014.

As the seat of the Commonwealth Government, the ACT's economy is heavily dependent on public sector employment. Some 40% of the Australian Public Service (APS) works in the ACT and by some measures the APS employs almost half of the ACT's workforce.

Growth in APS staff numbers has stalled since 2012 as the Commonwealth has imposed efficiency dividends on departments. Ongoing APS staff numbers are now declining and retrenchment rates have increased. The 2014-15 Commonwealth Budget contains a further reduction of 16,500 staff by mid-2017.

While the reduction in APS employees will present challenges for the public service dependent ACT economy, private sector job vacancies have been climbing since mid-2013, pointing to a level of business optimism and possibly outsourcing of public sector activity.

State budget and finances

Budget position

The ACT Government fulfils the role of both a state and local government, and therefore is responsible for the provision of municipal services ordinarily provided by local councils in other parts of Australia.

The ACT budget fell into deficit in 2012-13. The ACT Government forecasts a deficit AUD332mn in 2014-15, but projects a return to surplus by 2017-18.

The ACT is the first state or territory to commit to phasing out inefficient transaction based taxes, including stamp and insurance duties.

Government Debt levels

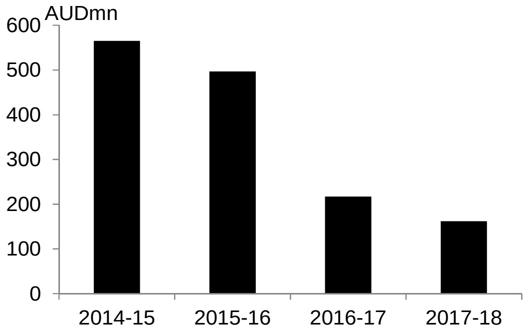
The territory's net debt is projected to increase from AUD1.8bn in 2013-14 to AUD3.5bn in 2017-18. This significant rise in borrowings reflects the government's initiative to invest in major infrastructure to ensure a stable construction sector and the development of assets that will help increase the economy's productivity.

Credit Rating

ACT currently holds a AAA credit rating with stable outlook by S&P. The rating agency considers ACT's financial management a "very positive" rating factor while the territory's above-average capability to generate revenue from asset sales is seen as a strong factor supporting the territory's budget flexibility. Offsetting these strengths, revenue growth has declined and the increase capital program over the coming years is forecast to result in weaker budgetary performance (see Exhibit 96). In S&P's opinion, the main risk to ACT's budgetary performance lies on the territory's ability to achieve revenue targets from its land release program.

Bloomberg ticker	AUSCAP
Website	http://apps.treasury.act.gov.au

Exhibit 97: Projected borrowing programme



source: ACT Treasury

ACT Treasury Directorate

Function

The ACT Treasury Directorate ("ACT Treasury") provides strategic financial and economic advice and services to the ACT Government with the aim of improving the territory's financial position and economic management.

Amongst other functions, ACT Treasury is responsible for the management of the territory's financial assets and liabilities including the borrowings and investments of the ACT Government. Territory borrowings are undertaken by ACT Treasury. A centralised approach has been established for the territory's debt raising and debt management activities with the objectives of achieving competitive borrowing rates, commensurate with the territory's credit rating and providing for an efficient and effective debt management function.

Issuance and funding

ACT currently has 5 bonds on issue with an aggregate amount outstanding of AUD2.44bn. ACT Treasury currently estimates its funding requirements for 2014-15 to be around AUD565m. The borrowing programme is projected to decline over the forward estimates with funding for 2017-18 estimated to be AUD162mn.

Notes

Important notices