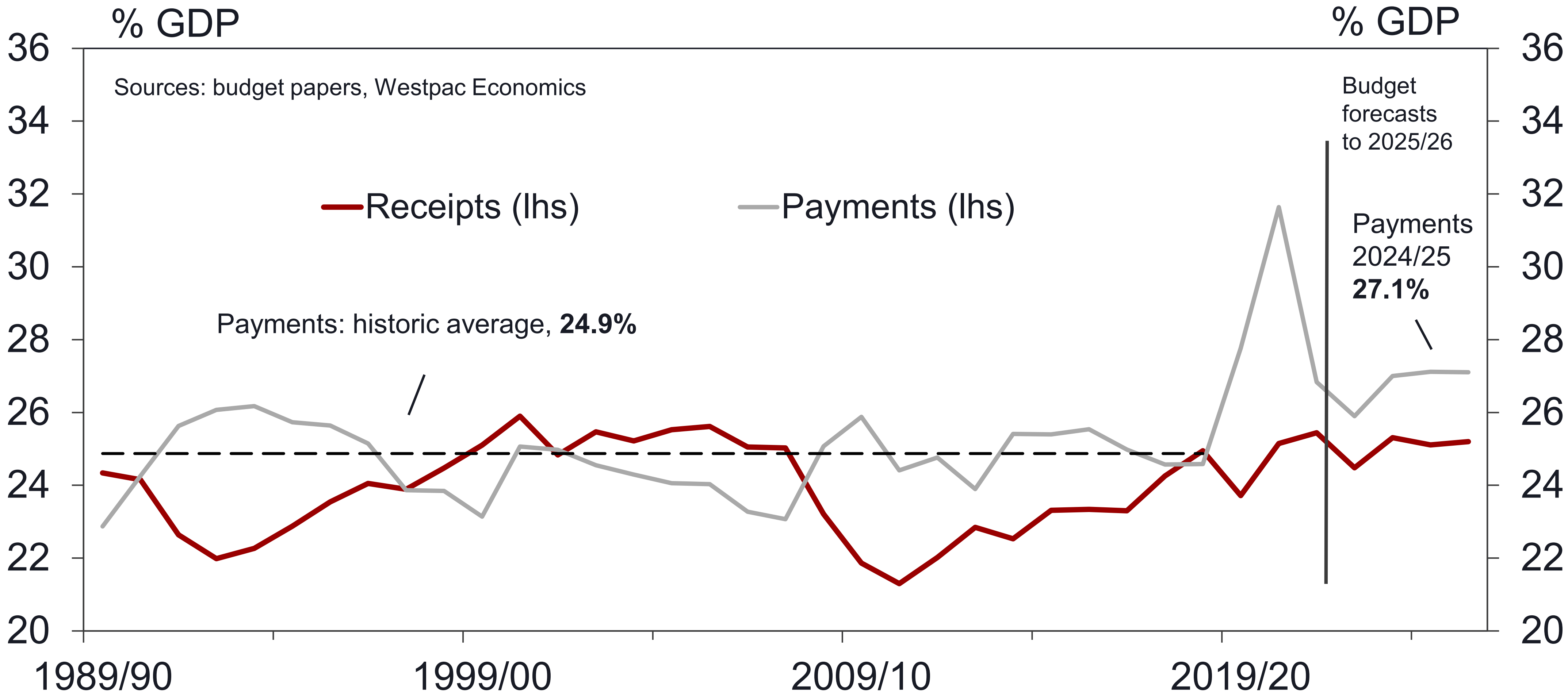
EUROPEAN ECONOMIC UPDATE

Presented by Westpac Chief Economist, Bill Evans

Westpac Institutional Bank

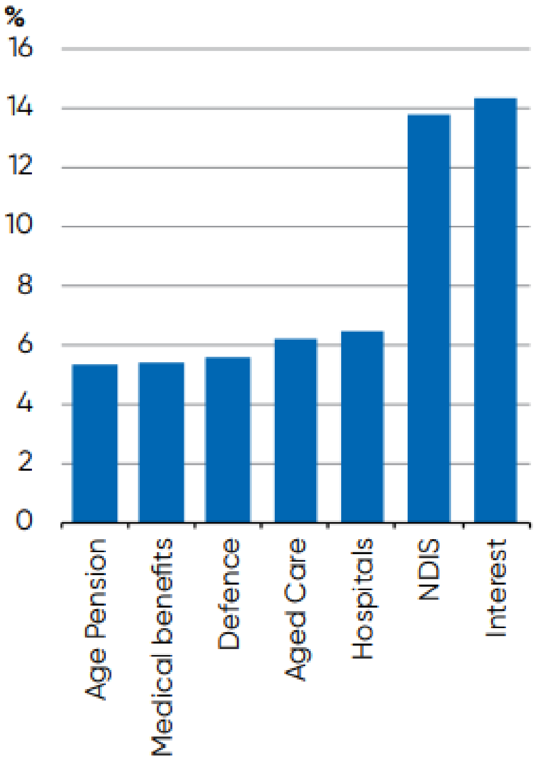
December 2022

Federal Budget: receipts and payments



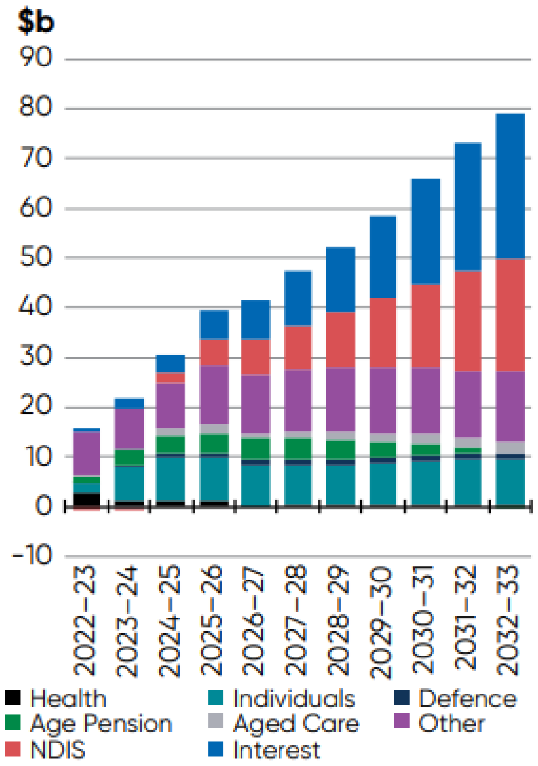
Structural pressures on the Budget

Average annual growth in major payments, 2022–23 to 2032–33



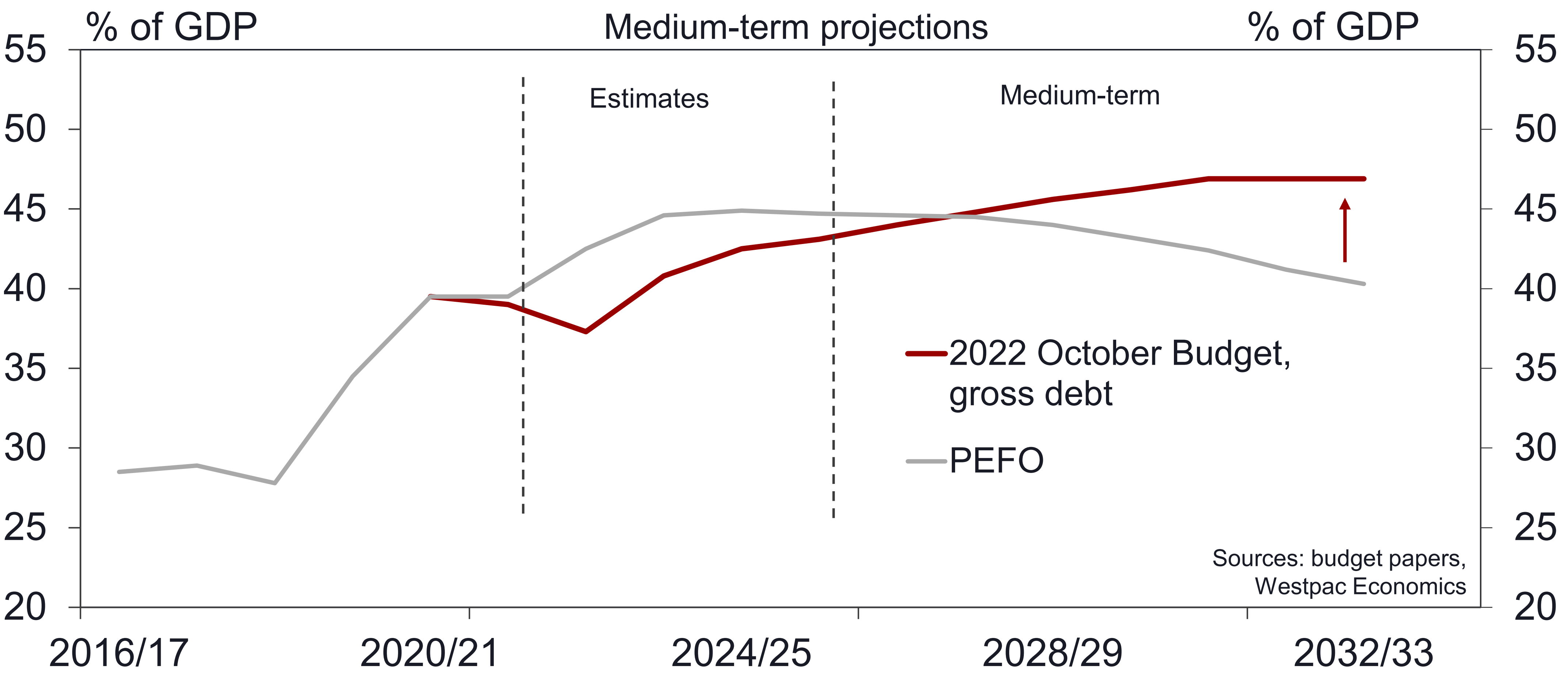
Source: Treasury

Revisions to major payments since pre-election estimates, 2022–23 to 2032–33

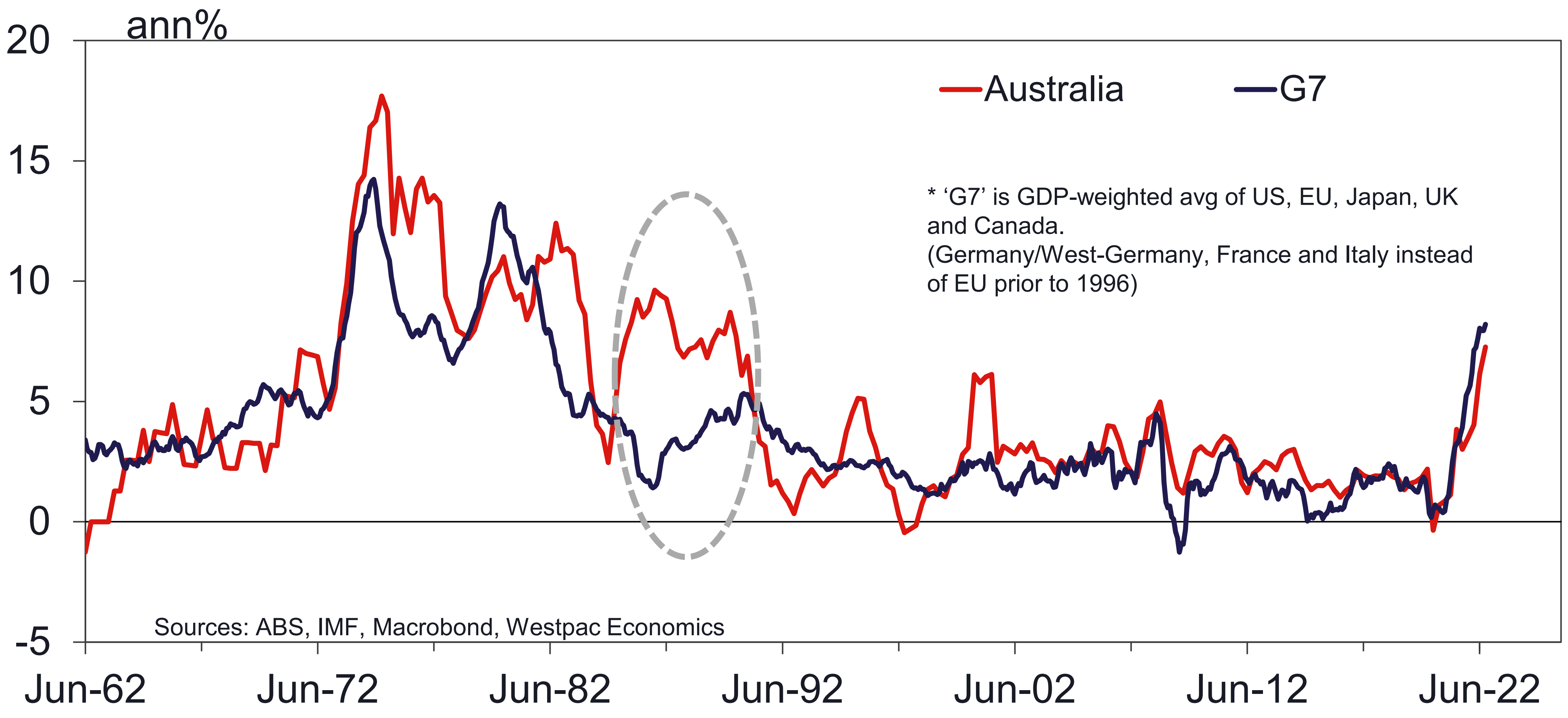


Source: Treasury

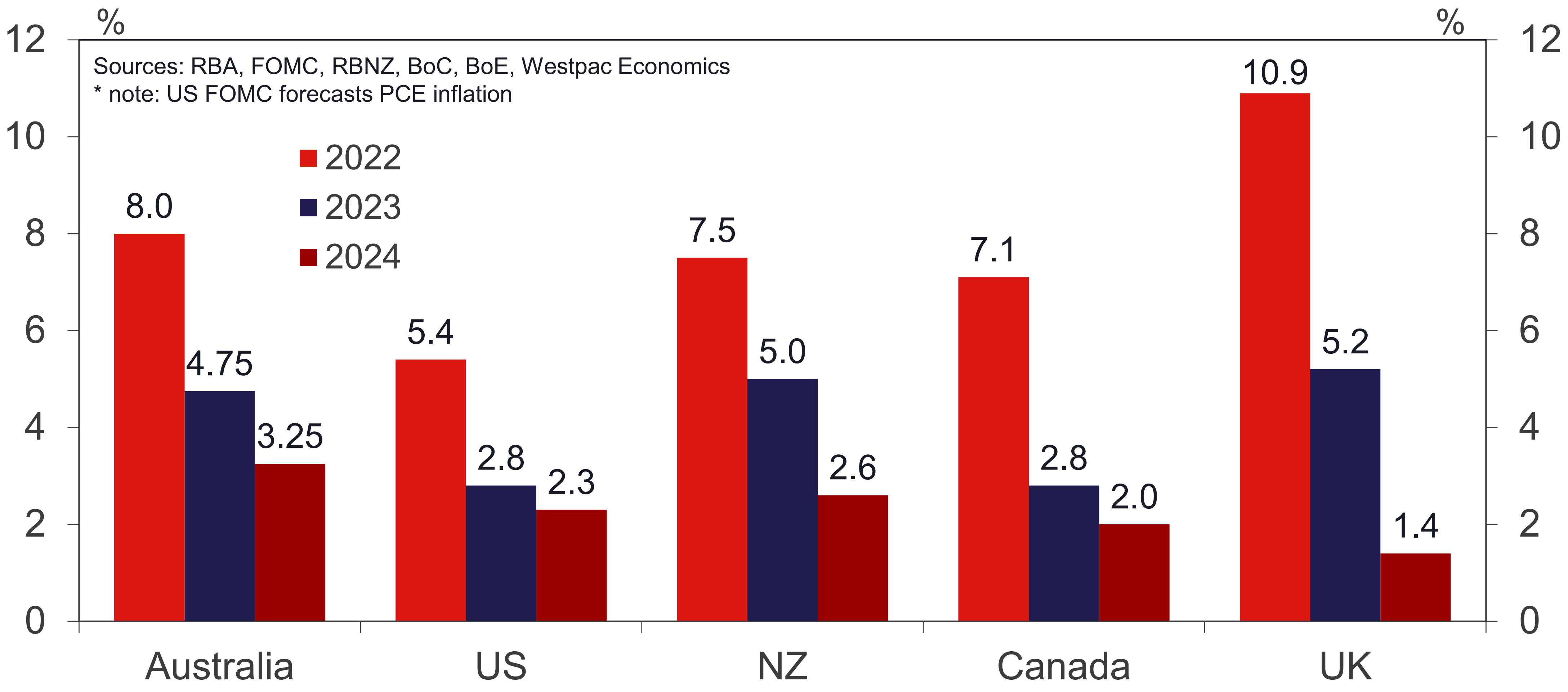
Public gross debt projections



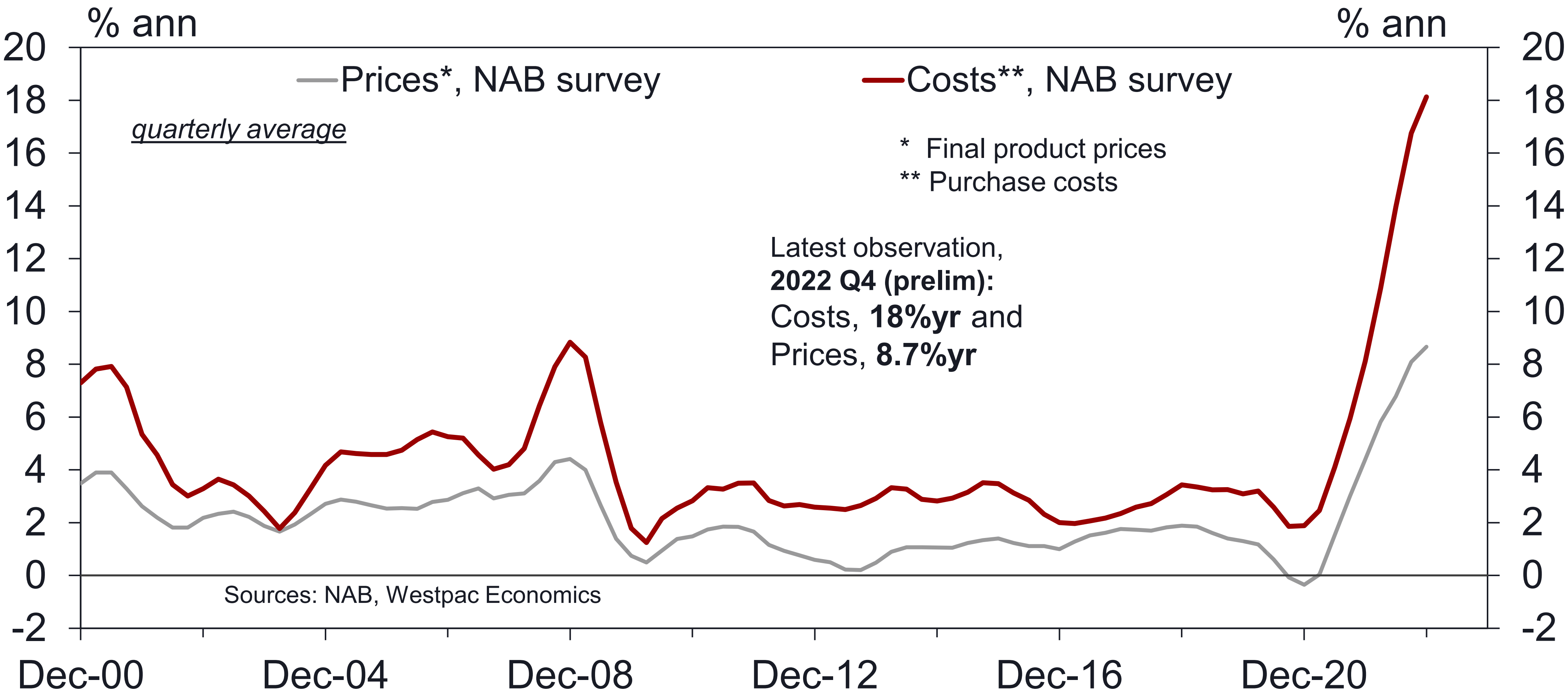
Inflation: long history: G7 challenge



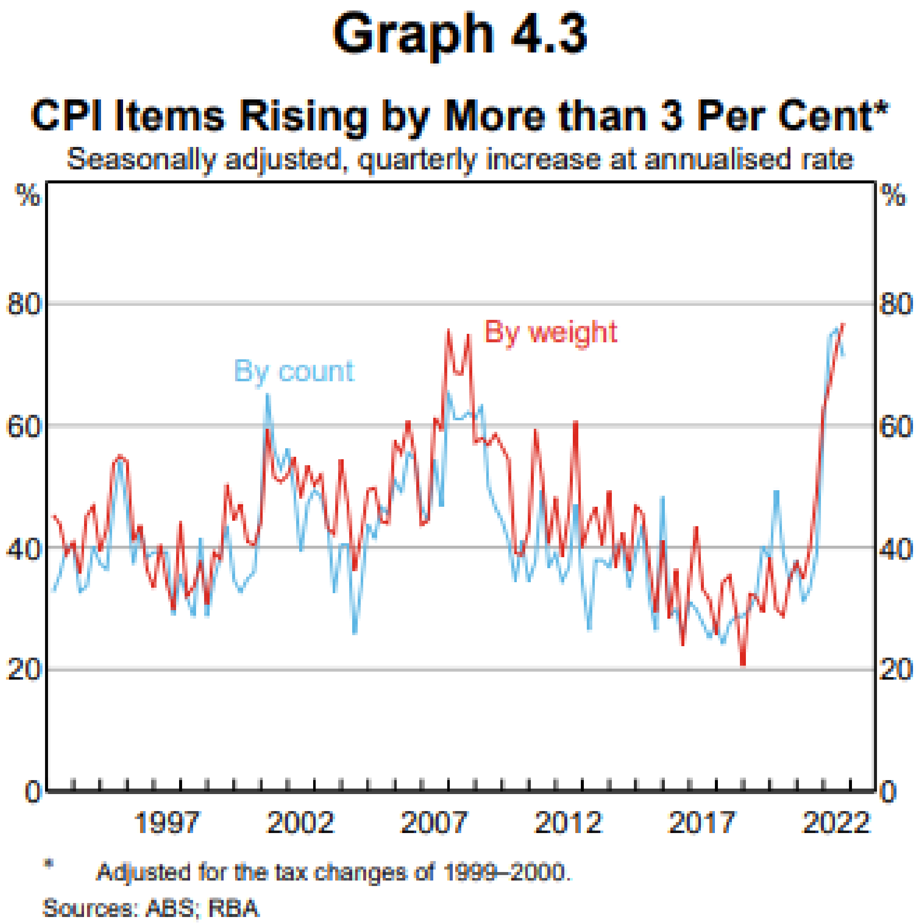
Central bank inflation forecasts – RBA; 3 years outside target band



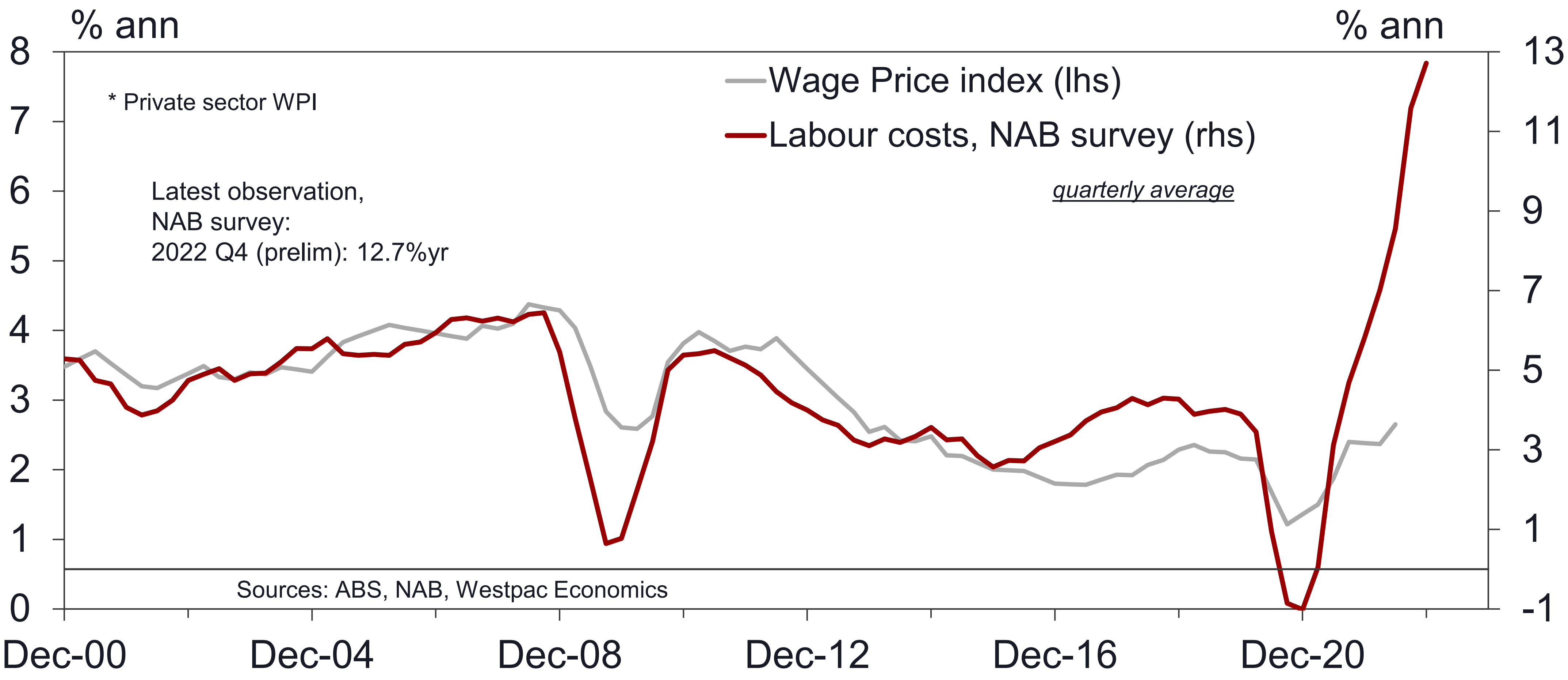
Spiralling costs leading to price pressures



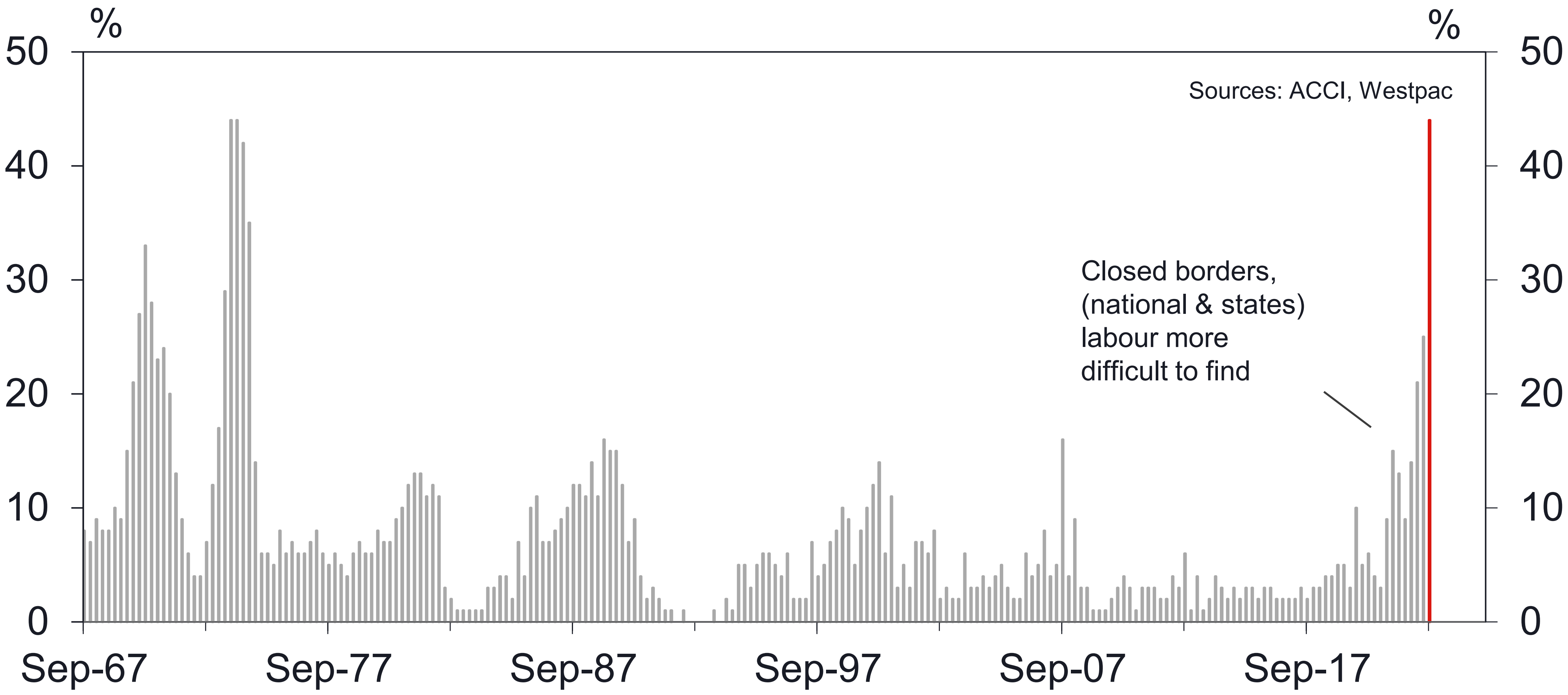
CPI items rising by more than 3 per cent*



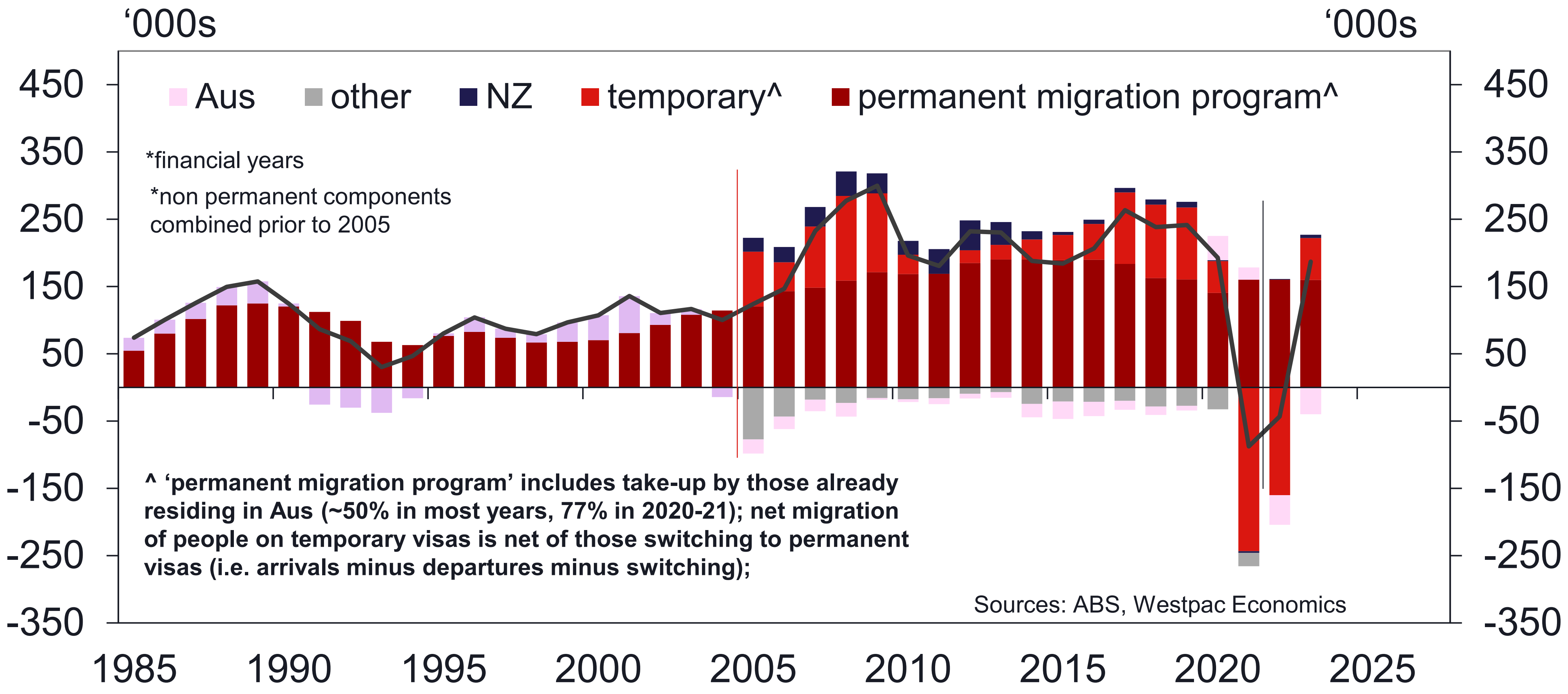
Labour costs: significant pressures



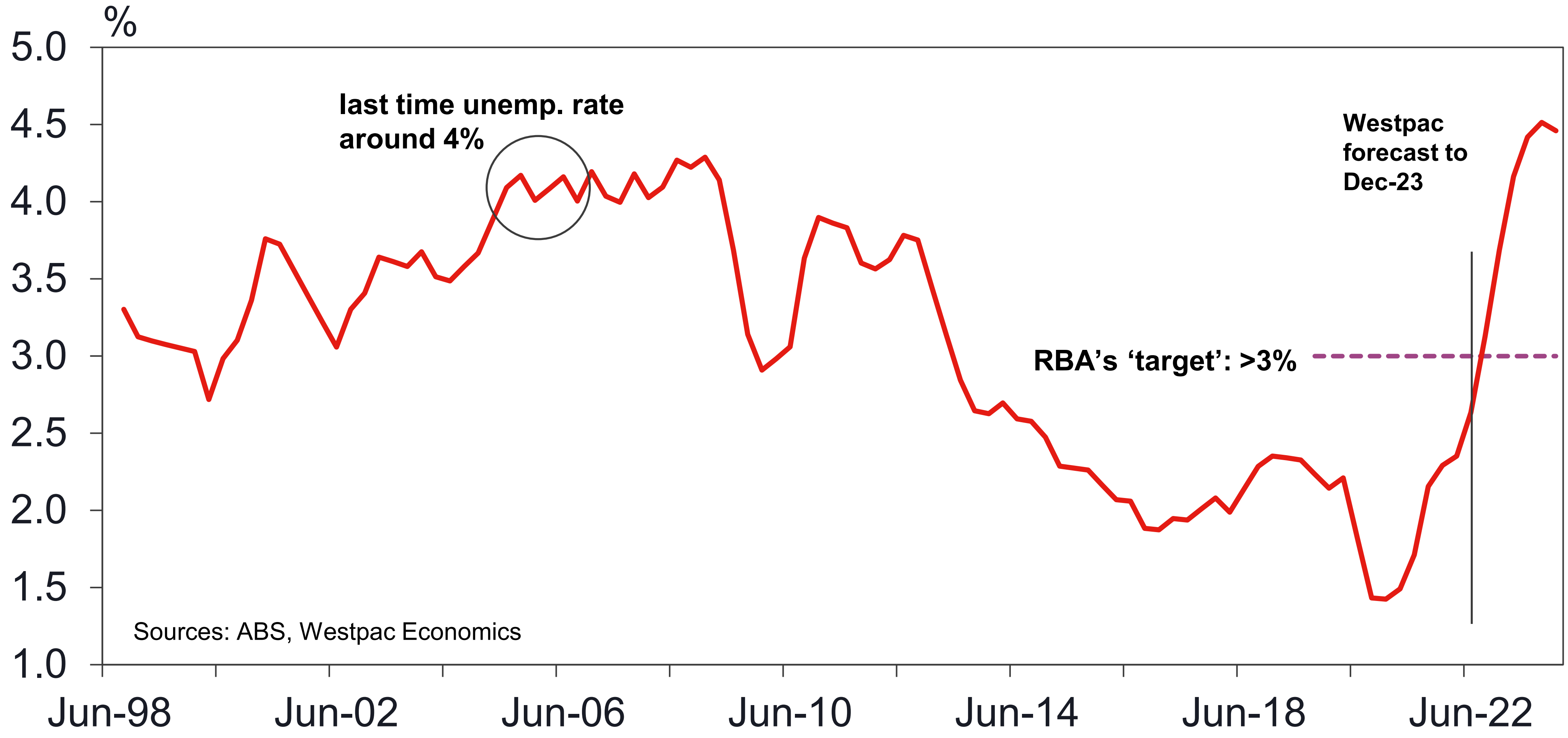
Labour: "single factor" most limiting production



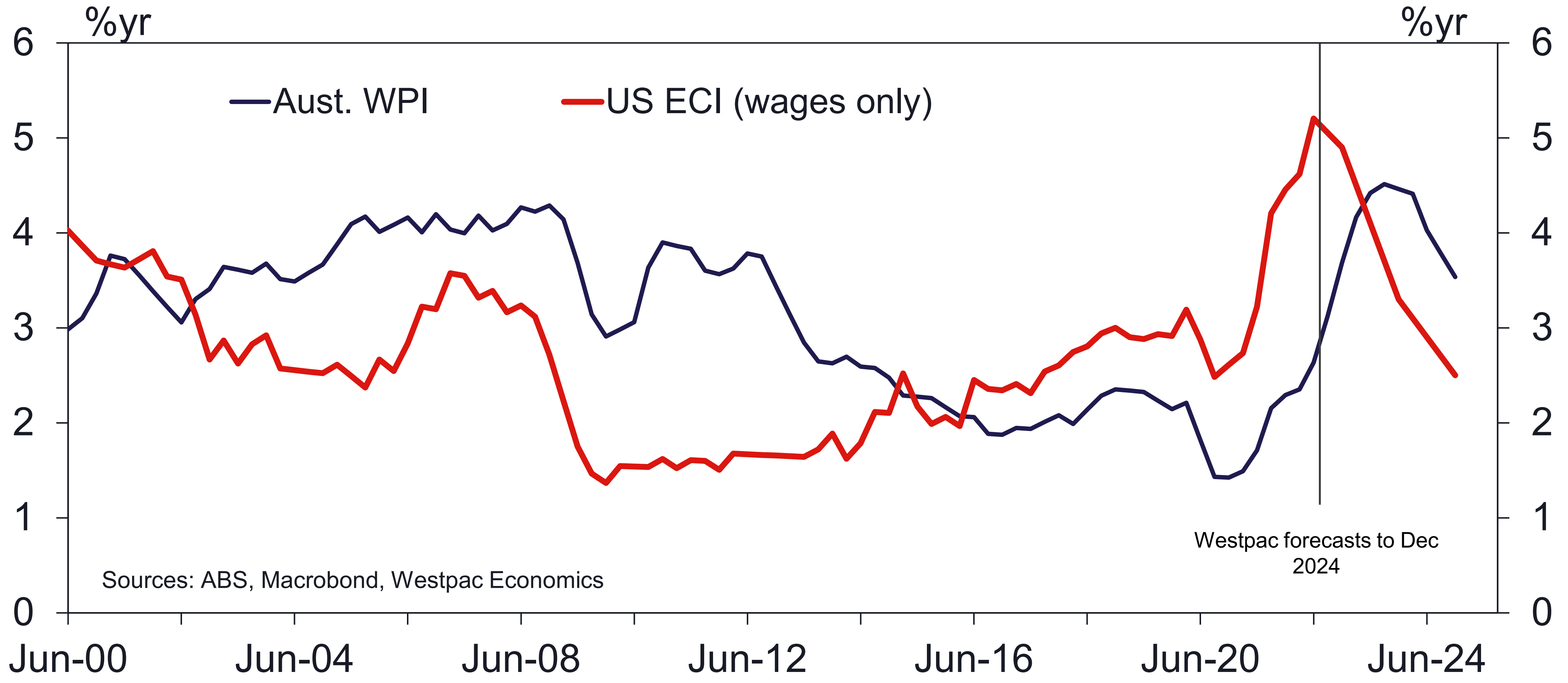
Net migration: 240,000 (2019) to –130,000 (2021 and 2022)



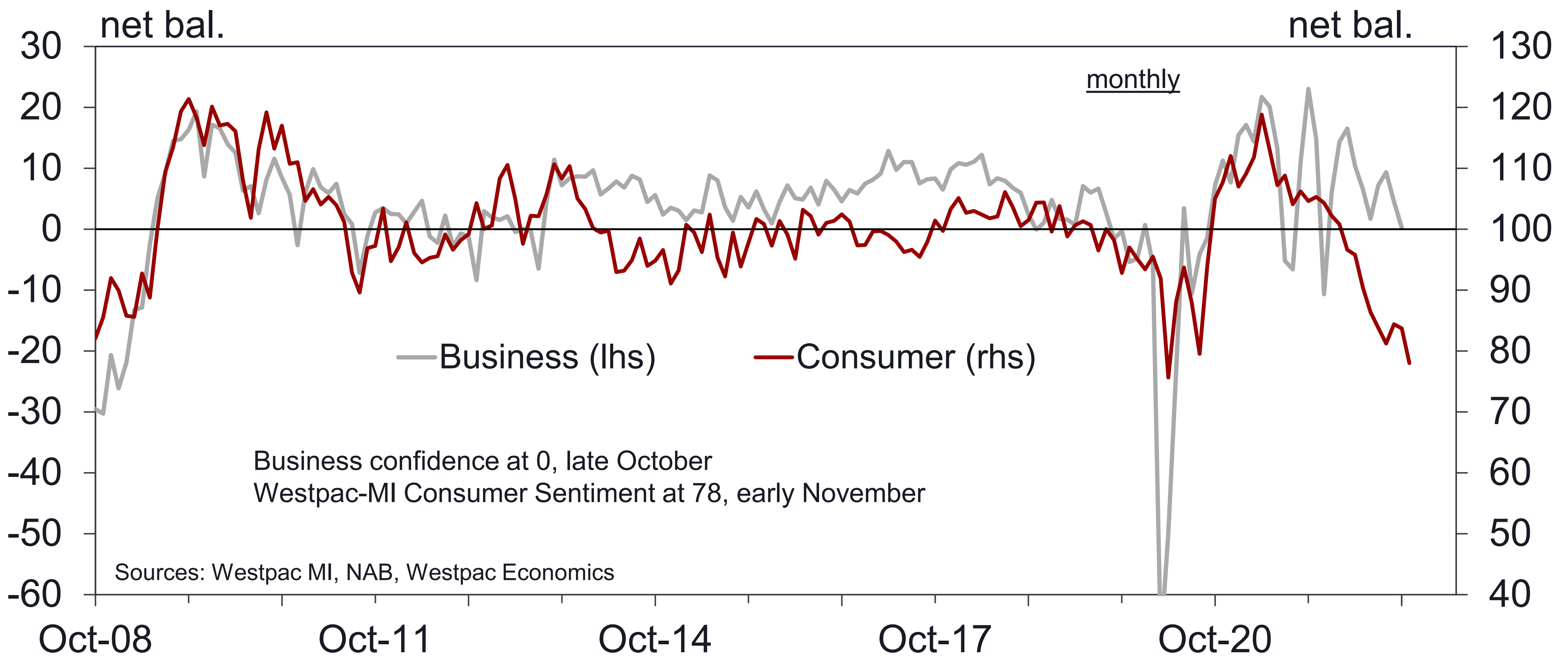
Wages growth: key to RBA outlook – 4.5% peak, at least



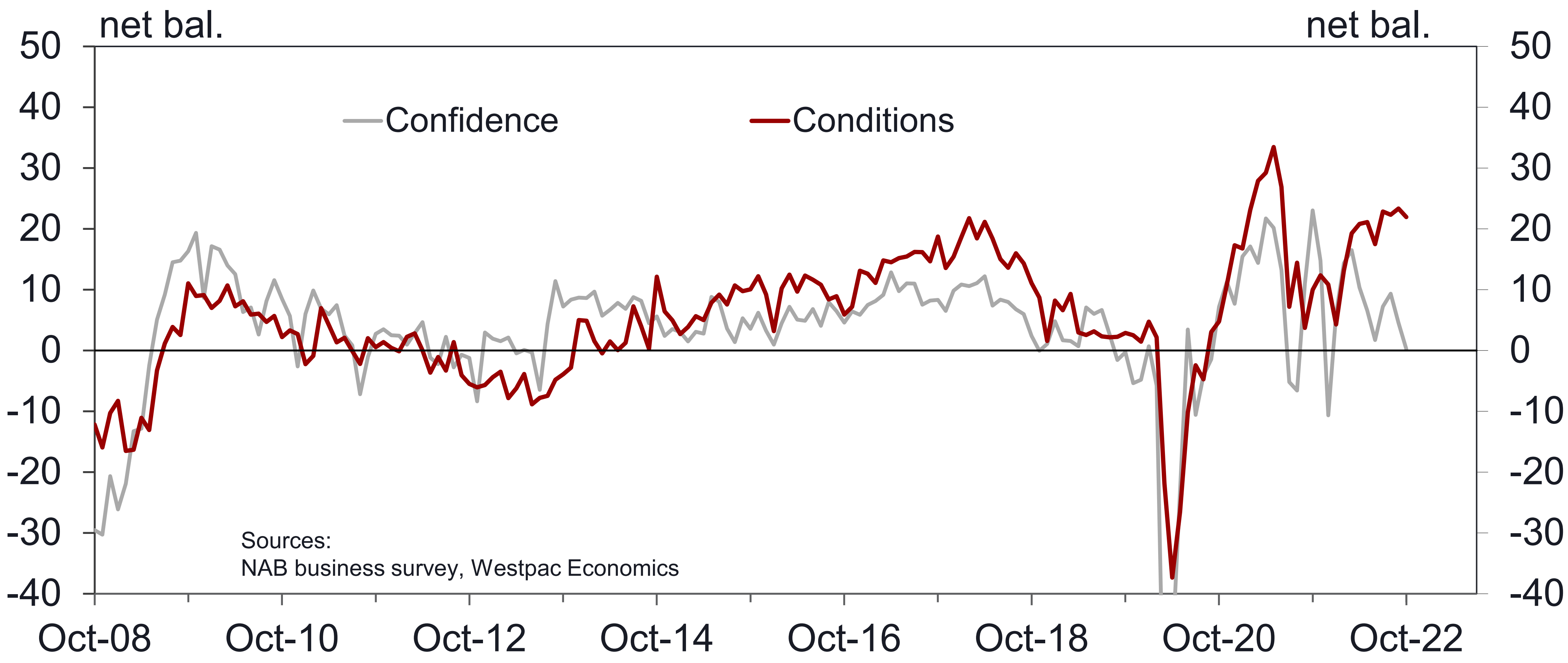
Australian wages lagging US wages – but outlook is strong



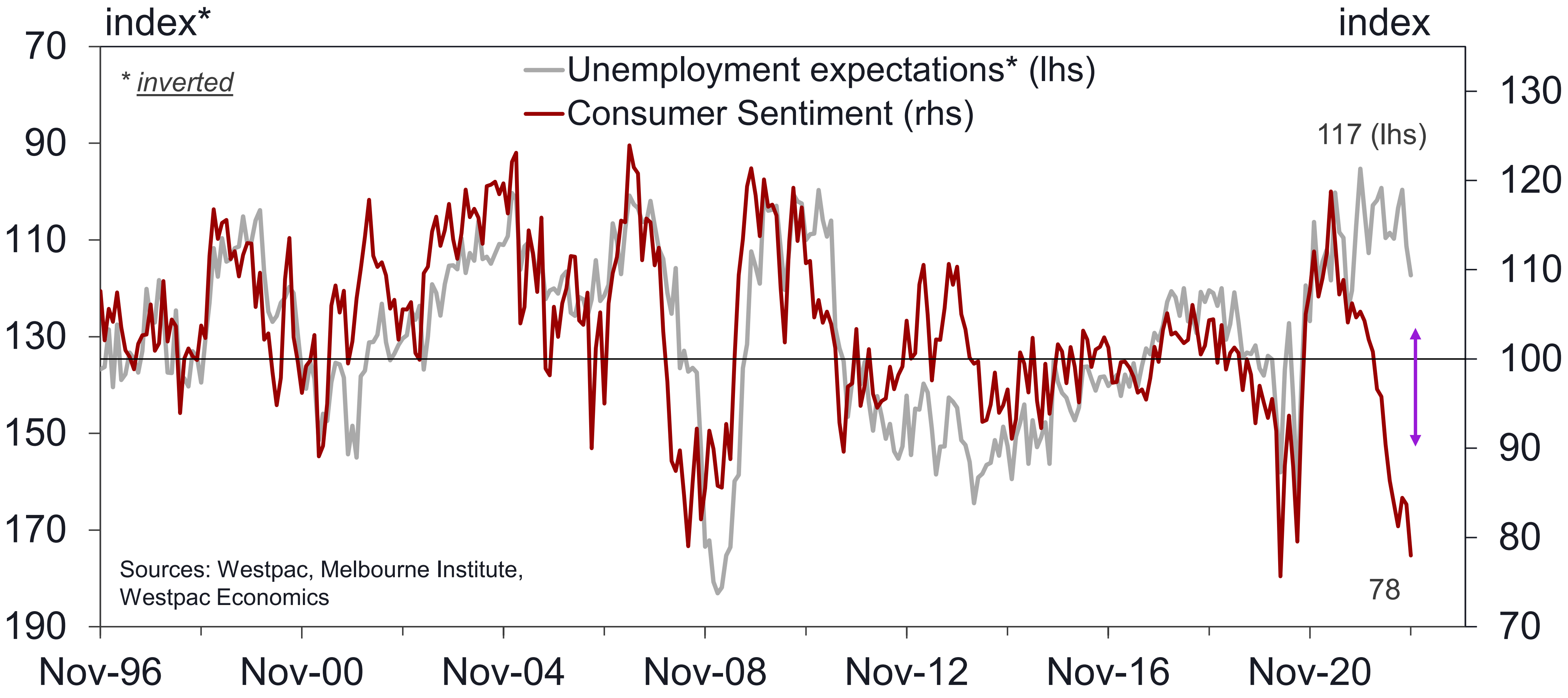
Confidence: consumers and businesses



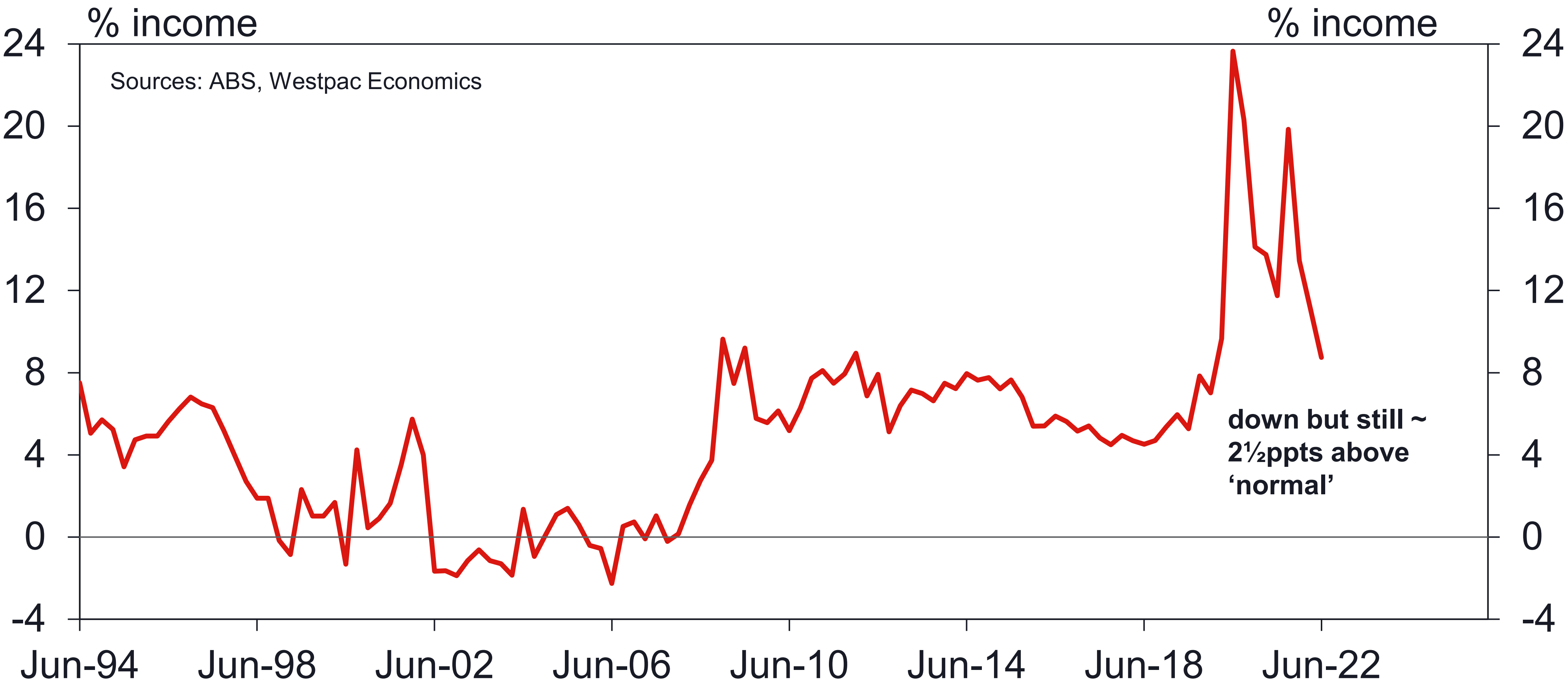
Business conditions and confidence



Consumers: Sentiment & Unemployment ' expectations – differ

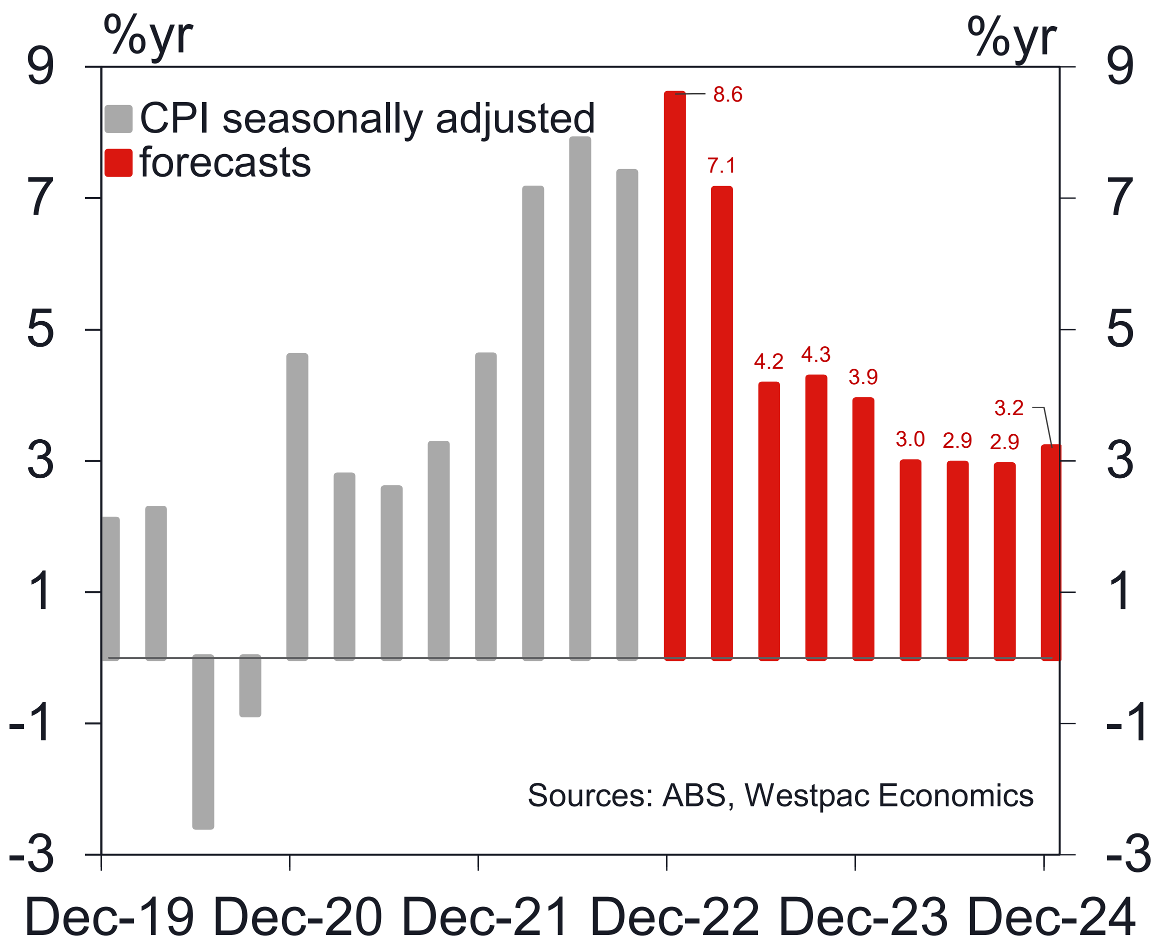


Savings ratio – boosted spend by $7 bn ; $260 bn in savings

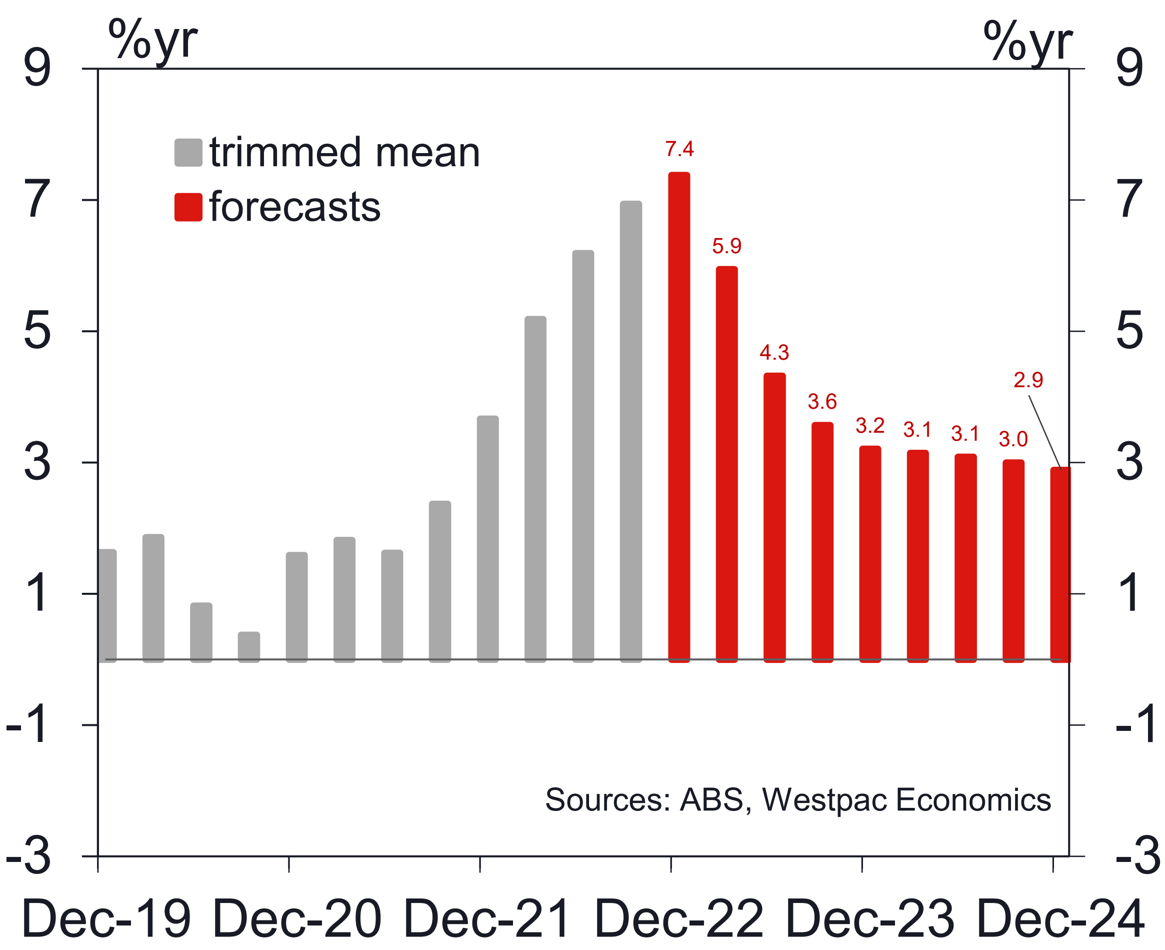


The pace of inflation moderates though 2023

Six month annualised



Six month annualised



Financial and Economic Forecasts

	End-2022	2023	2024
GDP (%pa)	3.4	1.0	2.0
Unemployment rate (%)	3.3	4.5	5.2
Inflation (%pa)	7.9	4.1	3.0
Dwelling prices (%pa)	-6.0	-8.0	2.0
Wages growth (%pa)	3.25	4.5	3.6
Cash rate (%)	3.10	3.85	2.85

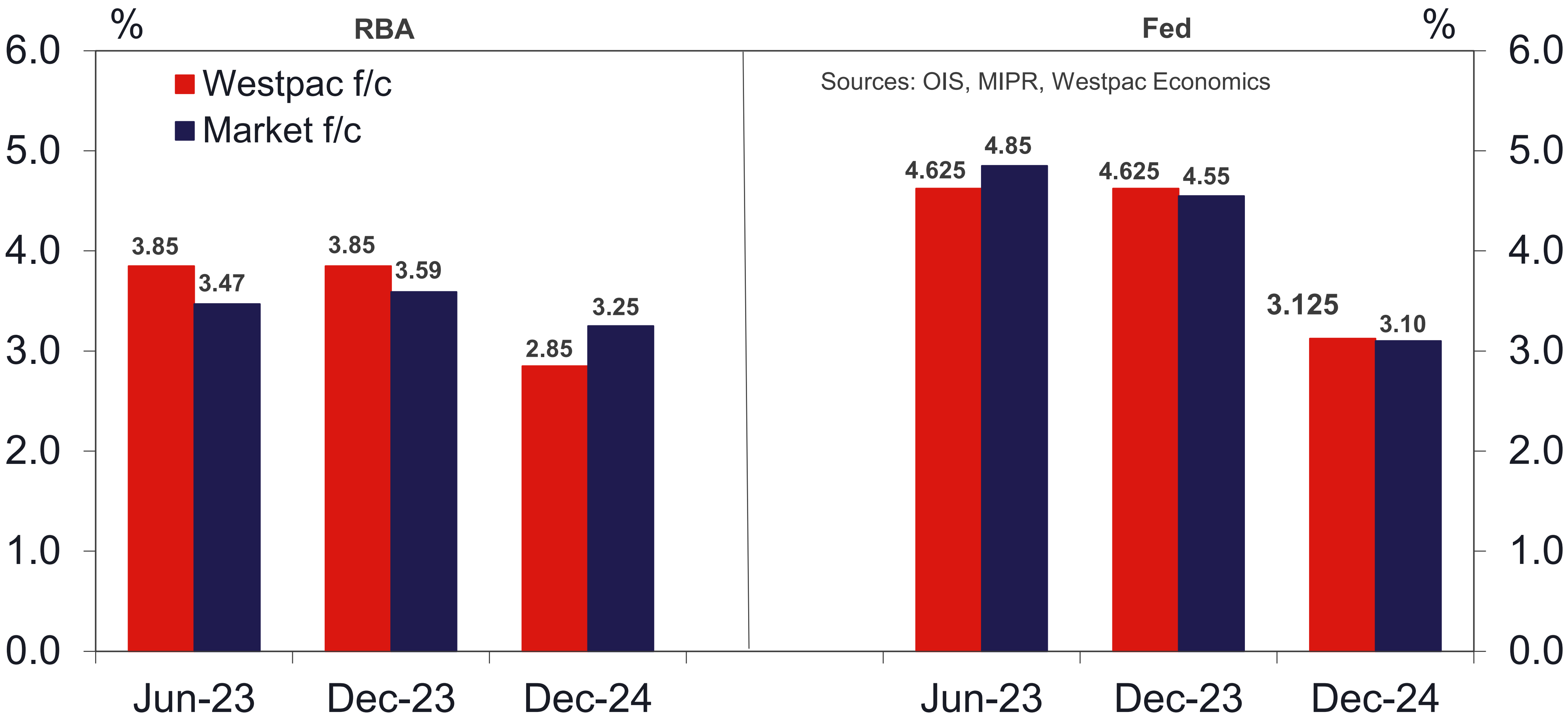
Sources: Westpac Economics

Detailed Forecasts – bond rates up; then lower in 2023 and 2024

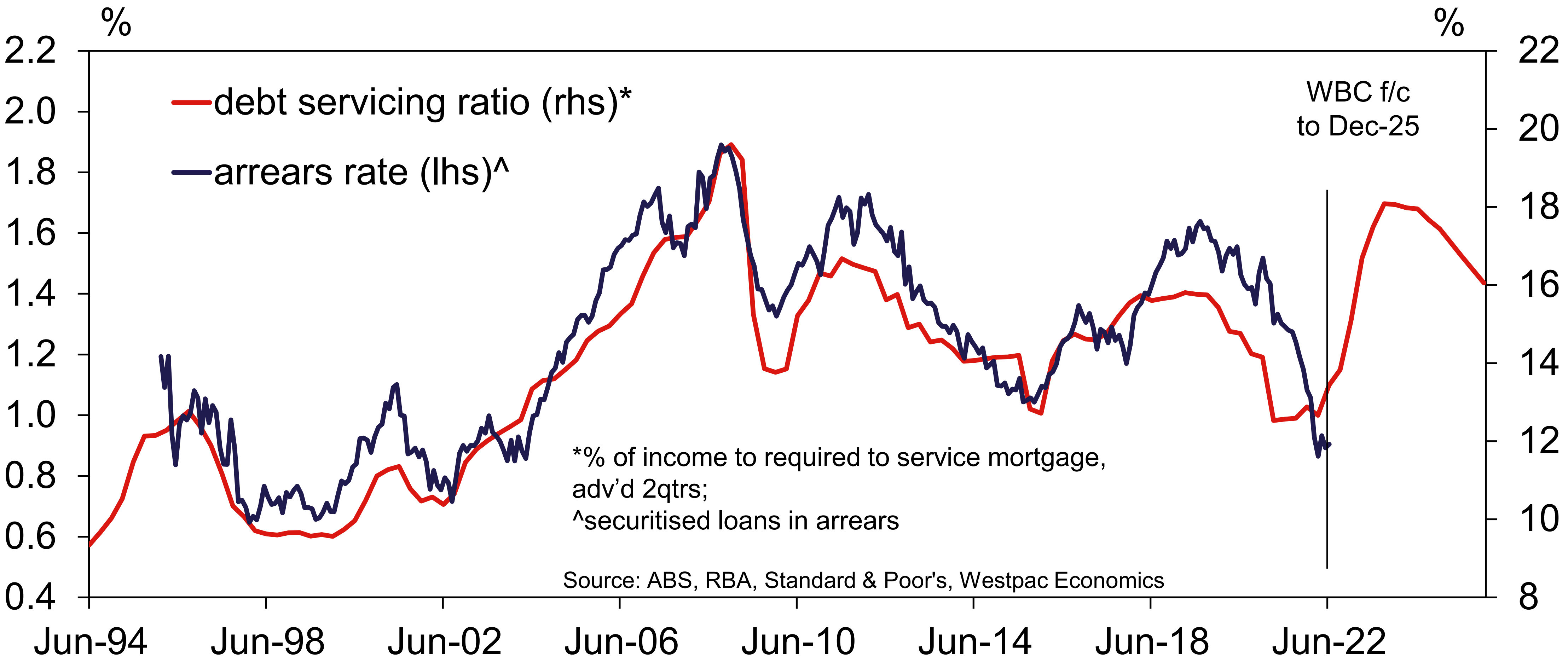
	Latest (2/12)	Jun-23	Dec-23	Dec-24
RBA Cash	2.85	3.85	3.85	2.85
3yr swap rate	3.56	3.85	3.60	3.40
AU10yr bond	3.39	3.60	3.20	2.50
Fed Funds	3.875	4.625	4.625	3.125
US 10yr bond	3.54	3.80	3.40	2.50
AUD/USD	0.68	0.70	0.74	0.77

Sources: Bloomberg, Westpac Economics

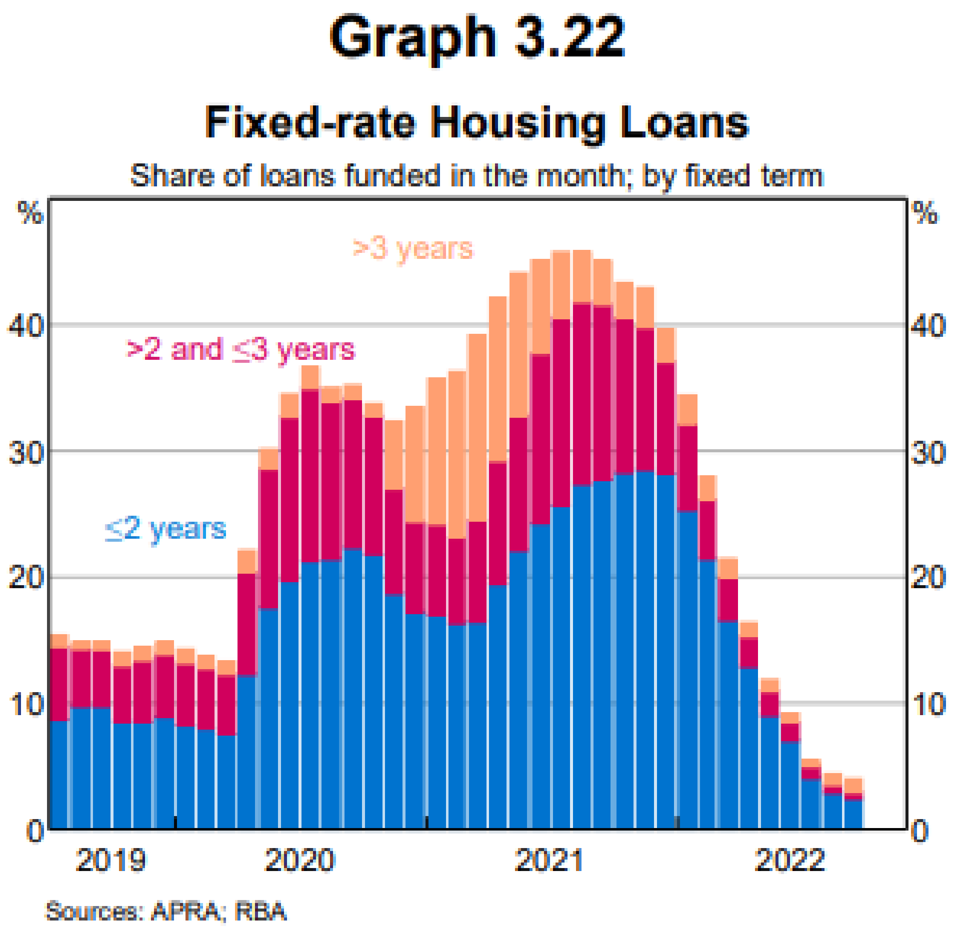
Market Expectations for RBA & US Fed – December 2



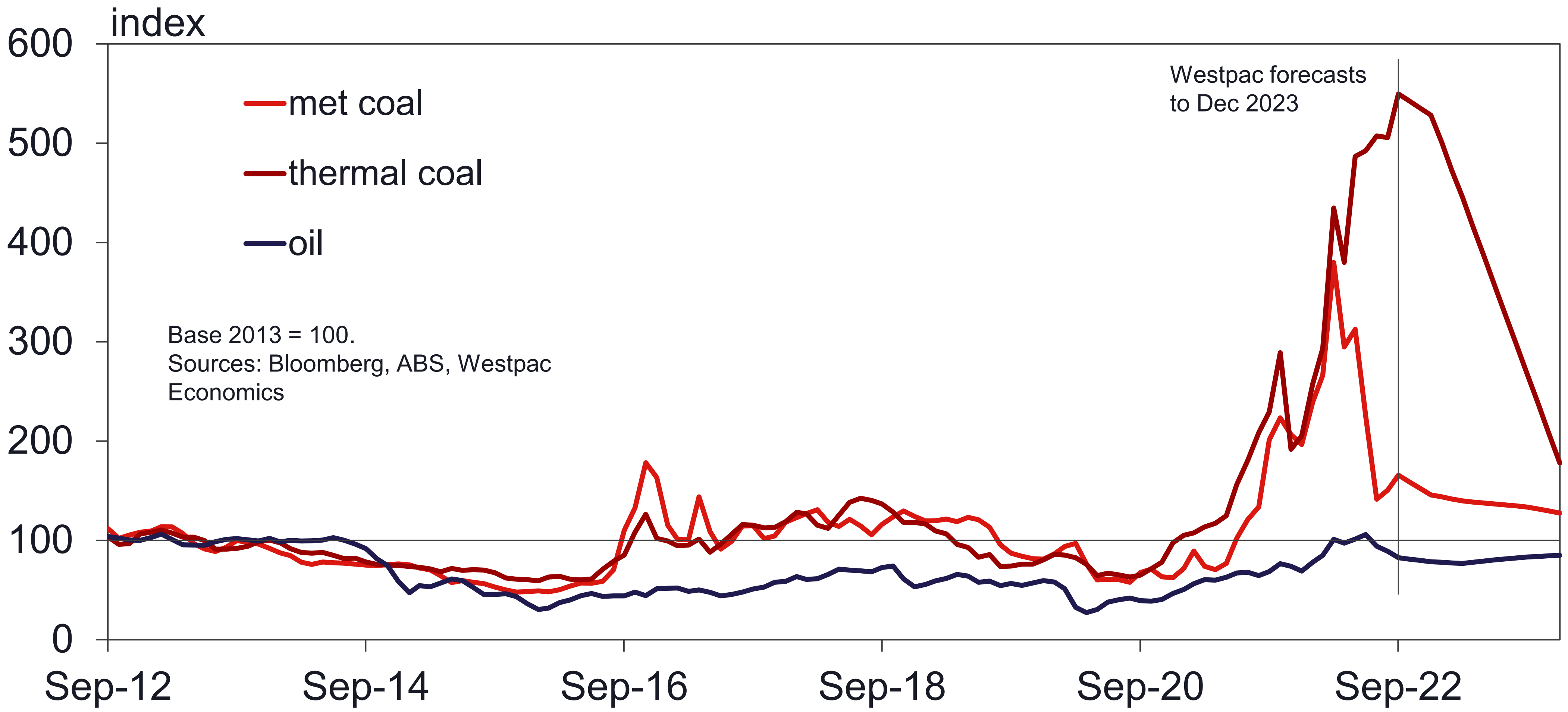
Household debt servicing ratio vs arrears



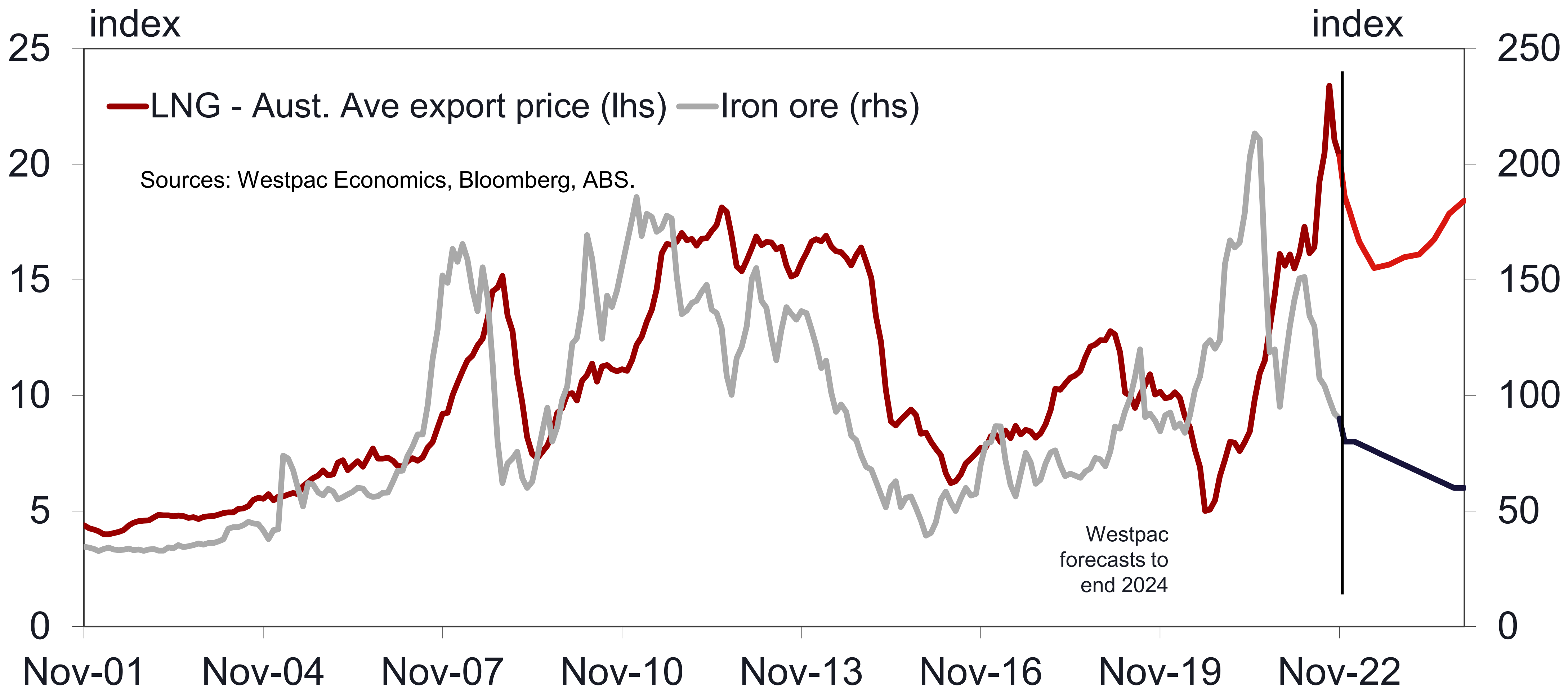
Fixed-rate housing loans – switch to higher rates in 2023



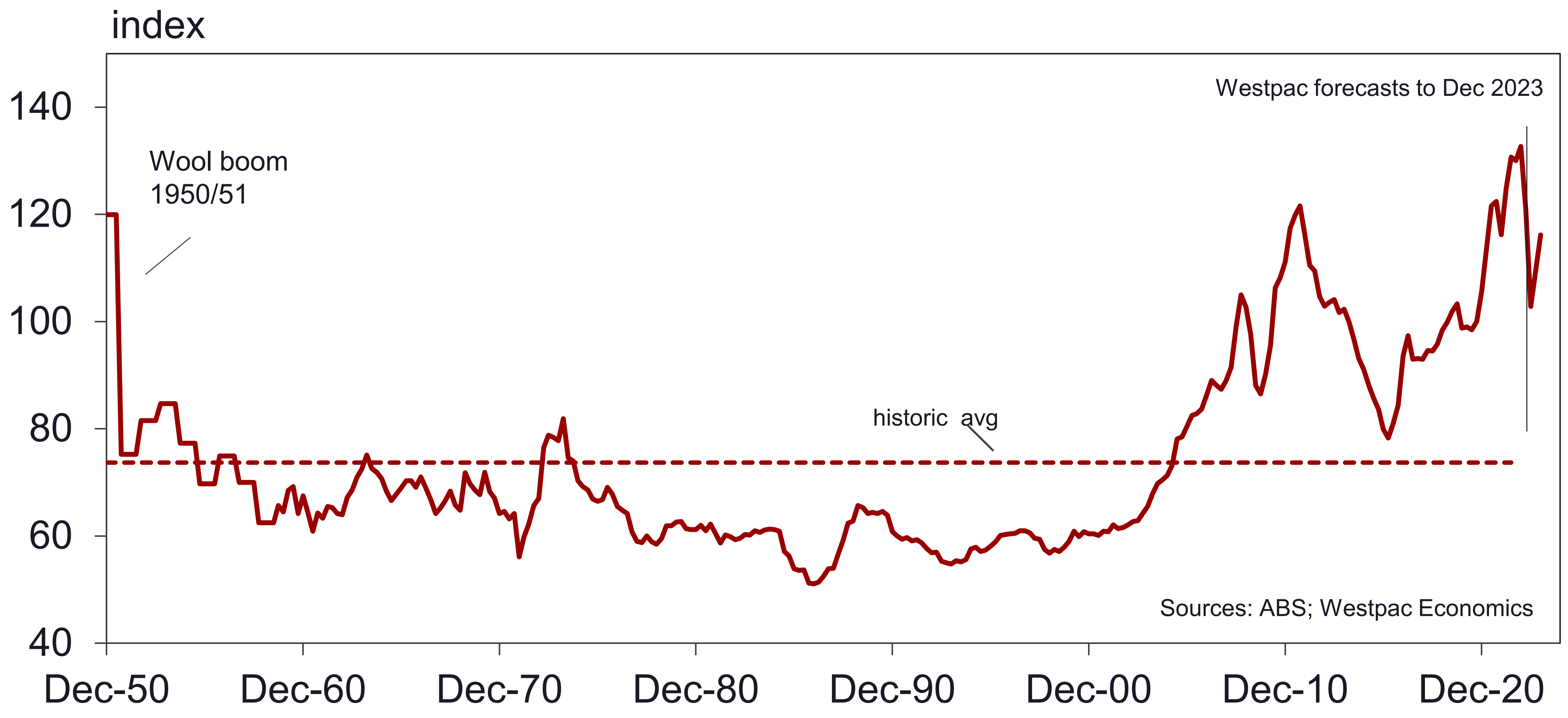
Australian commodity prices – coal boom



Commodity prices – US$; iron ore to trend down



Terms of trade: riding high (77% above long-term average)



Conclusion

- Three stages of Great Inflation: supply; war; inflation psychology takes hold.
- Material and labour shortages at extreme levels – not seen since 70’s; labour should ease by 2024; demand and supply shock slowdown key to easing in inflation.
- RBA cash rate to rise quickly in 2022 – 3.10% by year’s end; peak at 3.85% by May.
- High household debt will limit rate increases but offset by high savings – higher peak Debt Servicing Ratio than previous two peaks.
- With tight labour market (unemployment rate falls to 3.3%), inflation control relies on slowing interest sensitive sectors.
- Bond rates to fall in 2023 – as FOMC and RBA go on hold and markets look to cuts.
- Risk to economy is wage/price spiral; firms also identify scope; RBA should be nervous.
- Falling house prices in 2022 and 2023 – national; down 16% – SYD/MEL 18%.
- Border opening unlikely to see replacement of Covid losses in workforce.
- Central banks have erred with money printing during Covid – government support enough.

Conclusion

- Inflation must ease globally in 2023 to take pressure off central banks and avoid wage/ price spiral.
- US inflation structure and cycle conducive to earlier falls in inflation.
- Bond rates volatile but near peak; but progress towards much lower yields will be bumpy.
- Biggest risk to outlook is if inflation is much stickier than currently expected particularly precluding FOMC from cutting rates when US consumer flat lines in 2024 and RBA from easing rates in 2024 (RBA forecast of 4.7% inflation in 2023 and 3.2% in 2024 is risky).
- 2023 will mark the weakest consumer spending growth in US since GFC.
- China's prospects are still uncertain, current conditions in property markets are parlous – stimulatory policy (credit boost; lower rates); easing of restrictions on property and technology; zero Covid still cause for considerable caution as virus still spreads.
- AUD to benefit from easing of "risk aversion" in 2023 as inflation falls; US FED and China's patchy recovery will hold AUD back for the remainder of 2022.

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A$ RATES MARKET THEMES

Damien McColough

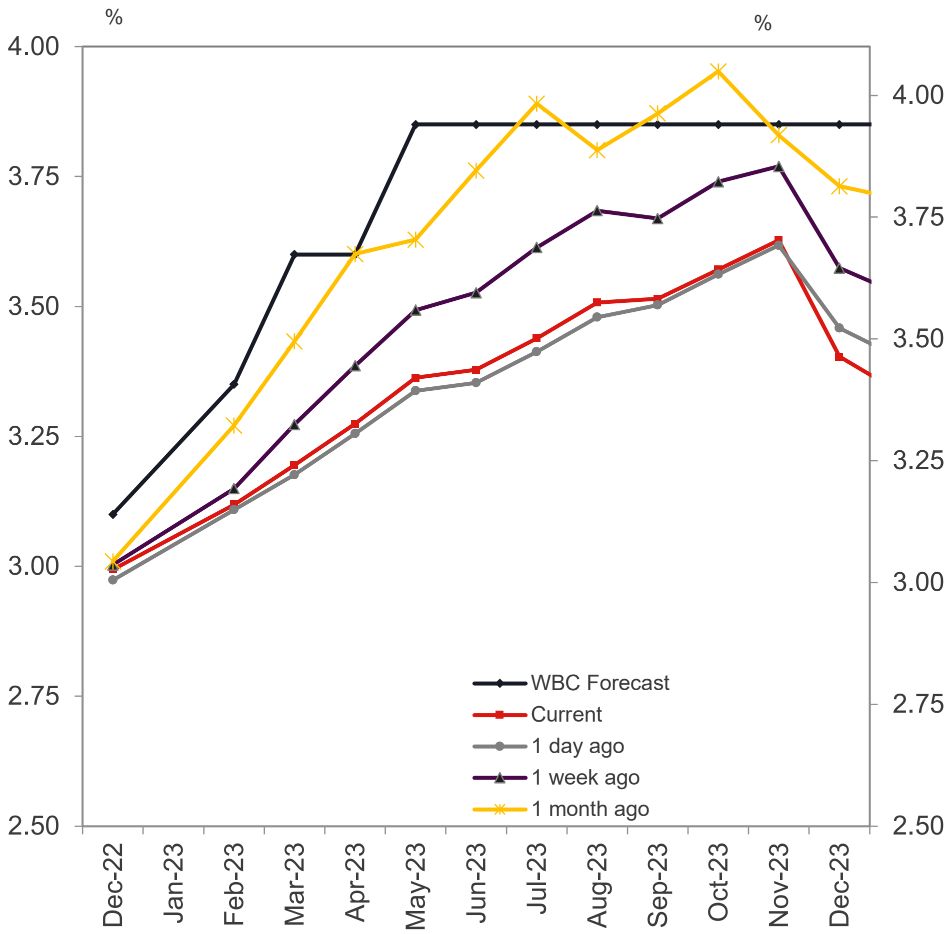
Westpac Institutional Bank

December 2022

RBA pricing has been pared back considerablty

… with the peak further out into 2023 than we expect

RBA Market Pricing



Source: Bloomberg; Westpac

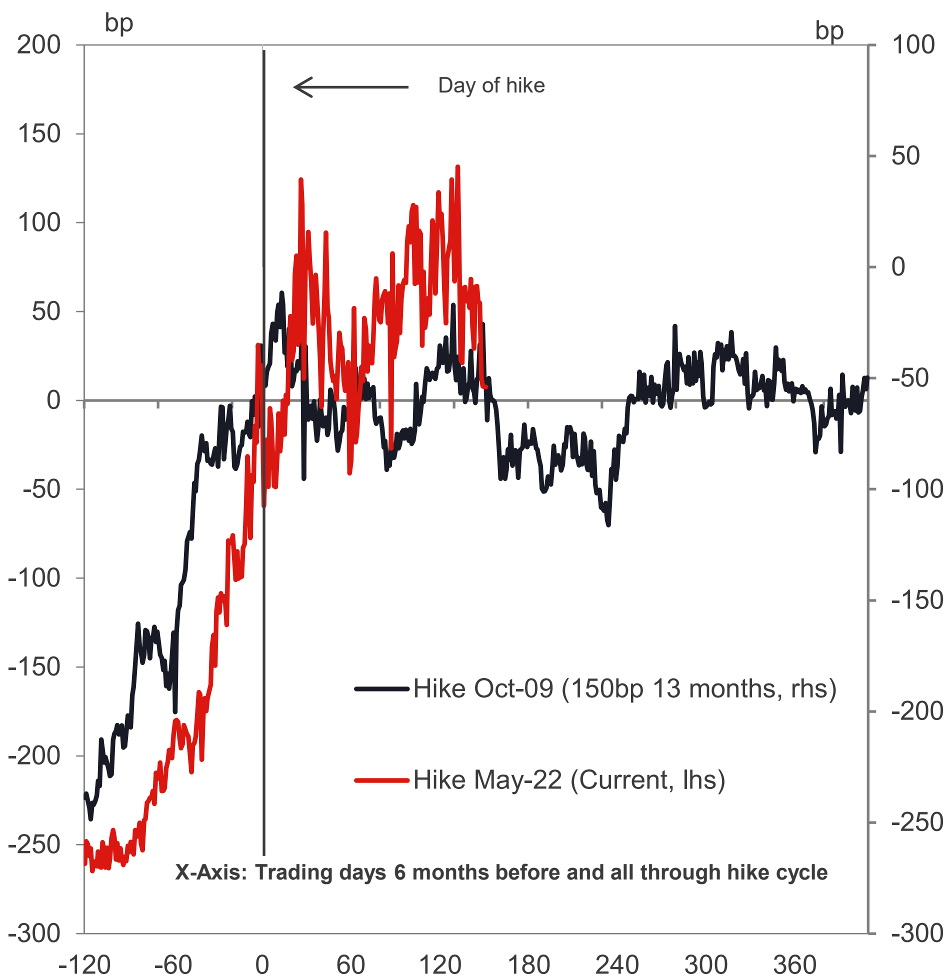
Fed Market Pricing

Source: Bloomberg; Westpac

Pricing is unlikely to significantly re-price near term ...

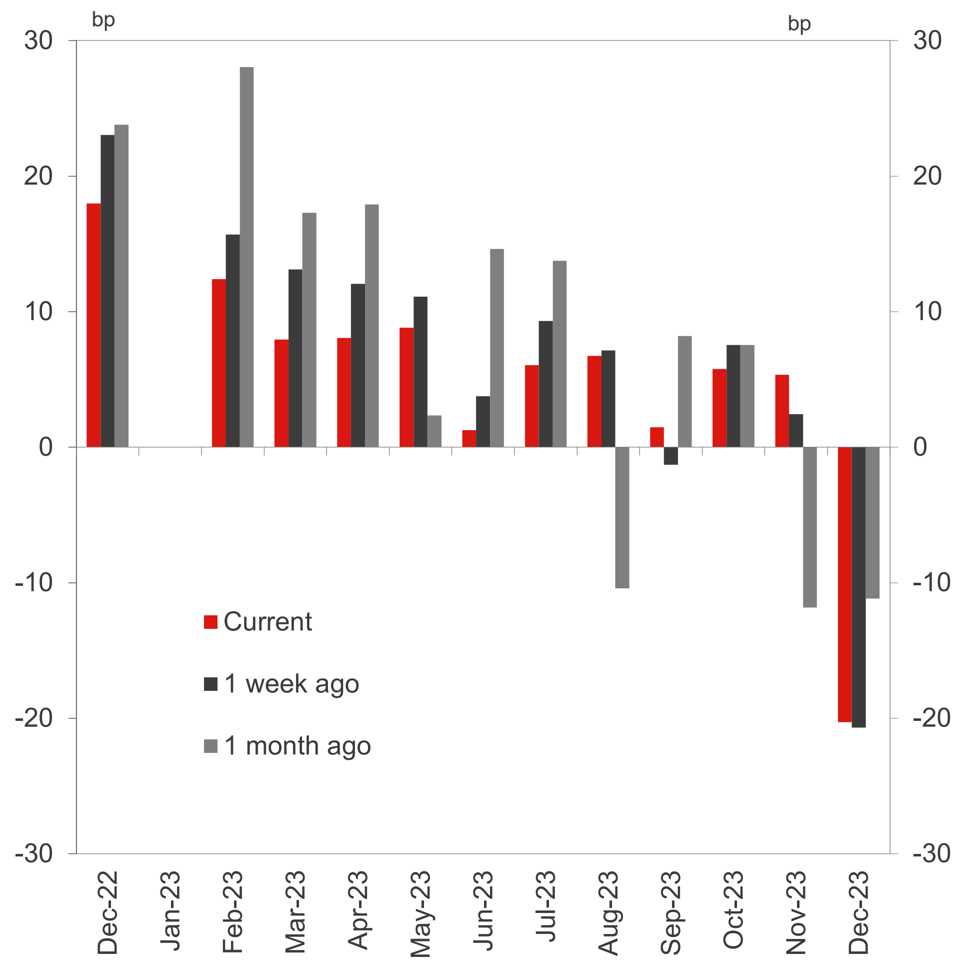
... but there will likely be an opportunity to fade valuations in the ne year.

Change in 1yr forward RBA Cash during tightening cycles



Source: Bloomberg; Westpac

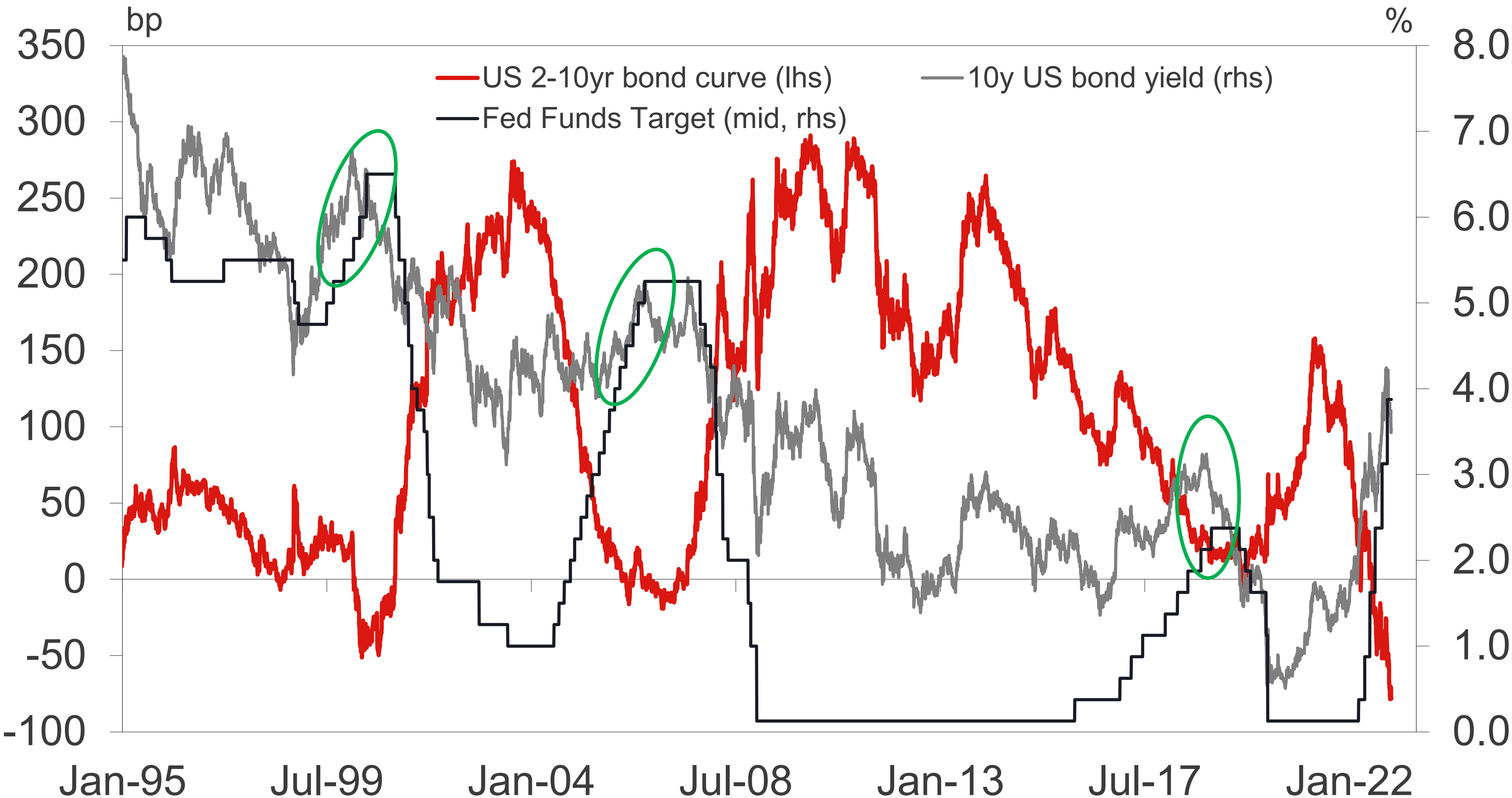
Evolution of OIS Implied changes per RBA meeting



Source: Bloomberg; Westpac

Will heavy inversion shift 10yr end of cycle behaviour?

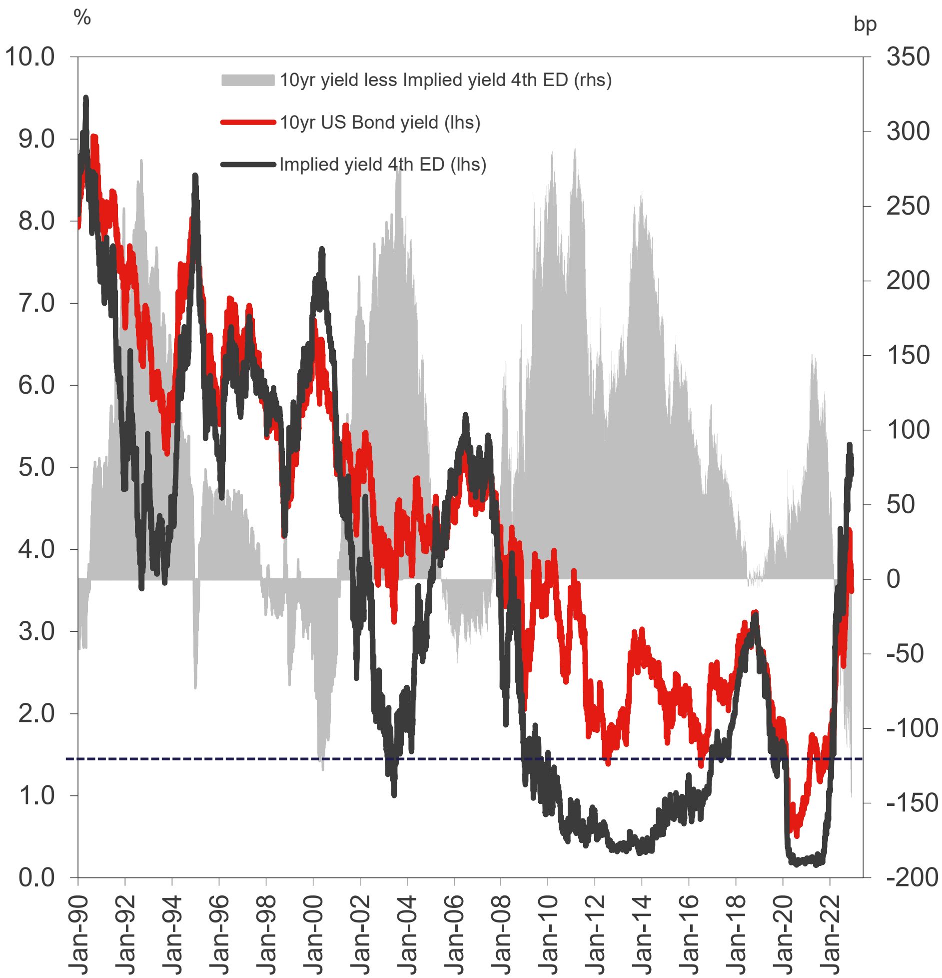
US 2-10yr bond curve vs 2yr & 10yr bond yields



Source: Bloomberg; Westpac

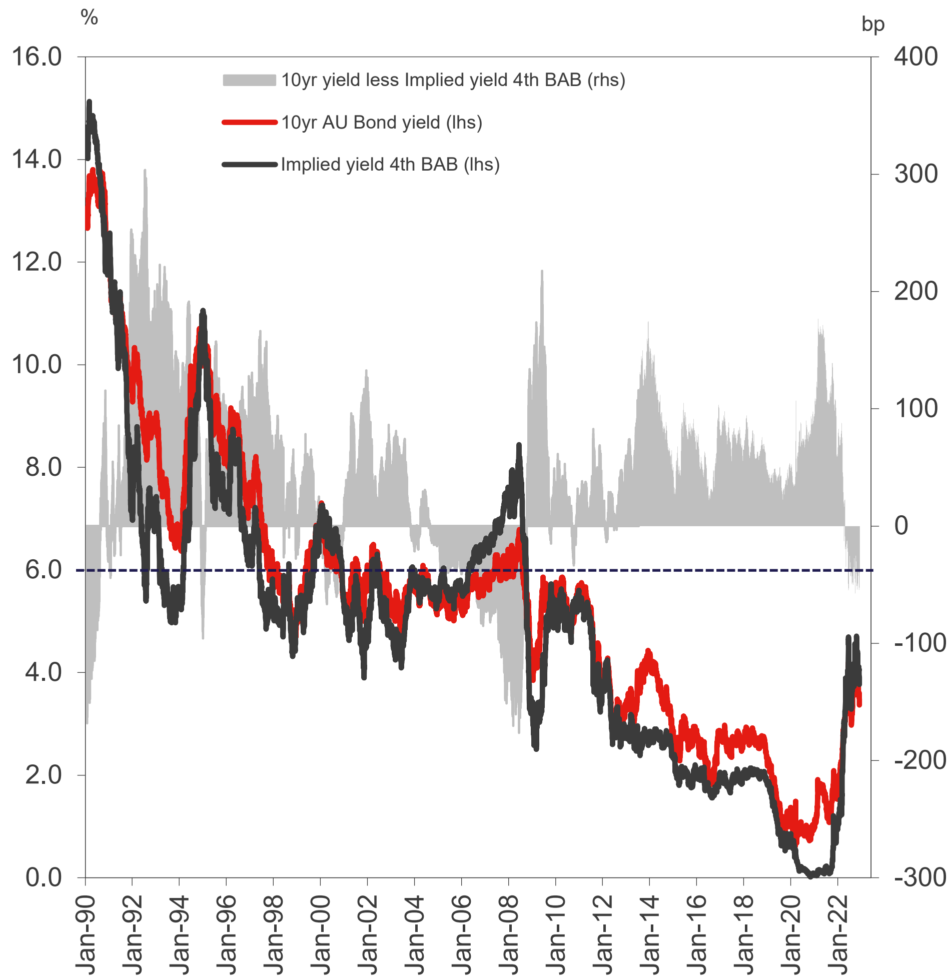
How low can US 10yr yields go?

US 10yr bond yields vs implied yield ED4



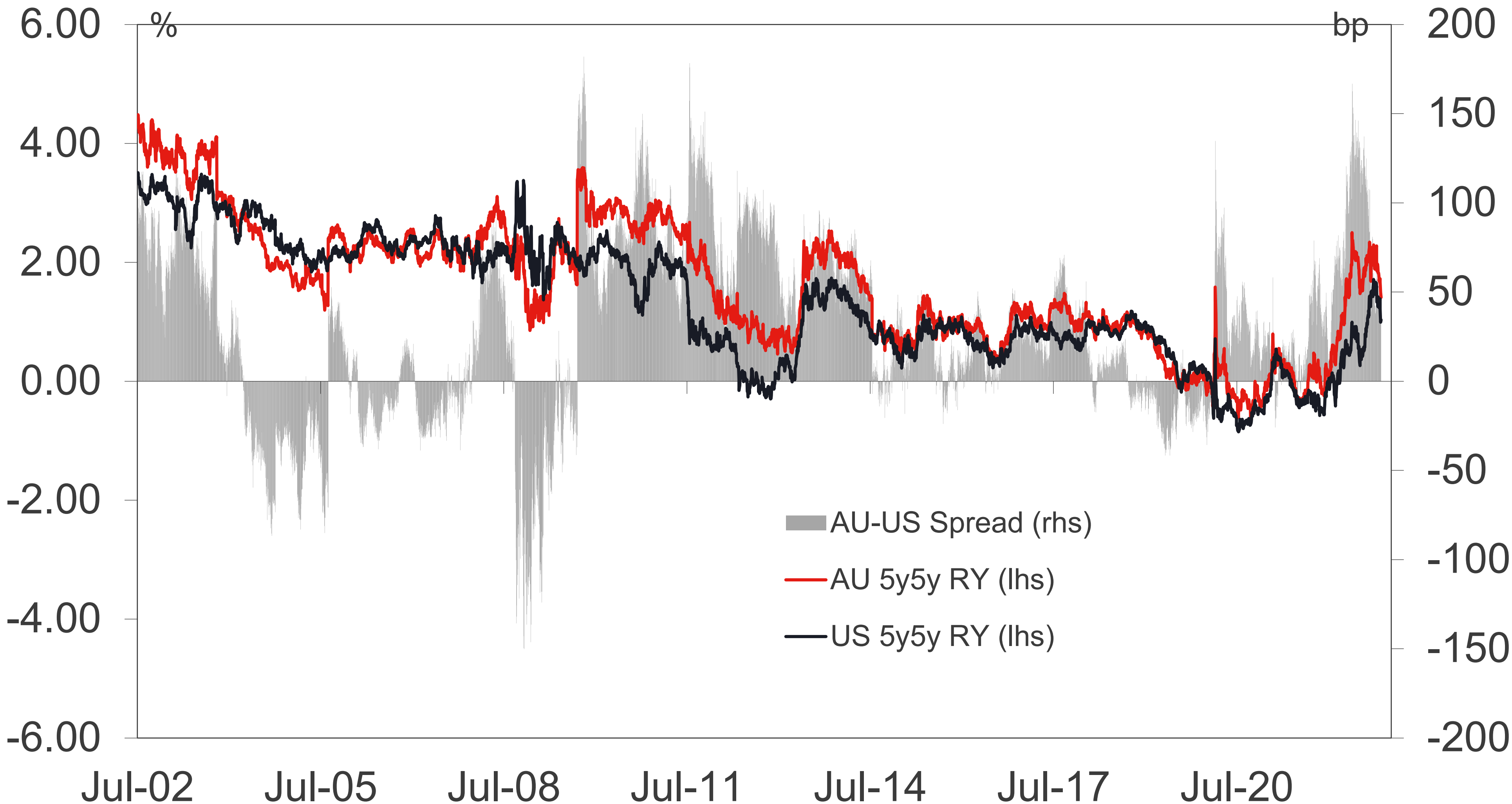
Source: Bloomberg, Westpac

AU 10yr bond yields vs implied yield 4th BAB future



Source: Bloomberg, Westpac

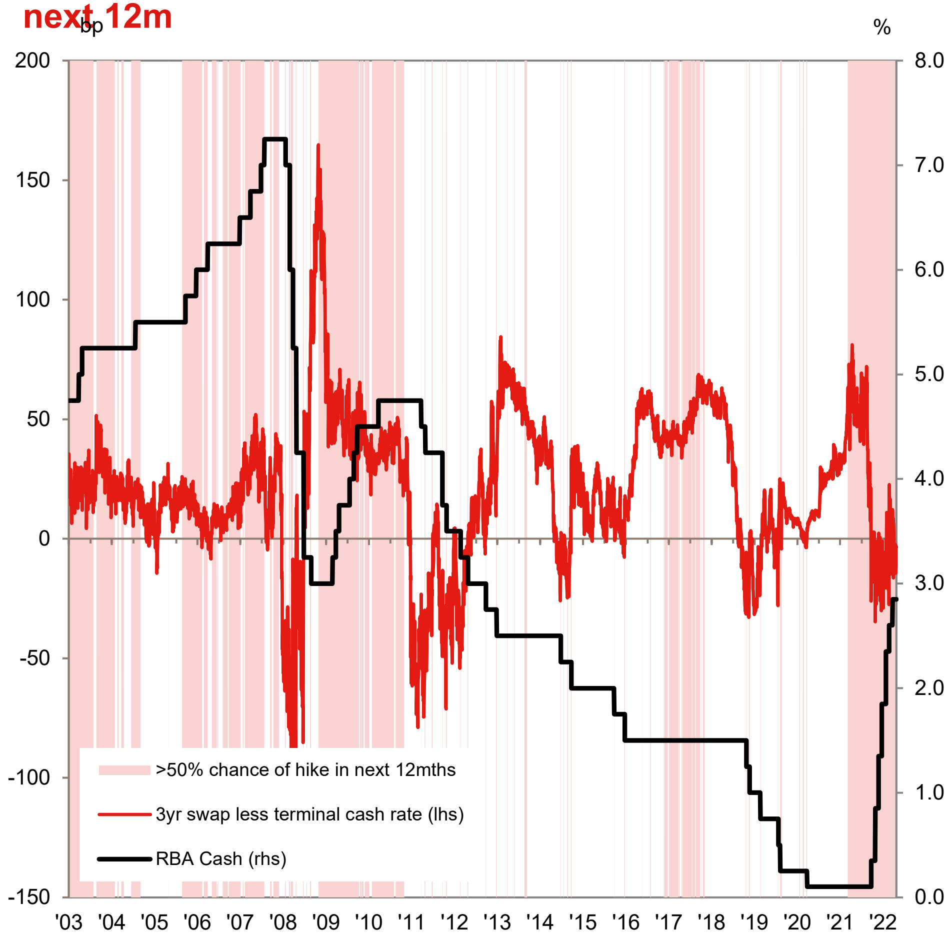
Long end real yields appear to have peaked?



Source: Bloomberg; Westpac

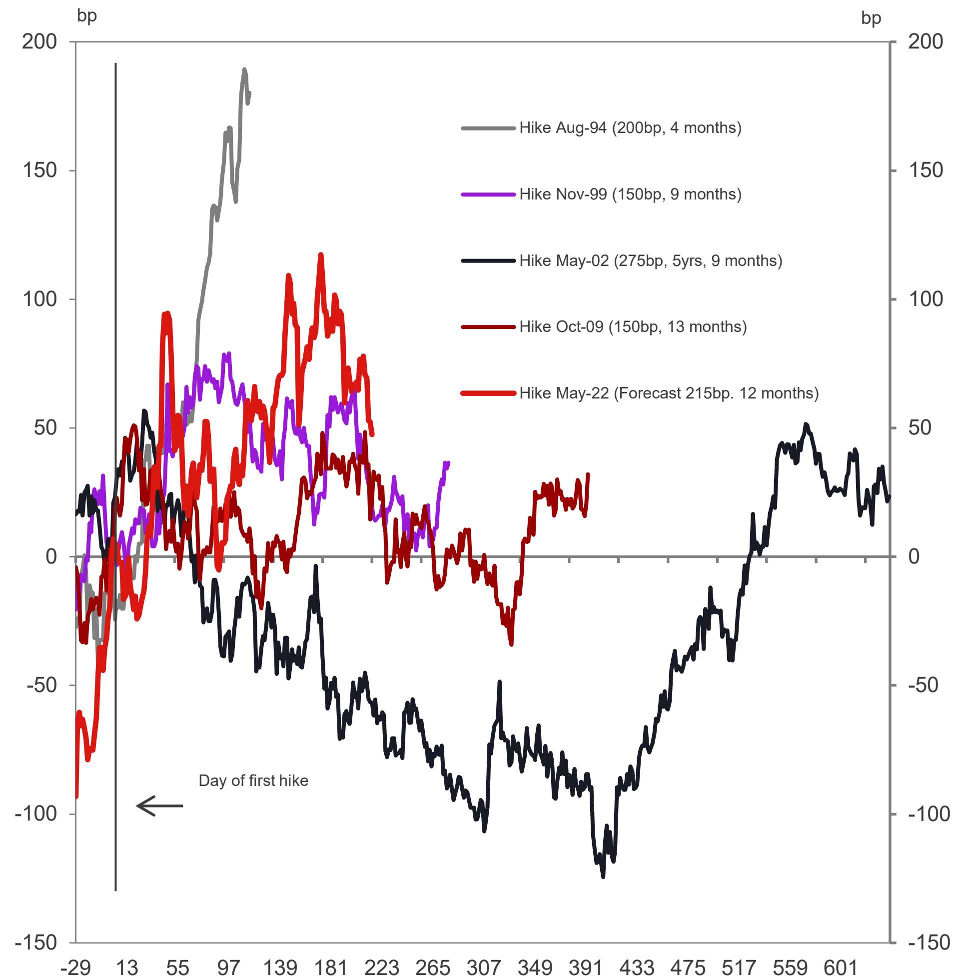
Have we reached a turning point in the cycle?

AU 3yr swap less Terminal; >50% chance of rate hike next 12m



Source: Bloomberg; Westpac

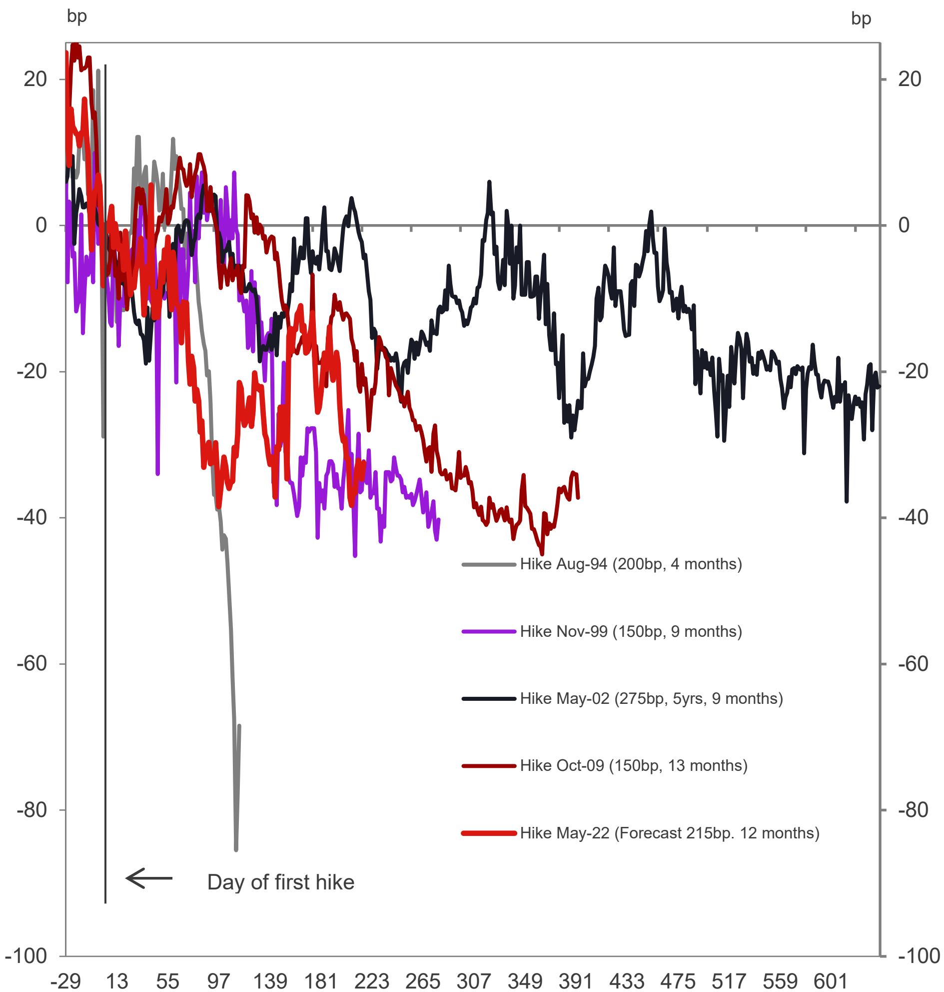
AU 2yr swap rate evolution



Source: Bloomberg; Westpac

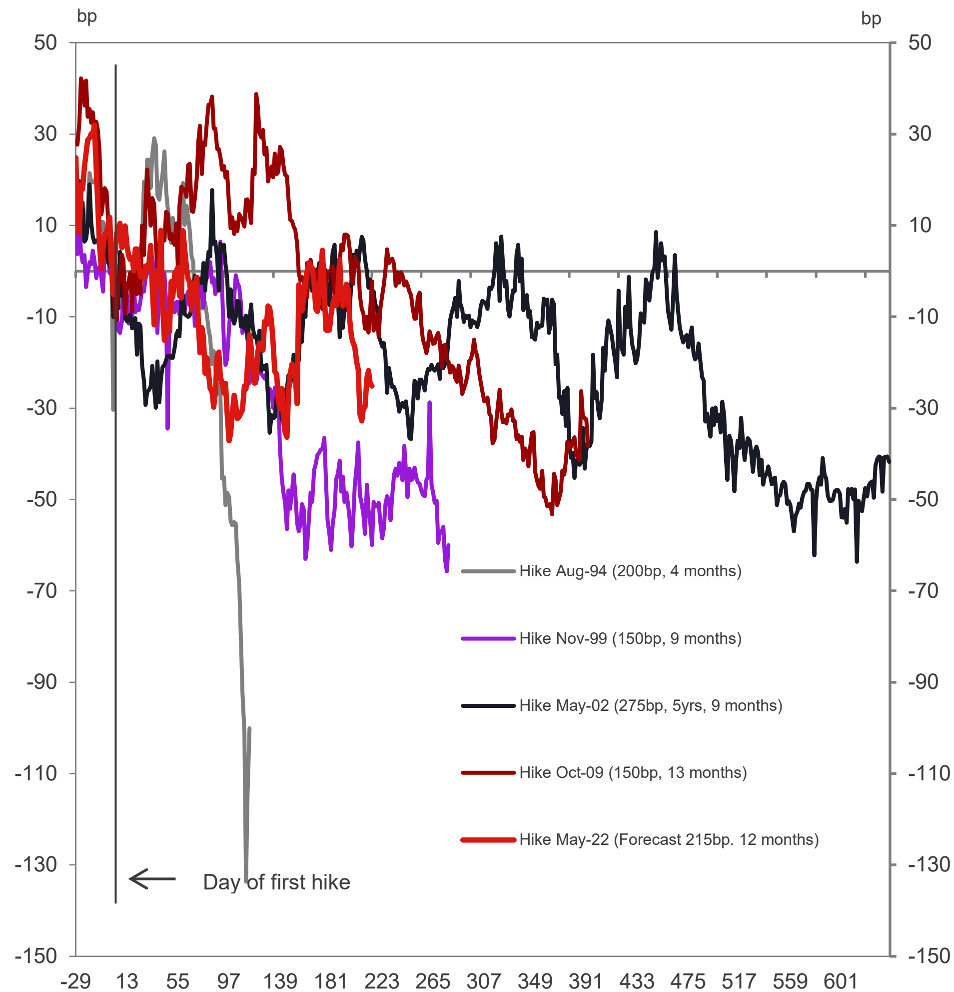
The curve is evolving similar to previous RBA hike cycles... and has further to flatten.

AU 2-5yr curve evolution



Source: Bloomberg; Westpac

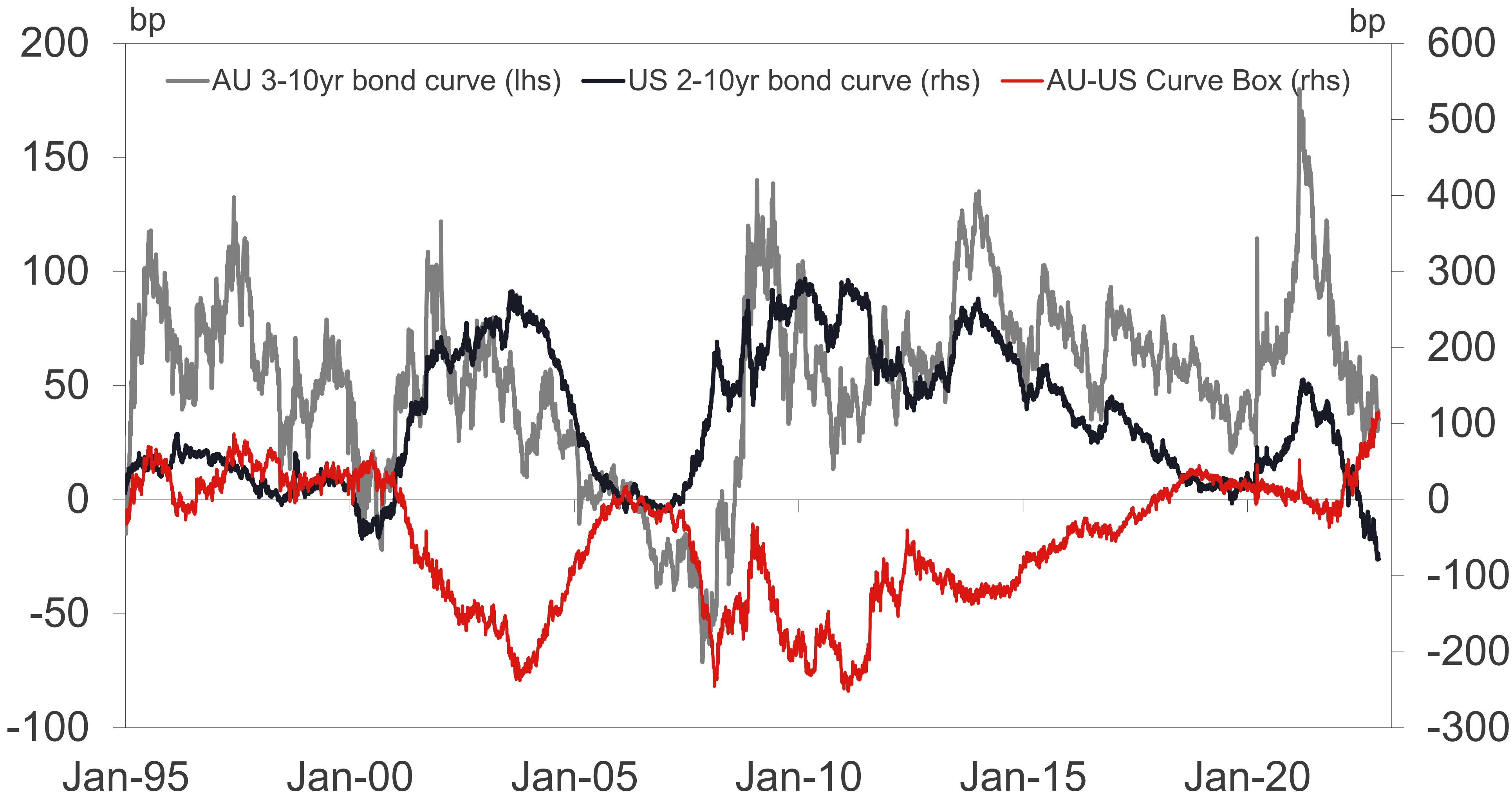
AU 2-10yr curve evolution



Source: Bloomberg; Westpac

Hike Nov-99 (150bp, 9 months) Hike Jun-02 (275bp, 5yrs, 9 months) Hike Oct-09 (150bp, 13 months) Hike May-22 (Forecast 215bp. 12 months)

AU 3-10yr bond curve remains historically steep relative to the US... but that is understandable

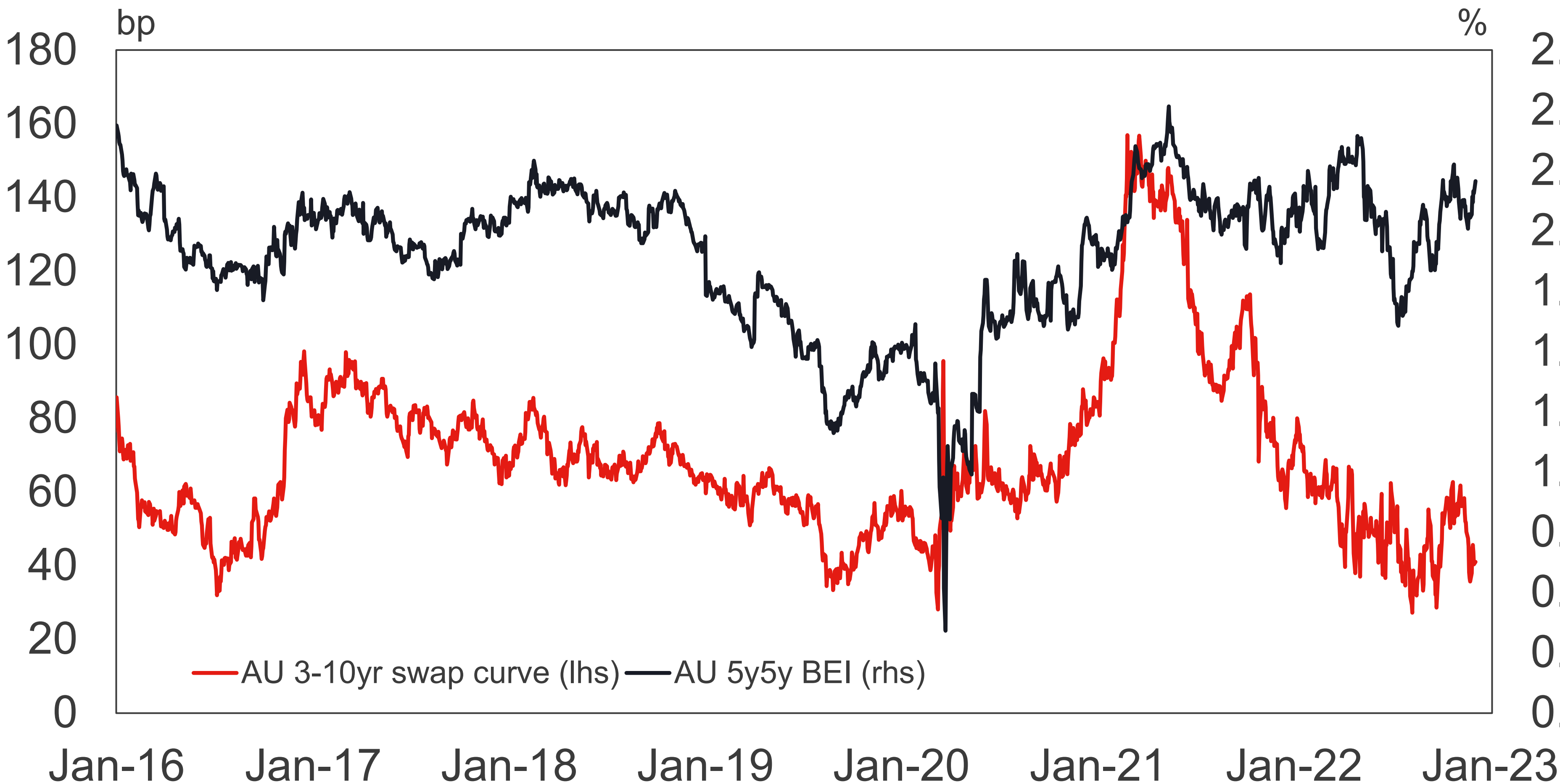


Source: Bloomberg; Westpac

Inflation expectations remain well anchored ...

... Which will remain supportive of flatter curves.

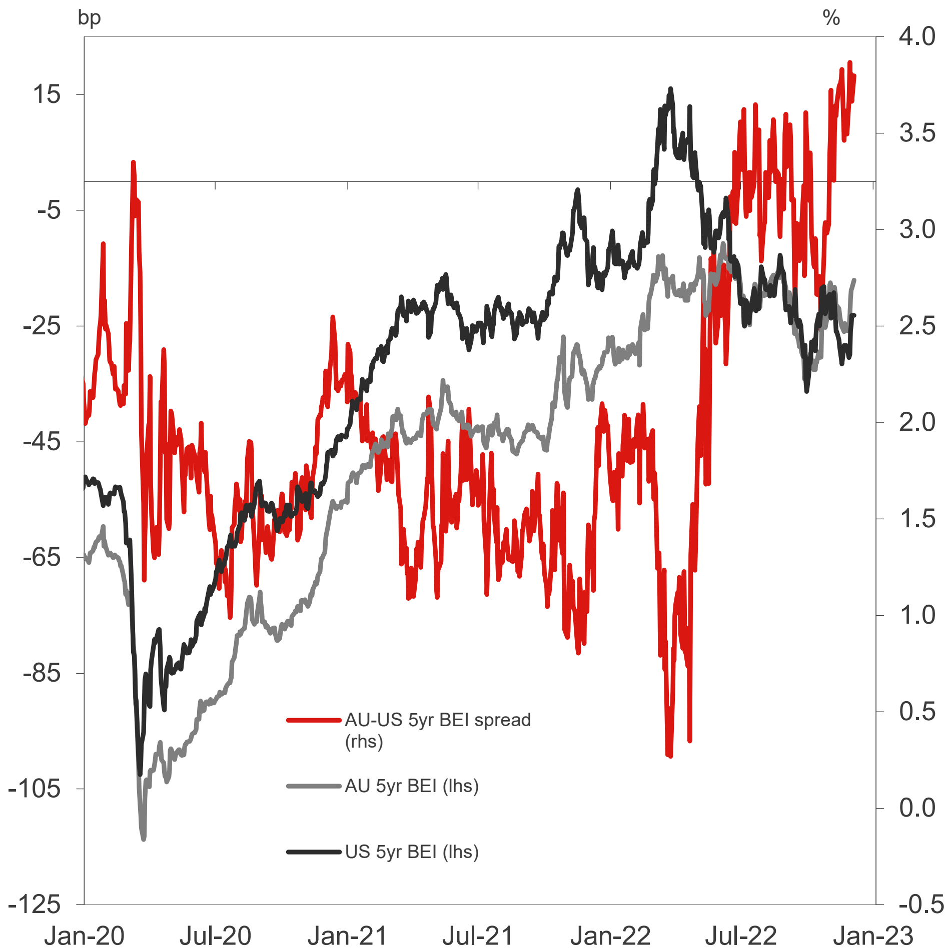
3-10yr swap curve vs 5y5y BEI



Source: Bloomberg, Westpac Strategy Group

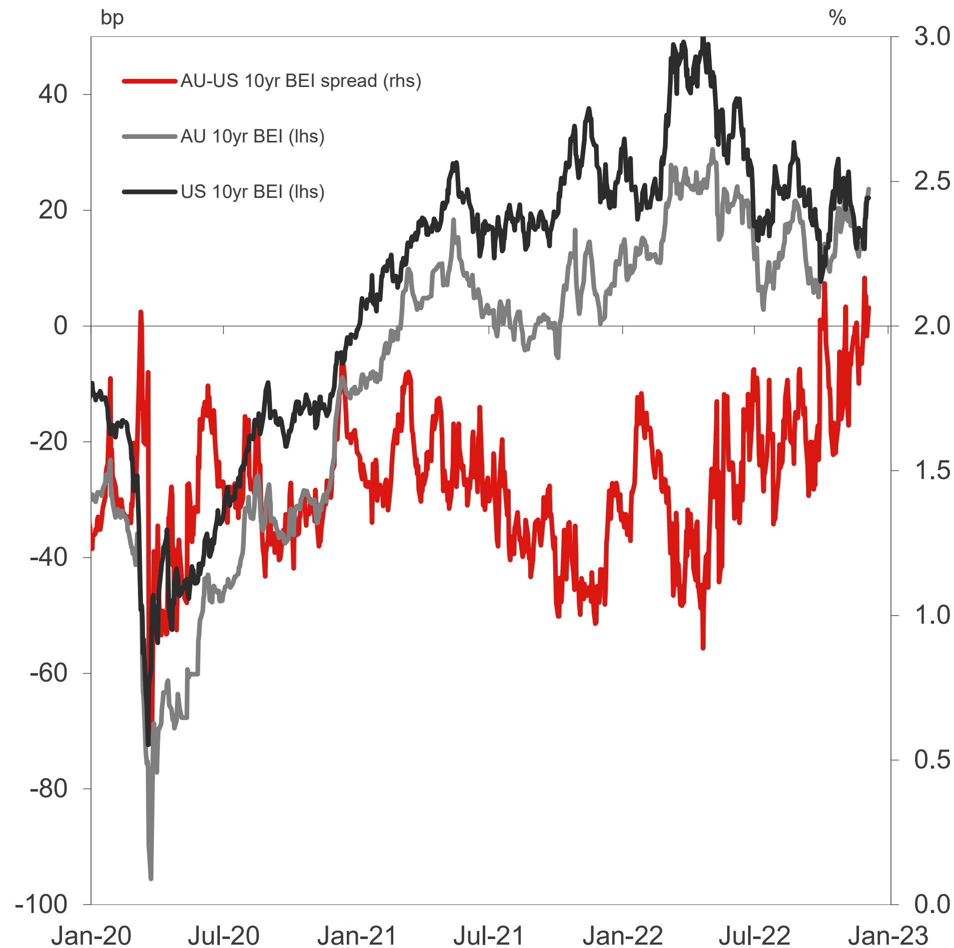
.. But can AU BEIs move significantly above the US?

AU & US 5yr BEI and spreads



Source: Bloomberg; Westpac

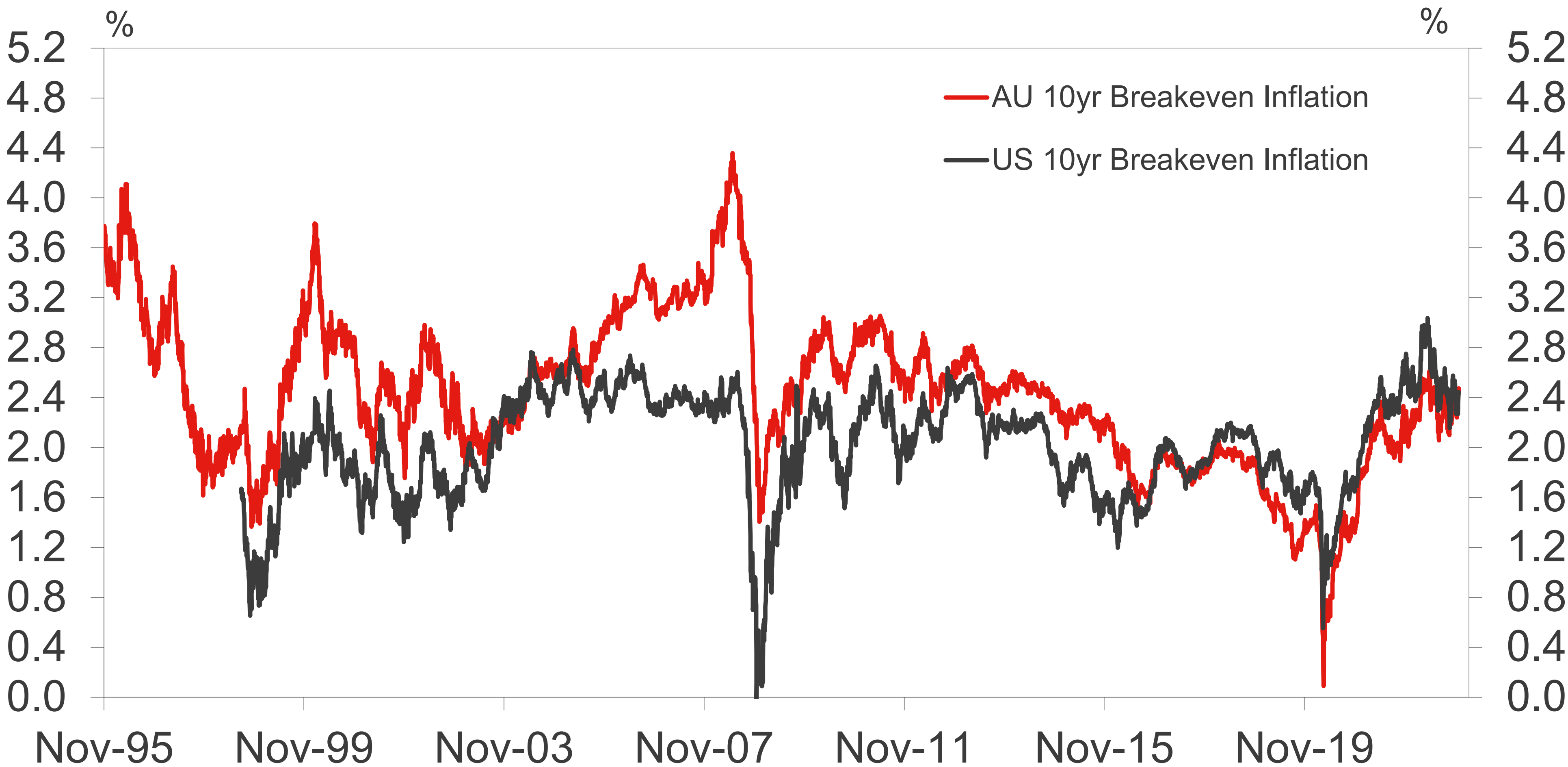
AU & US 10yr BEI and spreads



Source: Bloomberg; Westpac

AU traded inflation expectations remain contained...

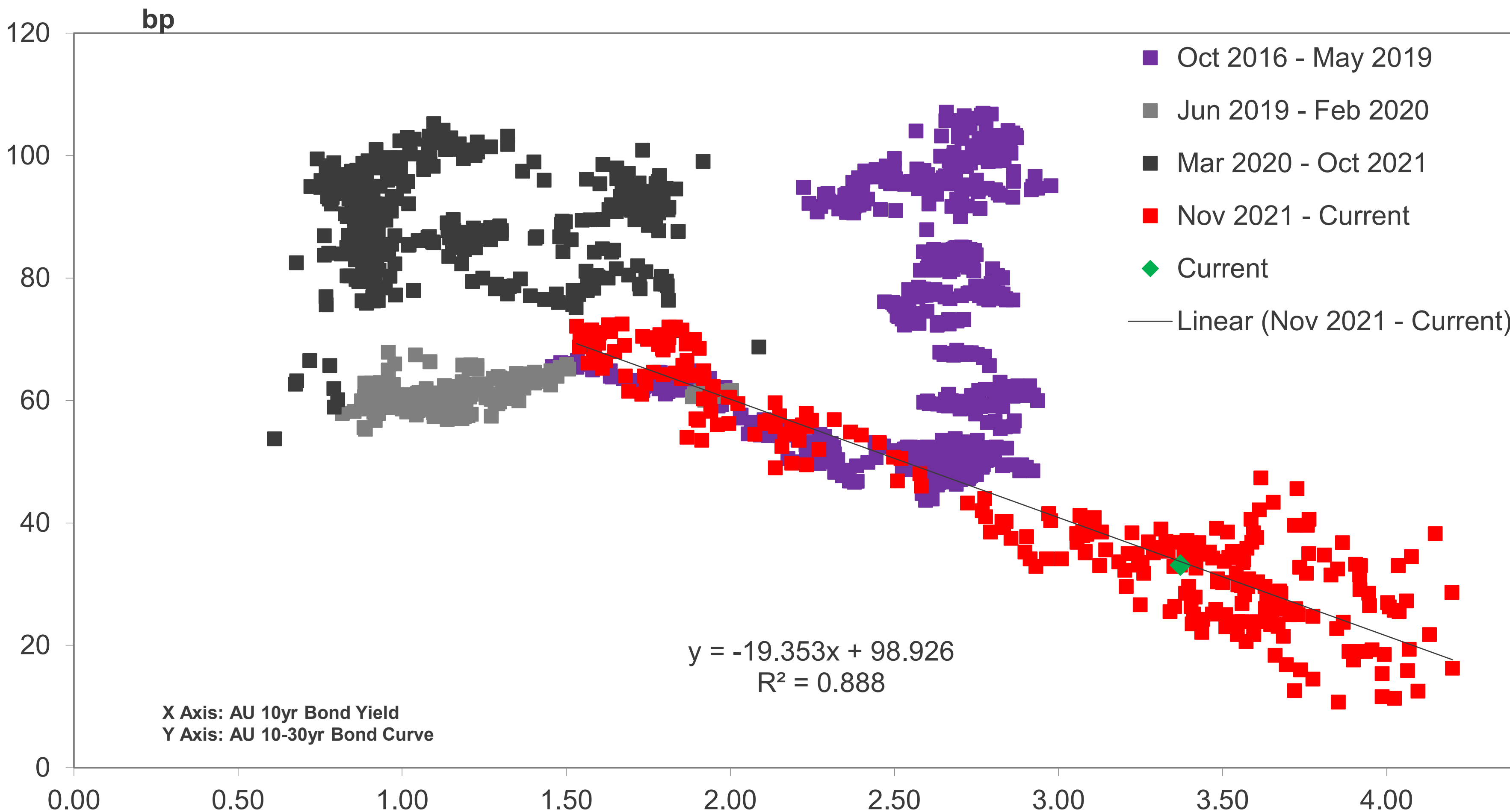
AU 10yr BEI vs US 10yr BEI



Source: Bloomberg, Westpac

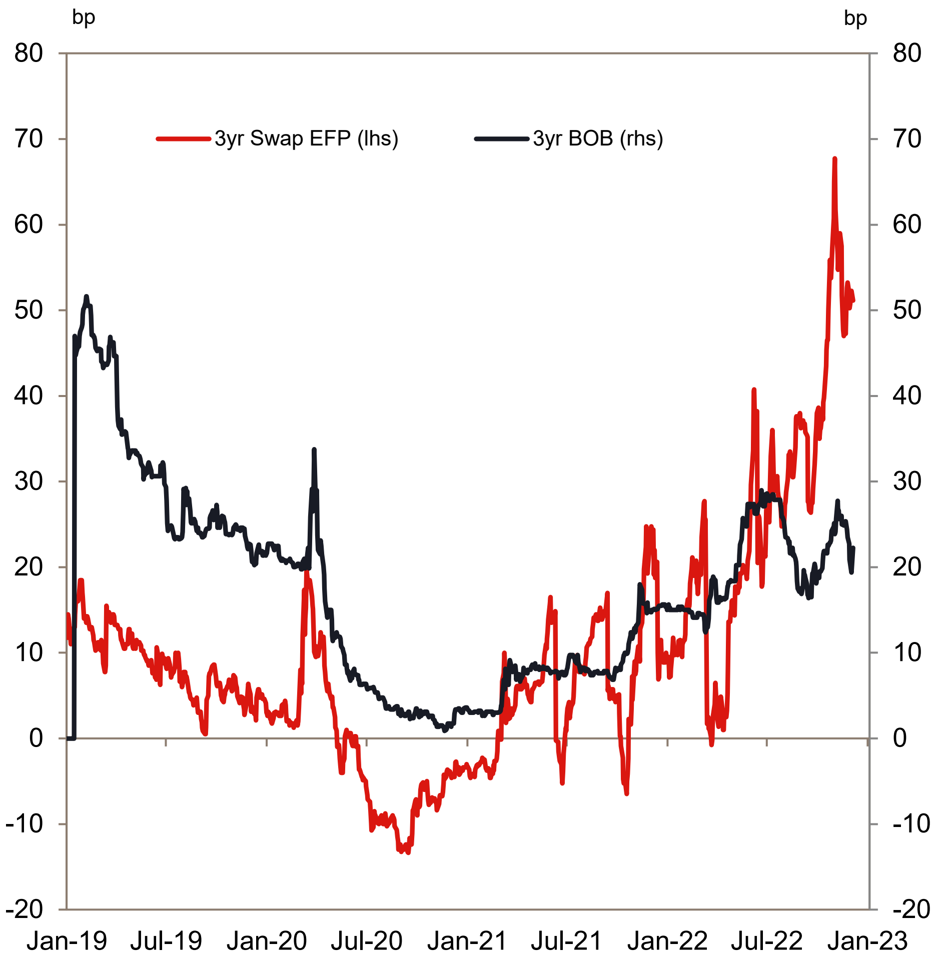
AU 10-30yr bond curve correctly priced relative to outright level

Relationship between 10-30yr curve & 10yr bond yield



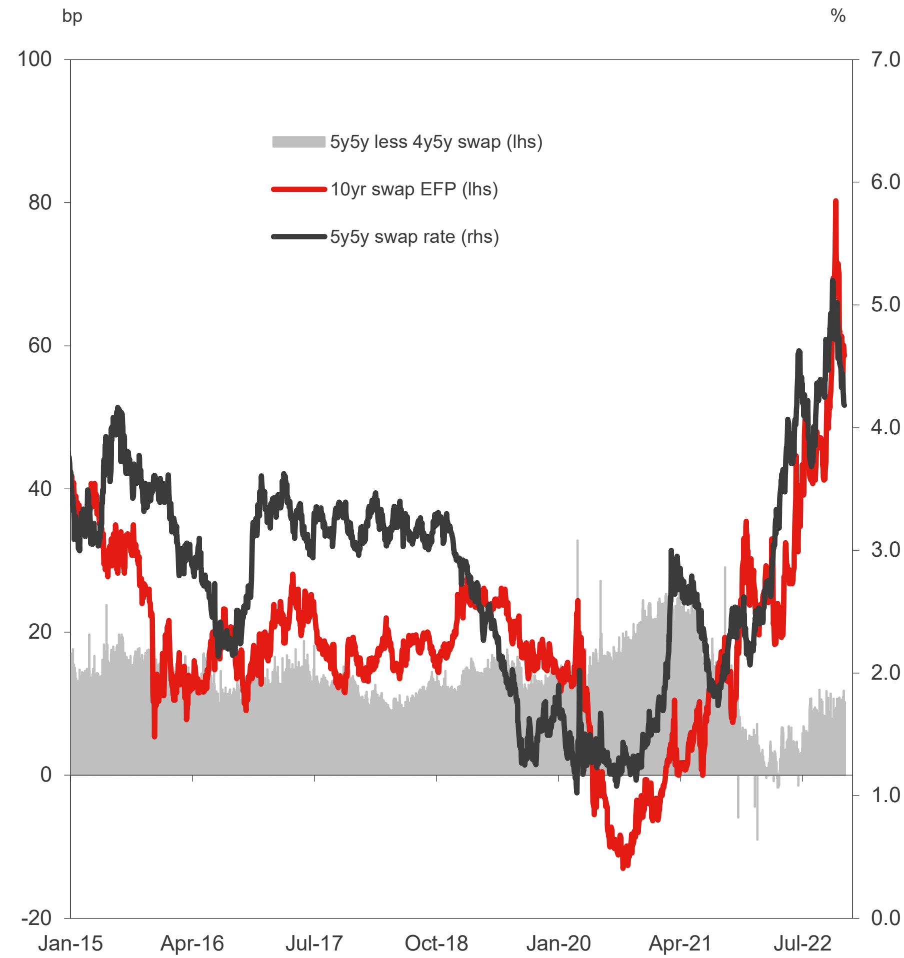
Have we seen the peak in AU swap spreads?

3yr EFP versus BOB



Source: Bloomberg; Westpac

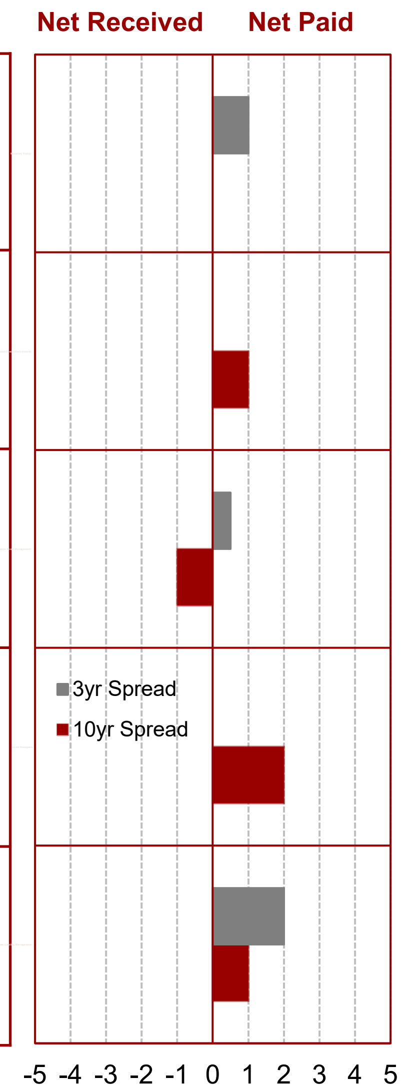
10yr swap spread vs 5y5y



Source: Bloomberg; Westpac

Swap Spread Checklist – Part 1

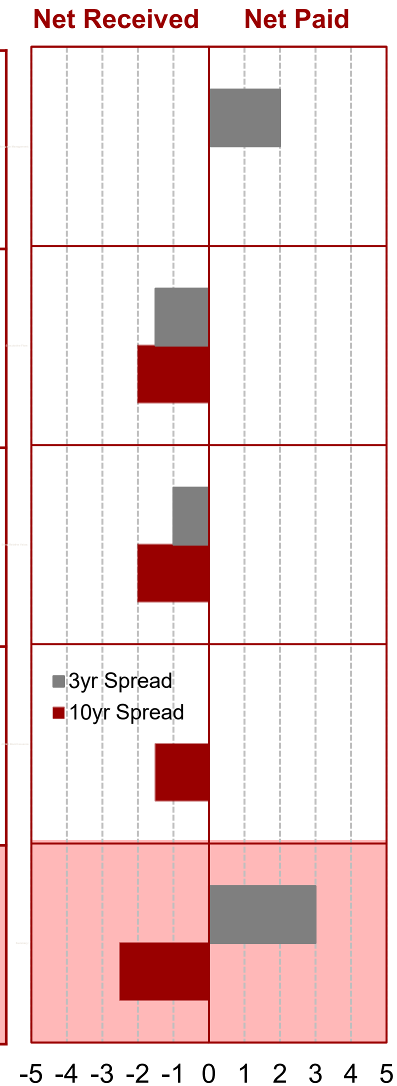
Monetary Policy:	• We expect the RBA to deliver 100bp more tightening before it pauses for an extended period. • However the risks in our view is that they will move into "tweak" mode as they have in previous cycles when they had their cash target someone near an equilibrium level. • That will underwrite a "higher for longer" expectation and bias swap spreads wider, everything else equal. **Spread Impact: Wider**
Global Credit Environment:	• Global credit spreads have narrowed significantly over the past couple of months, suggesting that we are through the worst of credit cycle. Whether that is true or not will likely come down to central bank and other policymaker's ability to manufacturer a soft-landing in 2023. So we are not fully out of the woods just yet. • While, given post-GFC reforms, the historical link between credit spreads and swap spreads is not as strong as it once was, elevated credit concerns, even if they have declined somewhat are still unlikely to supportive of narrower swap spreads. • Indeed, historically, rather than selling down physical paper, investor have chosen to pay swap as a hedge. That could increase toward the end of the cycle to head tail risks. **Spread impact: Wider**
Bank Balance Sheet Management:	• Household savings, and therefore deposits, remain strong, which suggests that there will be a natural offset to the increased mortgage paying ahead of the RBA tightening cycle (refer below). • Deposit growth will also limit the need for other funding sources, but the market is increasingly focused on swap related activity that could arise from smoothing of funding needs around Term Funding Facility (TFF) maturities. • Hedging of AUD senior unsecured fixed rate paper, which has potential to increase, is a potential receive side flow. **Spread Impact: Narrower**
Asset Swappers	• Payside flows emanating from asset swapping of longer bonds, largely from bank accrual books and by other investors for RV purposes, has been a major driver of the surge wider in swap spreads over recent months. • There is clearly a tactical aspect to this flow. That is, as swap spreads have been narrowing recently asset swappers have been more likely to delay the payside of the transaction in the hope of better future levels. • From an ADI perspective this is an ongoing structural flow. **Spread Impact: Wider**
Corporate Liability Management:	• The RBA tightening has seen ongoing significant payside from this sector, who had been historically under hedged in recent years for sensible reasons. The first RBA cycle in a decade changed the equation. • So, will there be an ongoing "supply" of payside from this sector. In our view, the greater amount of discretionary hedging has likely been undertaken. However that does not imply that there will be no participation from this sector going forward. • We expect that bond market rallies will continue to be paid into, shorter hedges to get over the "hump" of the tightening are likely to remain popular and a significantly flatter curve could evokesome "blend and extend" payside as well. **Spread Impact: Wider**



A "0" means "Receive-side" and "Pay-side" influences net out.

Swap Spread Checklist – Part 2

Household Mortgage Management:	• Households were well prepared for the RBA tightening cycle, taking advantage of the historically low fixed rates available at the peak of the pandemic-related unconventional monetary policy settings. • Most of these “pre-emptive” fixed rate mortgages will mature in the next 6 months or so, The big question is what this sector will do at that time. Will they elect to pay variable rates or will the “pain” of the surge in their monthly costs encourage another wave of fixed rate mortgages on the fear that rates could go even higher? That us what happened at the top of previous RBA hike cycles. The jump up to fixed rates would probably limit this, however should they drop below variable then a move of this kind is likely. **Spread Impact: Wider**
Speculative Flow:	• After many months of very few receive-side flows, there has been some renewed interest over the last few weeks. That is providing hope that some of the disenchantment with the RBA from its YCC exist and recent communication strategy which has impacted liquidity might be closer to being resolved. . • That has manifested itself in narrow basis spreads across the term structure and product space. • Should the RBA pause its cycle and the market’s enter a range trading environment we would expect flows from this cohort to increase. Spread Impact: Narrower
Swap Relative Value:	• As mentioned above, basis spreads have narrowed (e.g. 3m BBSW is flat to OIS) and 1y1y has fallen significantly in recent weeks, taking away some of the carry opportunities that were available not so long ago. • Even so, there are some attractive opportunities in cross market swap spread space, including a relatively wide AU-US 5y5y cross market narrowing opportunity. **Spread Impact: Narrower**
ACGB Bond Issuance & “Free Float”	• The Commonwealth budget is benefitting from the windfalls arising out of historically high commodity prices relative to conservative budget forecasts. That delivered a $30+ billion benefit last year and is on track to deliver a similar windfall this year. The resulting improved deficit position will reduce bond issuance, however the ALP government’/s first budget still projected significant future issuance. • That is a narrowing influence medium term. That is offset near term by the distortion at the front end of the curve caused by the RBA’s majority ownership of the YCC bonds and high ownership of QE bonds. **Spread Impact: Neutral / Narrower**
Summary:	As the RBA continues to move further into its tightening cycle so the balance of risks for swap spreads has shifted significantly, and now we are favouring further narrowing at the long end of the spread curve. That reflects the balance of risks, although we acknowledge that this is a very subjective process and it would be rare for either end of the swap curve to shift in different directions for any length of time.

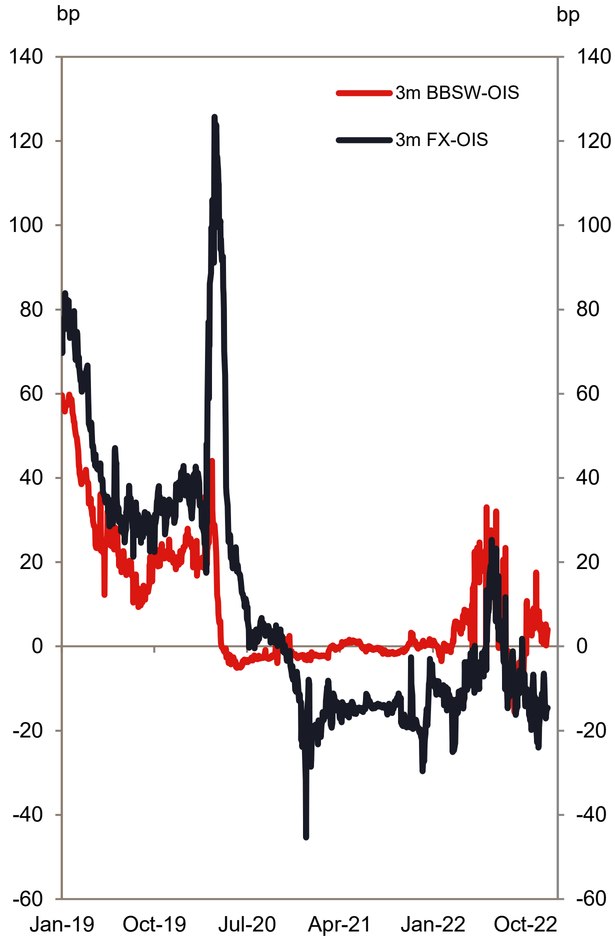


A “0” means “Receive-side” and “Pay-side” influences net out.

Will 3m BBSW-OIS move inverse?

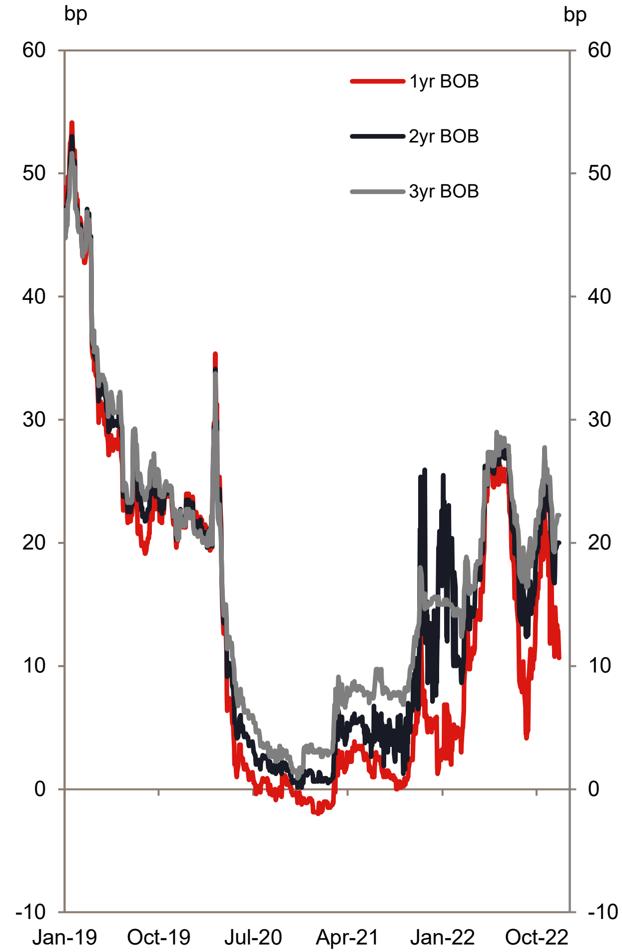
It is flat and as year end approaches we would expect spreads to continue to perform.

Spot 3m Funding Spreads



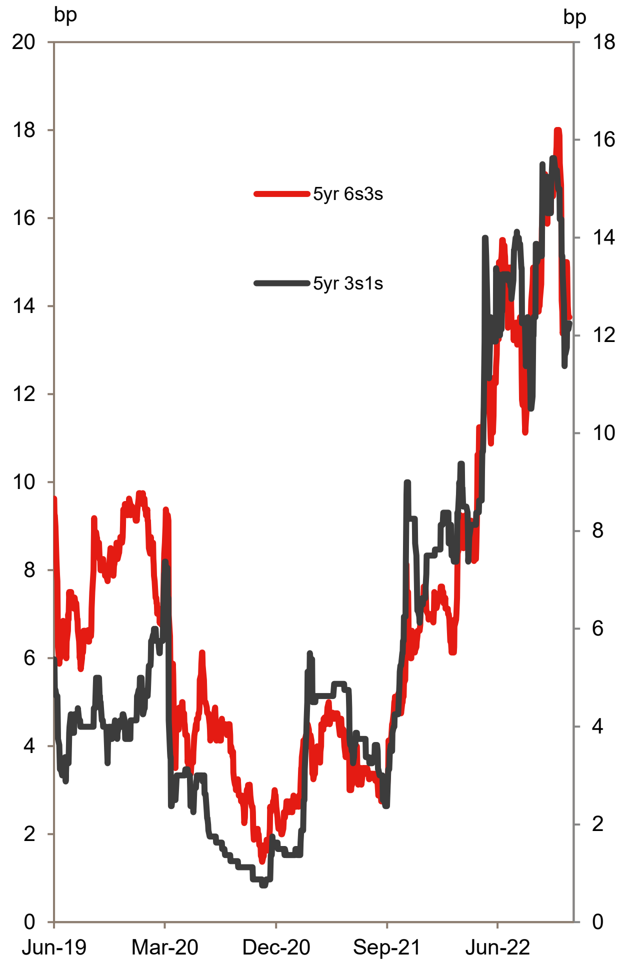
Source: Bloomberg; Westpac

BOB Spread evolution



Source: Bloomberg; Westpac

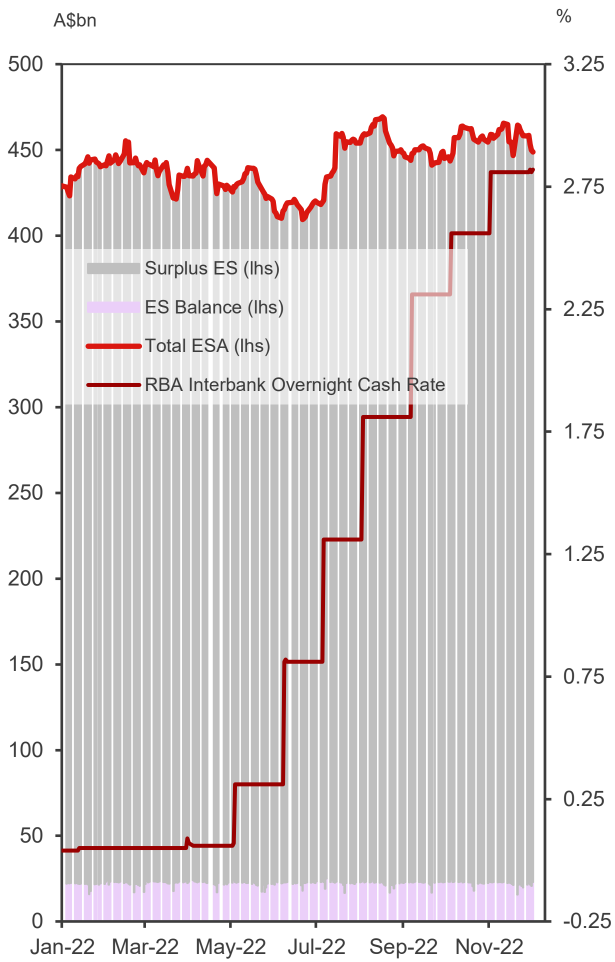
5yr Tenor Basis



Source: Bloomberg; Westpac

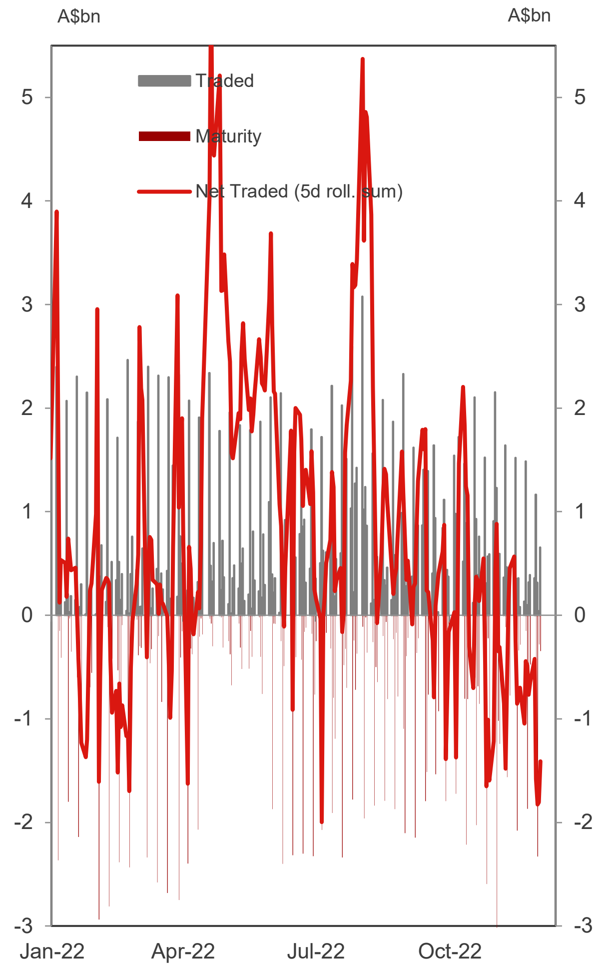
Excess liquidity will remain for many months.

ESA Balances vs Cash rate



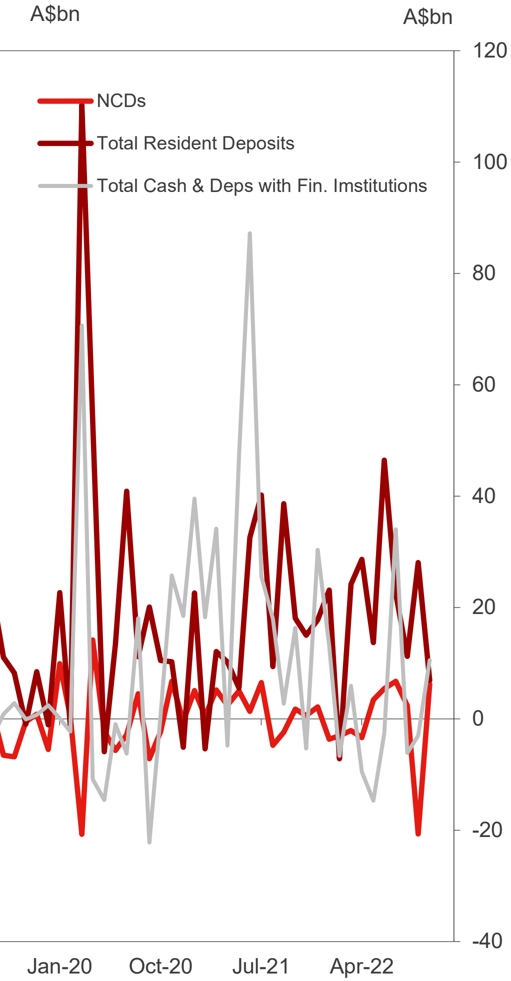
Source: Bloomberg; Westpac

Net Trades behind 3m BBSW



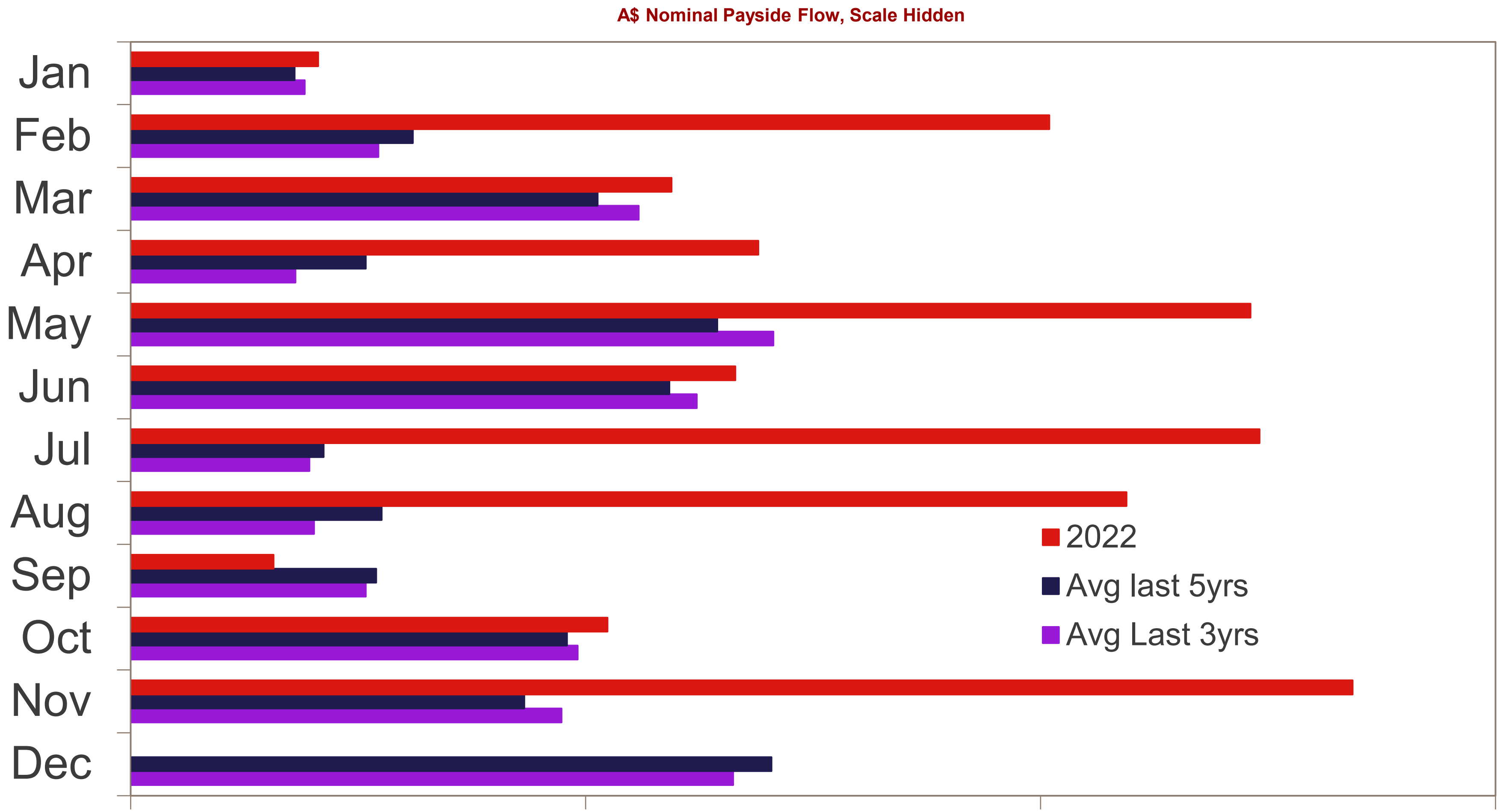
Source: Bloomberg; Westpac

ADI NCD issuance volumes – Month Chg



Source: Bloomberg; Westpac

How has 2022 corporate payside evolved?

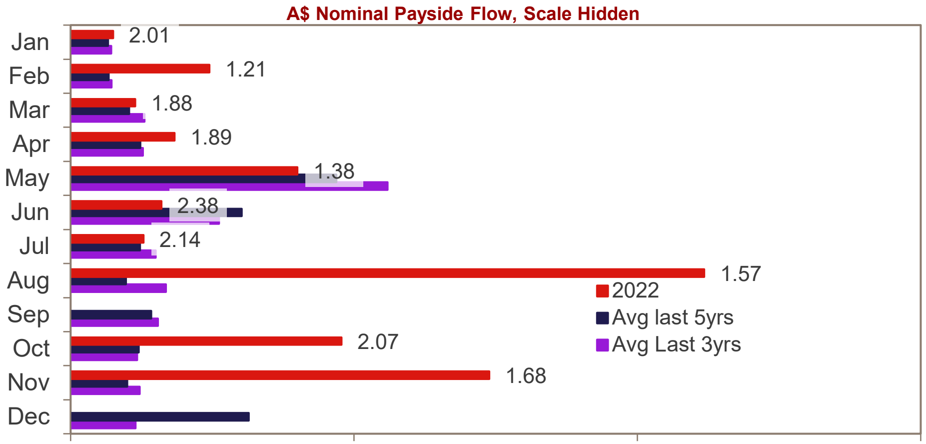


Source: Bloomberg; Westpac

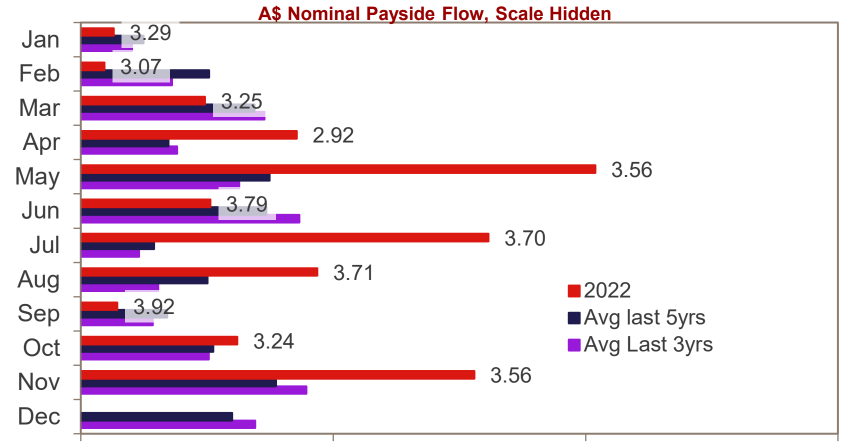
Corporate payside flows breakdown

Nominal flows by maturity

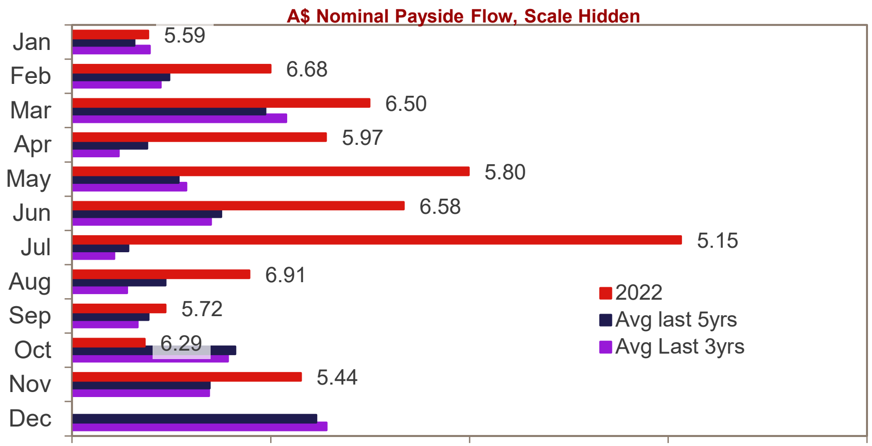
<2yr*



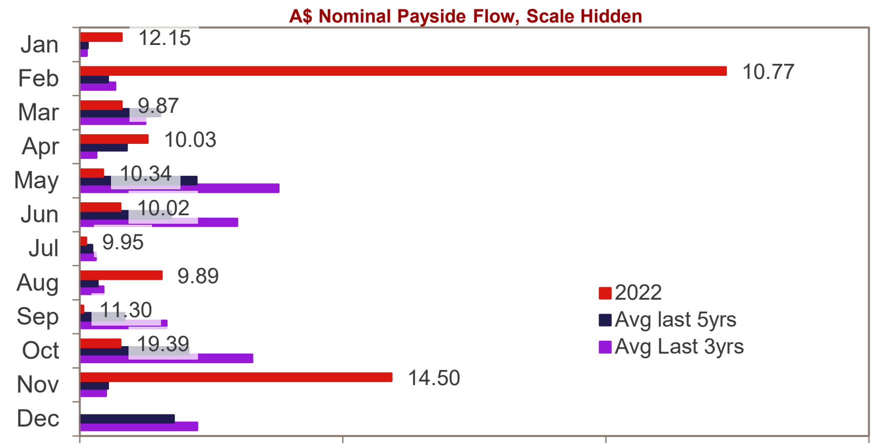
2-5yr*



5-10yr*



>10yr*



Source: Westpac

*Data labels reflect the 2022 weighted average maturity for each month

Projected Gross Issuance & Outstandings

Commonwealth & Semi-Government Programmes

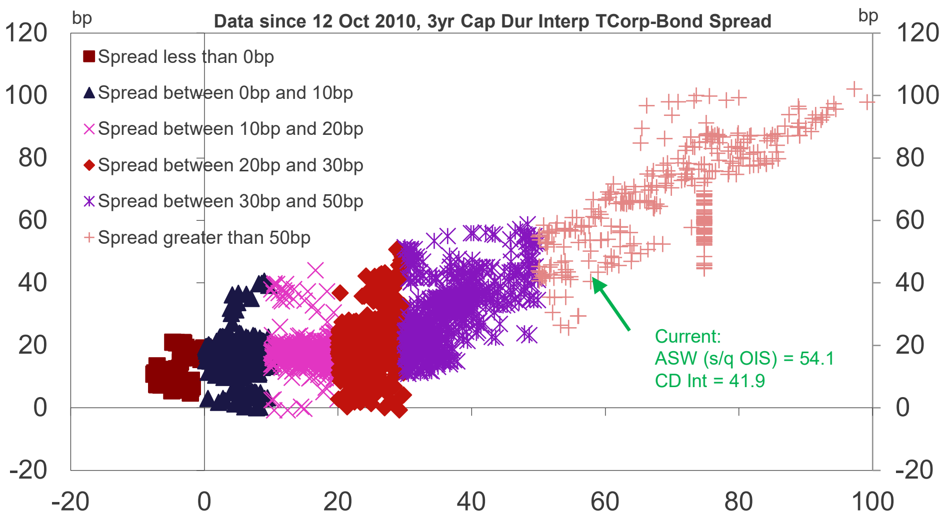
AGS & Semi Gross Borrowing Task & Projected Outstandings

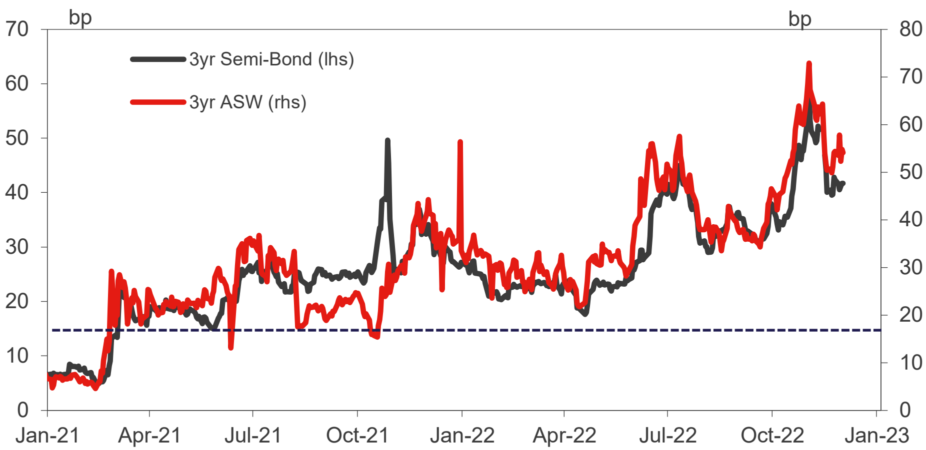
A$bn	FY23		FY24		FY25		FY26		
	Gross Issuance BGT 2023	Total FV end FY23	Gross Issuance BGT 2023	Total FV end FY24	Gross Issuance BGT 2023	Total FV end FY25	Gross Issuance BGT 2023	Total FV, end FY26	Gross Issuance 4yr Total
AGS	**97.5**	**965**	**113**	**1078**	**168**	**1246**	**152**	**1398**	**530.5**
NSW	24.0	137.6	30.4	168.0	28.4	196.4	31.1	227.5	*113.9*
TCV	15.7	129.0	32.1	161.1	29.5	190.6	25.0	225.6	*112.3*
QTC	14.4	132.0	18.5	150.5	17.7	168.2	18.4	186.6	*69.0*
WAT	5.1	52.1	6.9	59.0	7.4	66.4	7.6	74.0	*27.0*
SAF	6.6	34.6	6.2	40.8	5.9	46.7	5.1	51.8	*23.8*
TAS	2.25	9.5	2.6	12.1	1.5	13.6	2.0	15.6	*8.35*
ACT	2.0	9.2	2.2	11.4	2.0	13.4	1.5	14.9	*7.7*
NTT	1.5	9.8	1.4	11.2	1.0	12.2	0.8	13.0	*4.7*
Total Semi	**71.6**	**513.8**	**100.3**	**614.1**	**93.4**	**707.5**	**91.5**	**809.0**	**367**

Source: State Borrowing Authorities; State Budget Papers; Amounts in red have been announced by the borrower; Amounts in black are Westpac calculations.

Semi-Bond relationship with Swap-Bond spread

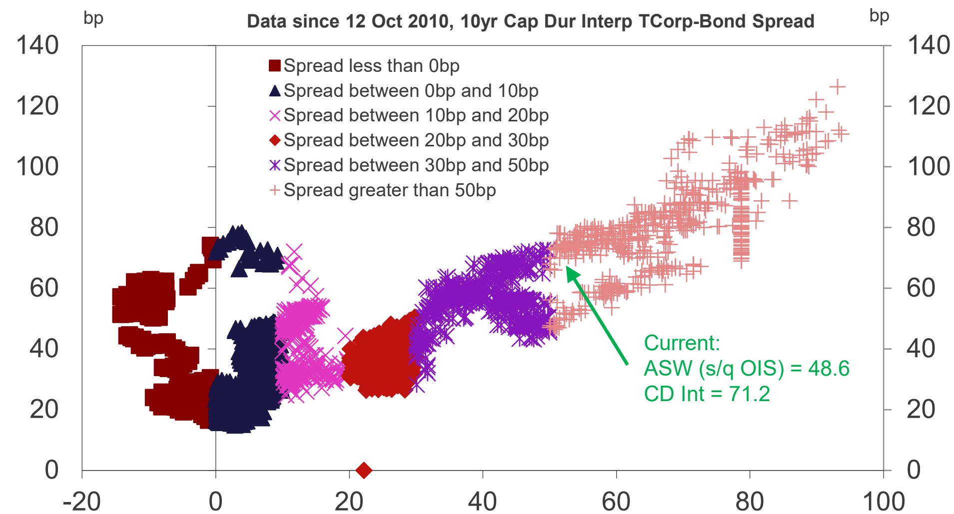
3yr Semi-Bond vs Swap Spreads

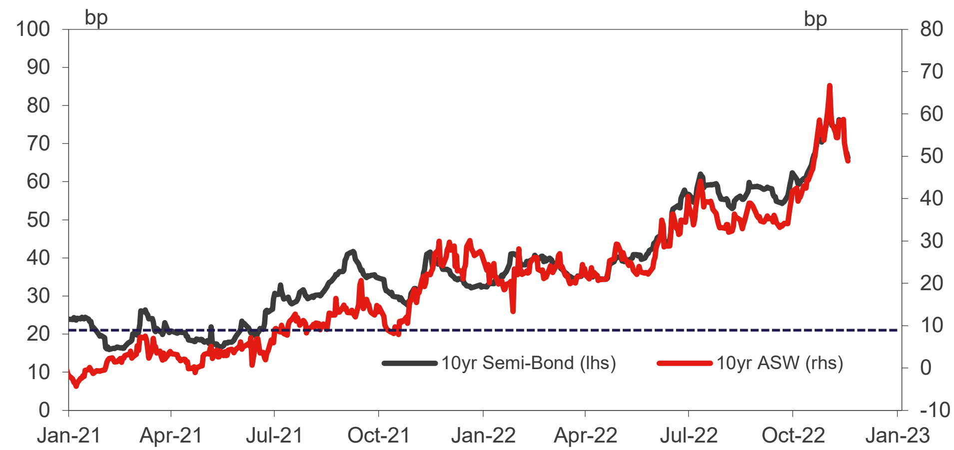




Source: Bloomberg, Westpac

10yr Semi-Bond vs Swap Spreads



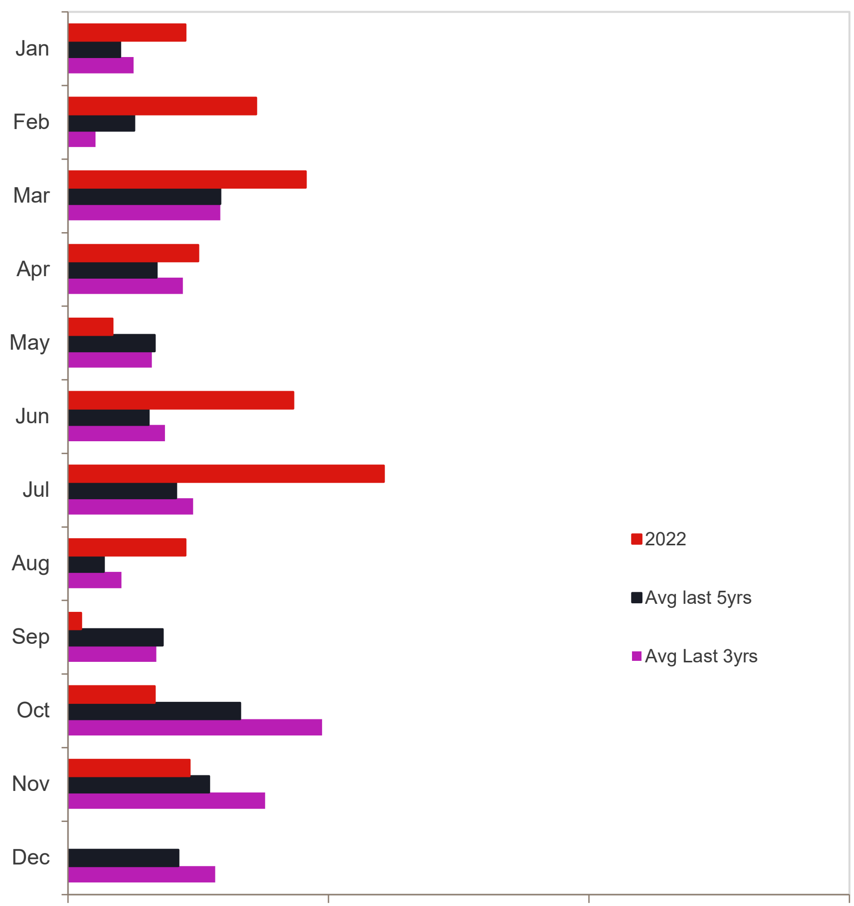


Source: Bloomberg, Westpac

WBC flows shows surge HQLA purchases slowing

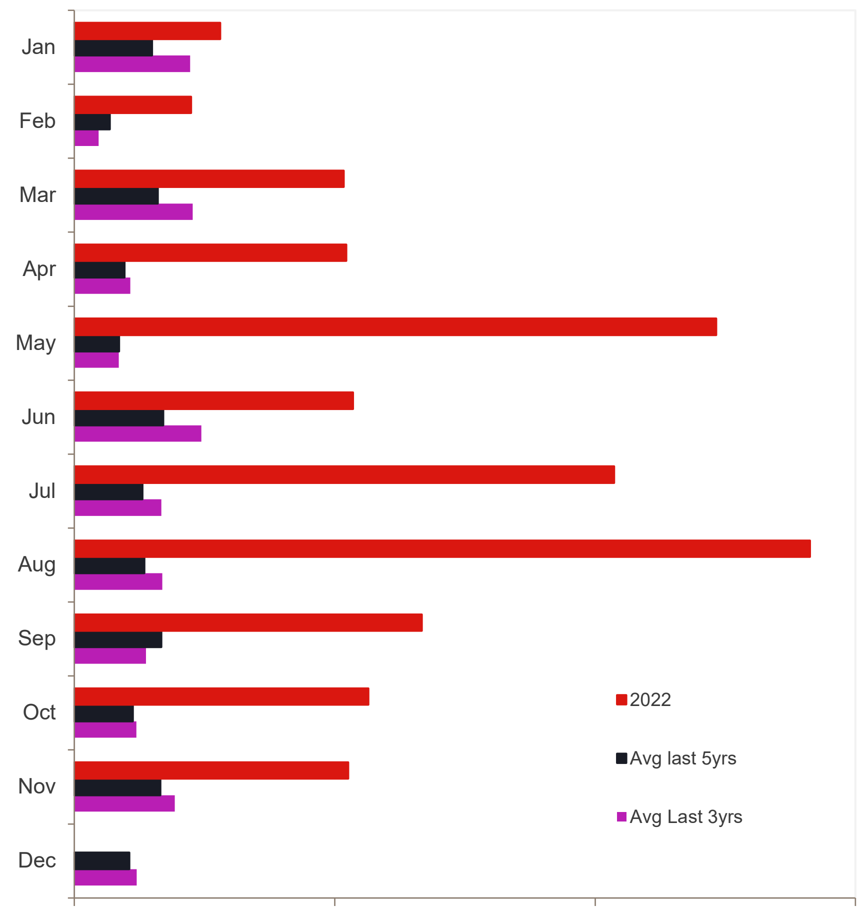
WBC Flows: ADI Nominal gross ACGB Purchases

A$ Nominal Buyside Flow, Scale Hidden*



WBC Flows: ADI Nominal Gross Semi Purchases

A$ Nominal Buyside Flow, Scale Hidden*

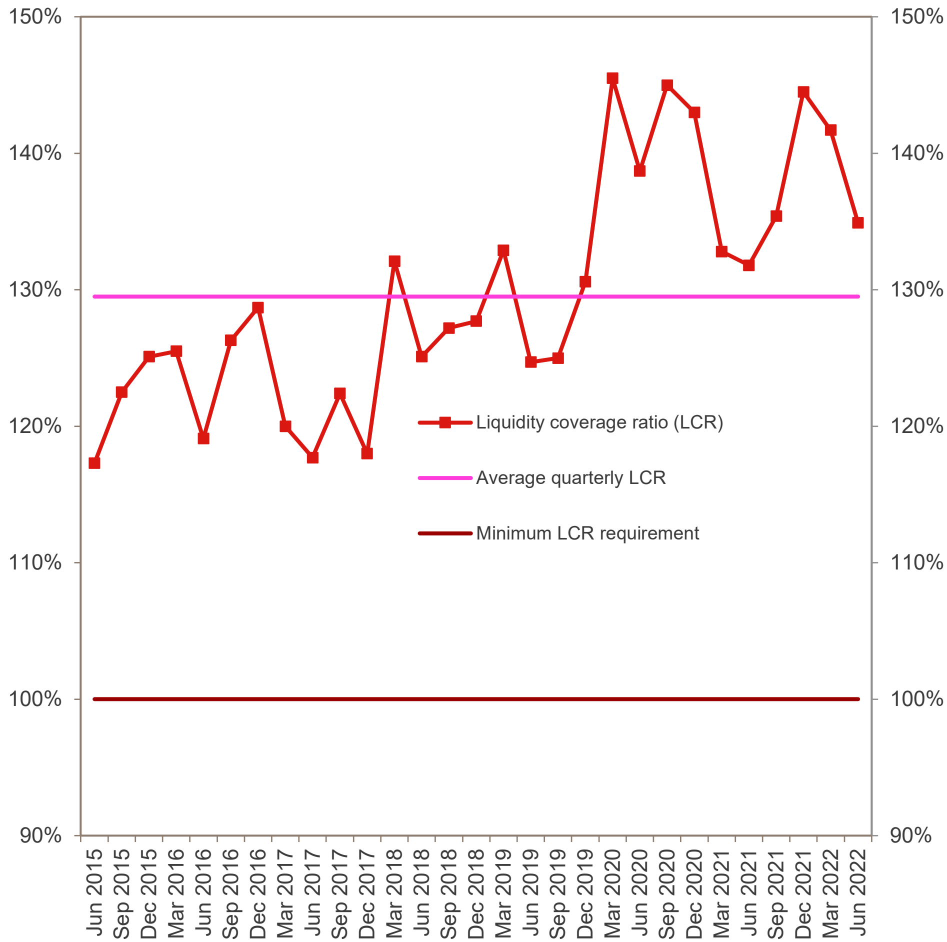


Source: Westpac

* Horizontal value scales are the same for both charts. Therefore they are directly comparable.

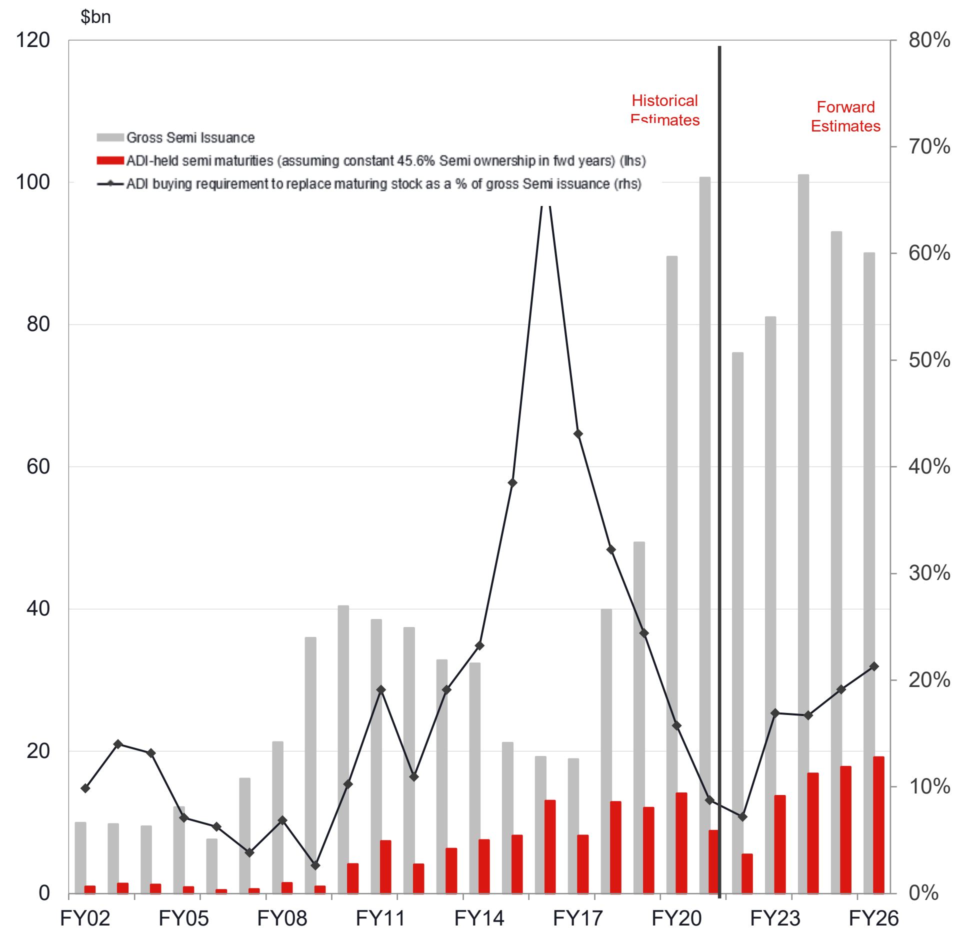
HQLA demand remains a key focus

The average qtrly LCR "buffer" has been 129%



Source: State Borrowing Tasks;' APRA, Westpac

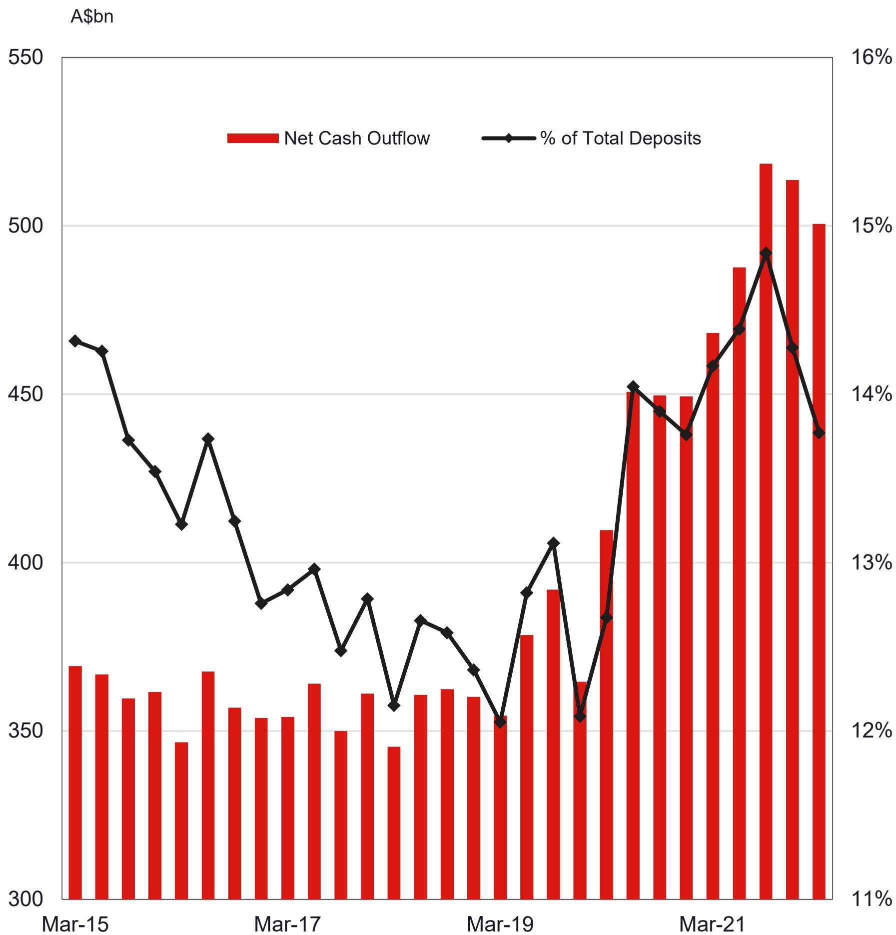
What do ADIs need to buy to replace HQLA



Source: State Borrowing Tasks;' APRA, Westpac

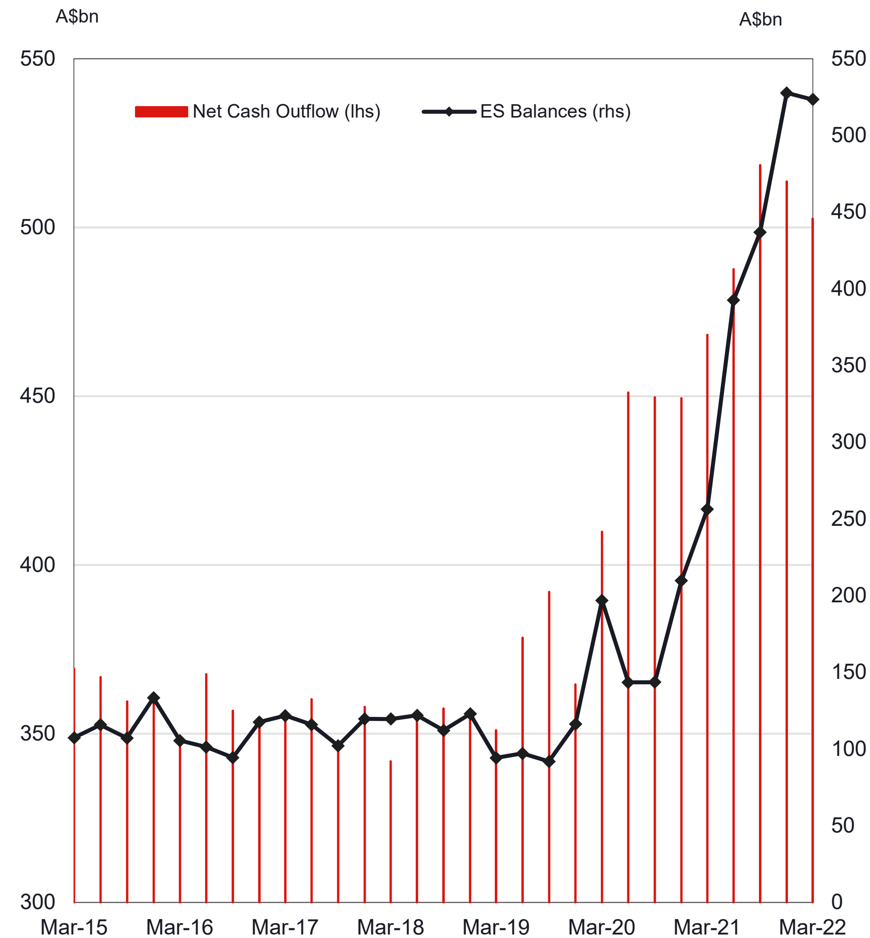
HQLA demand remains a key focus

NCO Growth as a % of Total System Deposits



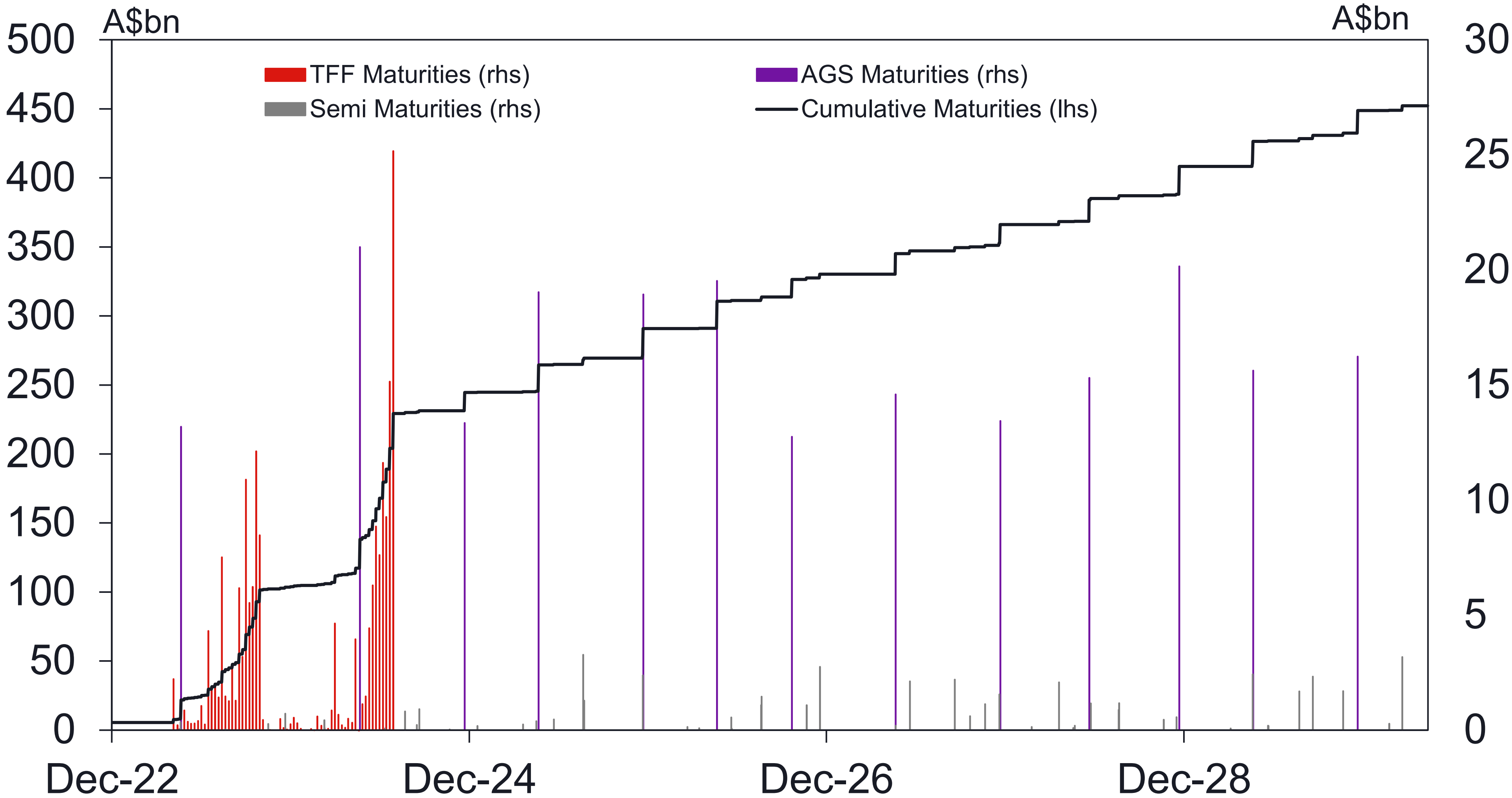
Source: APRA; Westpac:

NCO Growth vs ES Balances



Source: APRA; Westpac:

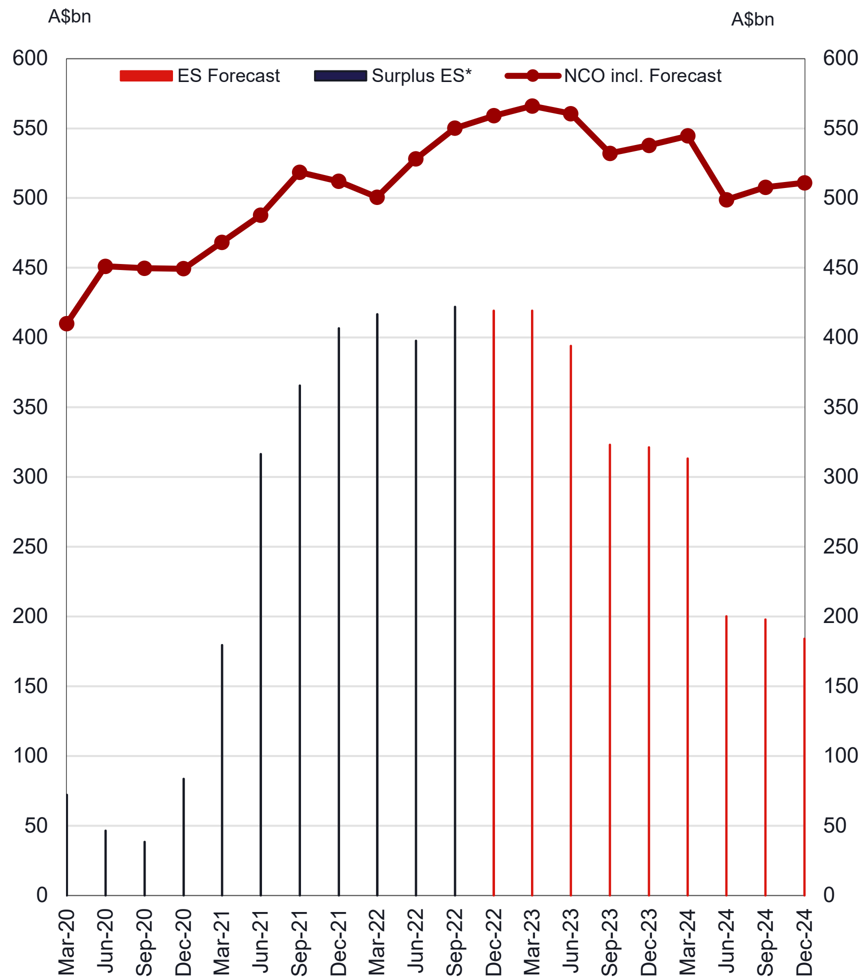
RBA Balance Sheet Run-Off



Source: RBA, Bloomberg, Westpac Strategy Group

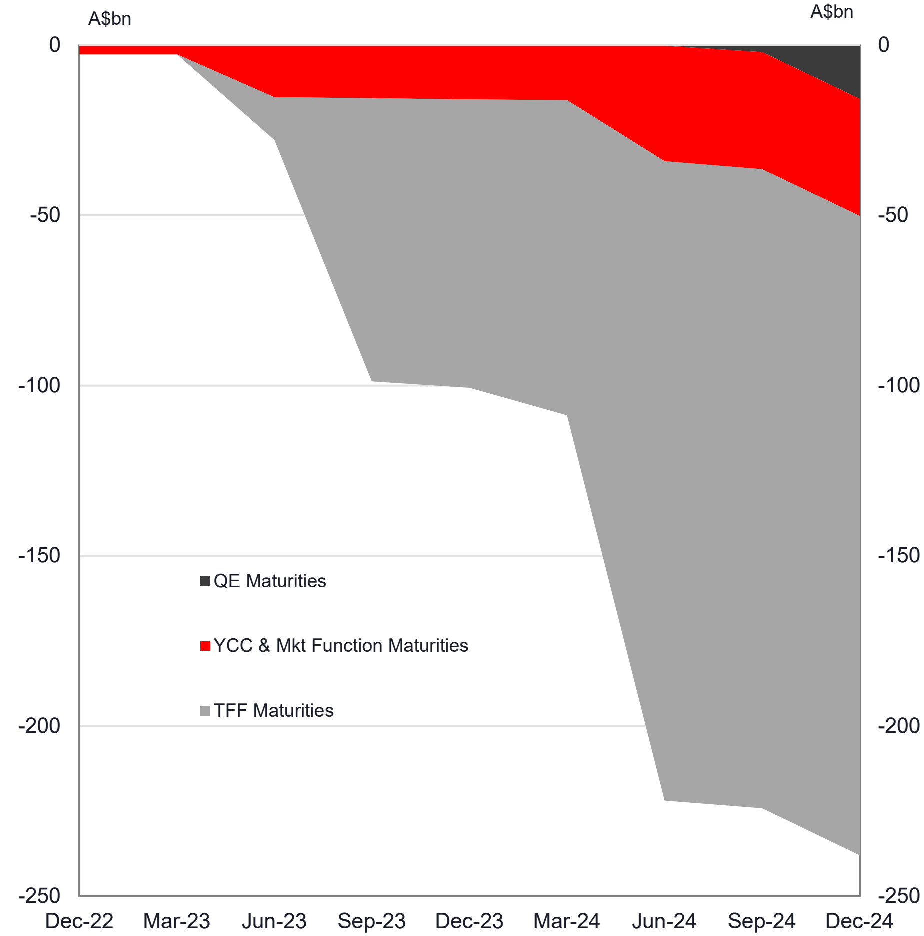
LCR - Relationship b/w NCOs & ES Balance is key

NCO Growth vs ES Balance Forecast



Source: APRA; Westpac:

ES Rundown – Forecast Breakdown



Source: APRA; Westpac: *Data from RBA Balance Sheet

Stylised ADI Demand Evolution

	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
Net Cash Outflow (NCO, $)	**512**	**501**	**528**	**550**	**559**	**566**	**560**	**532**	**538**	**545**	**499**	**508**	**511**
NCO Change / ES Change Qtr (%)				50	50	50	50	50	50	50	50	50	50
NCO Change due to ES Change Qtr ($)				12	-1	0	-13	-35	-1	-4	-57	-1	-7
Annual Balance Sheet Growth (%)				8	8	5	5	5	5	8	8	8	8
NCO Change due to Bal. Sheet growth Qtr ($)				10	10	7	7	7	7	11	11	10	10
NCO Change per Qtr (%)				4	2	1	-1	-5	1	1	-8	2	1
Total NCO Change per Qtr ($)				22	9	7	-6	-28	6	7	-46	9	3
Buffer above 100% LCR (%)	45	42	35	38	35	34	33	32	31	30	30	30	30
Buffer above 100% LCR ($)	230	212	184	209	196	192	185	170	167	163	150	152	153
Buffer Change per Qtr ($)		-19	-28	25	-13	-3	-7	-15	-4	-3	-14	3	1
LCR incl. Buffer ($)	742	712	712	759	755	758	745	702	705	708	648	660	664
LCR incl. Buffer change per Qtr ($)			0	47	-4	4	-13	-43	2	3	-59	11	4
LCR incl. Buffer consisting of ($)													
CLF Holdings	102	98	65	25	0								
- Decline per Qtr (%)		0	0	61	100								
- % of LCR incl. Buffer	14	14	9	3	0								
- Total change per Qtr ($)		-4	-32	-40	-25								
HQLA holdings	**648**	**615**	**647**	**734**	**755**	**758**	**745**	**702**	**705**	**708**	**648**	**660**	**664**
- % of LCR incl. Buffer	87	86	91	97	100	100	100	100	100	100	100	100	100
- Total change per Qtr ($)		-33	32	87	21	4	-13	-43	2	3	-59	11	4
Of which:													
- ES ($)	**407**	**417**	**398**	**422**	**419**	**419**	**394**	**323**	**321**	**313**	**200**	**198**	**184**
- ES (% of LCR incl. Buffer)	55	59	56	56	56	55	53	46	46	44	31	30	28
- ES (% of HQLA)	63	68	62	58	56	55	53	46	46	44	31	30	28
- ACGBs ($)	**64**	**63**	**72**	**87**	**106**	**106**	**112**	**119**	**120**	**124**	**139**	**145**	**149**
- ACGBs (% of LCR incl. Buffer)	9	9	10	12	14	14	15	17	17	18	22	22	23
- ACGBs (% of HQLA)	10	10	11	12	14	14	15	17	17	18	22	22	23
- SEMIs ($)	**177**	**168**	**196**	**224**	**230**	**233**	**240**	**260**	**263**	**271**	**309**	**317**	**331**
- SEMIs (% of LCR incl. Buffer)	24	24	25	30	30	31	32	37	37	38	48	48	50
- SEMIs (% of HQLA)	27	27	30	31	30	31	32	37	37	38	48	48	50
- SEMI / ACGB Ratio	2.75	2.68	2.72	2.57	2.17	2.19	2.14	2.18	2.20	2.19	2.22	2.18	2.21

Source: APRA; Westpac

Stylised ADI Demand Evolution

There are many possible variables that enter the calculation of the LCR, with each component crucial to the mix of outcomes that will drive future ADI demand for HQLA securities. To provide a high level example of how this demand could evolve below we outline a stylised evolution of potential ADI demand for semis under a number of assumptions.

The table shows semi demand rising throughout the period, from 26% of the total HQLA portfolio as of 31 March 2021 to 38% by December 2023. That corresponds with an increase in Semi holdings from $177bn to $244bn over the period. We project ACGB demand to increase too, rising from 10% of HQLA holdings to 17% by the end of our projection period. As is well known, the main driver of the shifting mix will be the decline in surplus ES balances, which is most influential in 3Q2023, and our view that NCOs have peaked. The charts on the page over provide a visual on the main shifts in this “forecast” over the projection period.

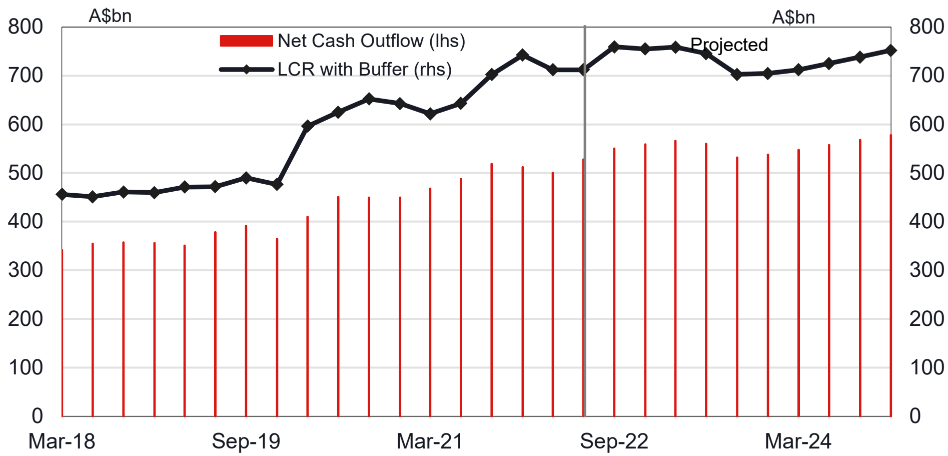
In undertaking this process, we made the following assumptions:

- Our starting point data is from APRA’s Quarterly ADI Performance statistics as at 30 June 2022.
- NCOs change is the net of: 50% of the decline in surplus ES balances each quarter against increasing at the same pace as balance sheet growth.
- ES balances decline at the pace of the current maturity profile for the RBA balance sheet (refer chart next page).
- Balance sheet growth averages 7.5%p.a. in 2022, falling to 5%p.a in 2023, lifting to 8% in 2024.
- LCR buffer falls back toward long term average level (130%) linearly over the period.
- ACGBs rise from their current record low % of HQLA portfolio (10%) to around 18%.
- The ratio of Semis to ACGBs in the HQLA portfolio moves from 2.7% to 2.2%, just above the LT avg level (1.9%).
- CLF steps down in discrete jumps to $0bn by Dec 22 from its $102bn level on 1 Jan*.

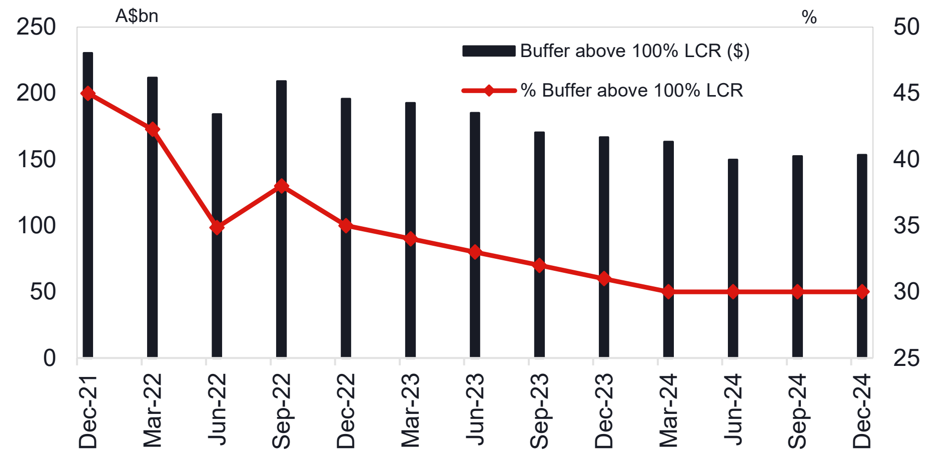
Source: APRA; Westpac

Stylised ADI Demand Evolution

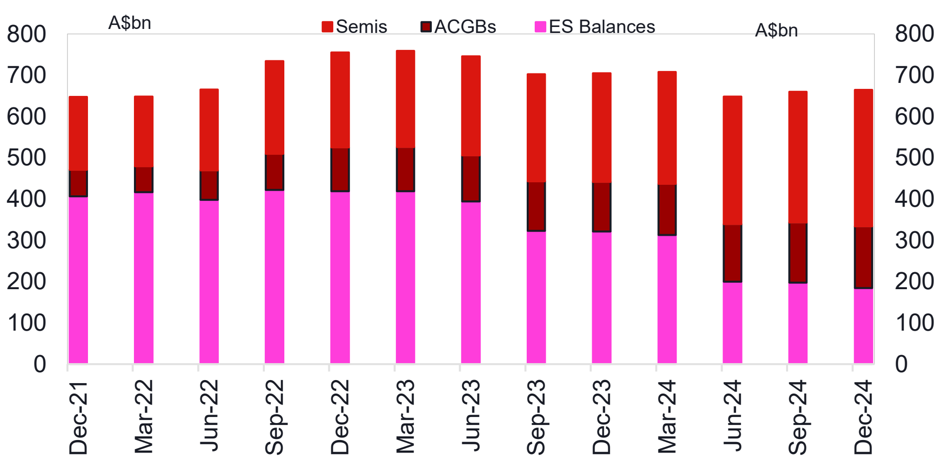
Historical & Projected NCO & LCR evolution



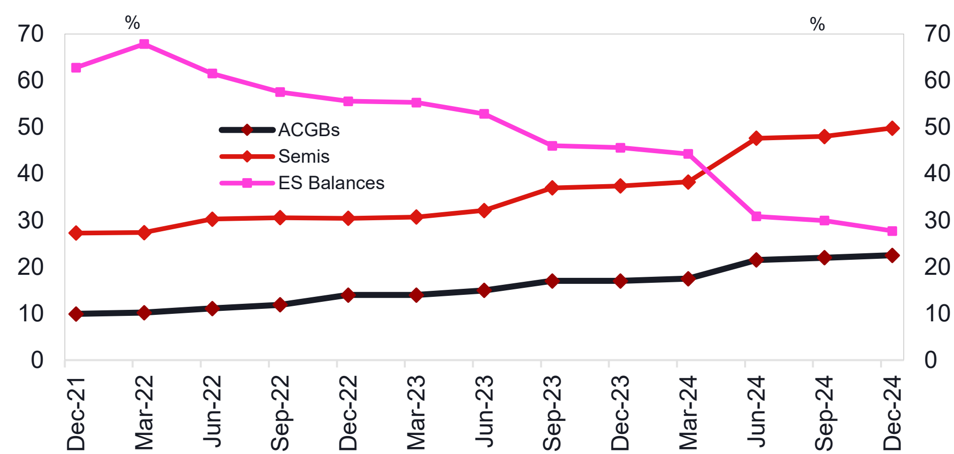
Projected LCR Buffer



Projected HQLA breakdown (A$bn)



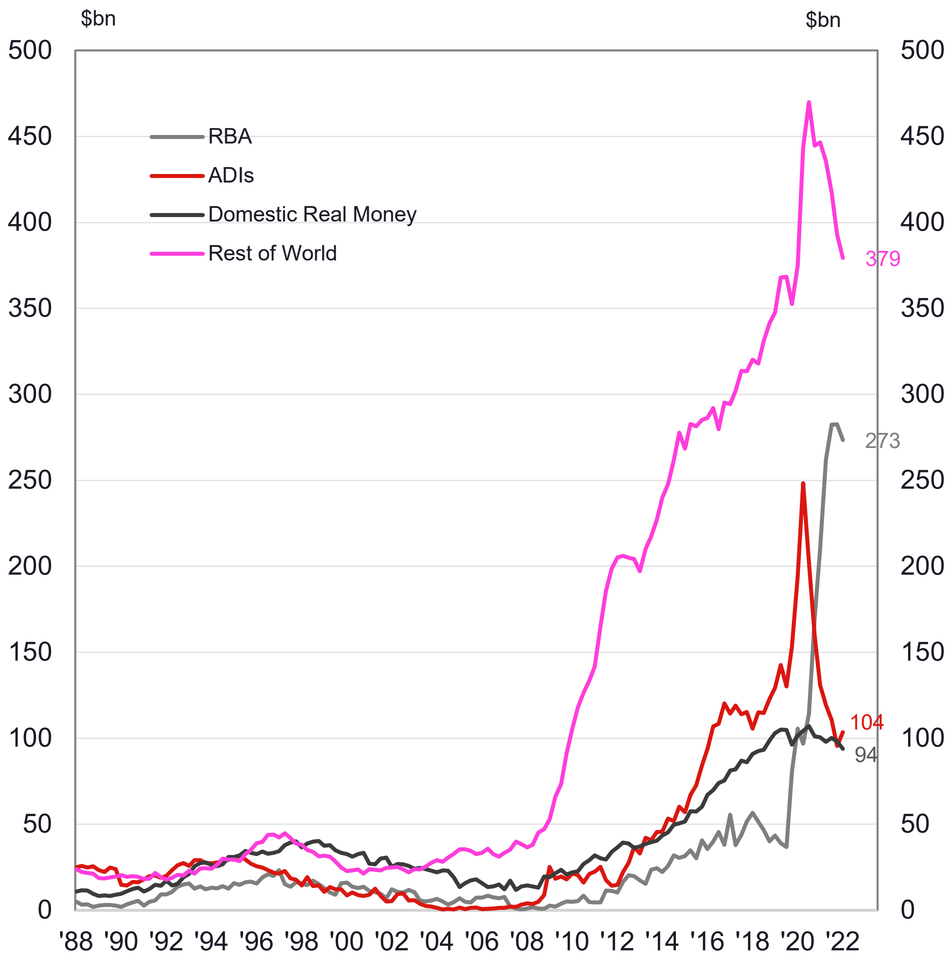
Projected HQLA breakdown (% of HQLA)



Source for all charts: APRA; Westpac

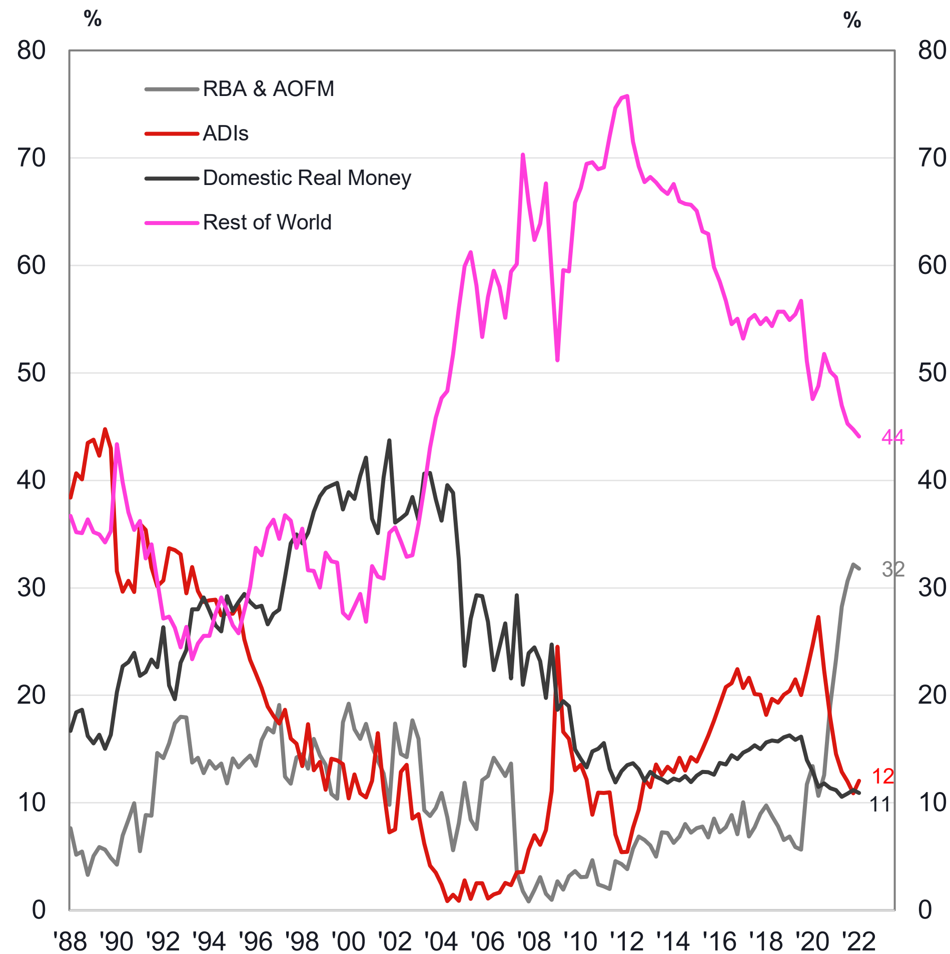
ACGB Ownership Profile

ACGB Ownership Profile – Billions ($A, MV)



Source: ABS, Westpac; Latest data as at 2Q2022

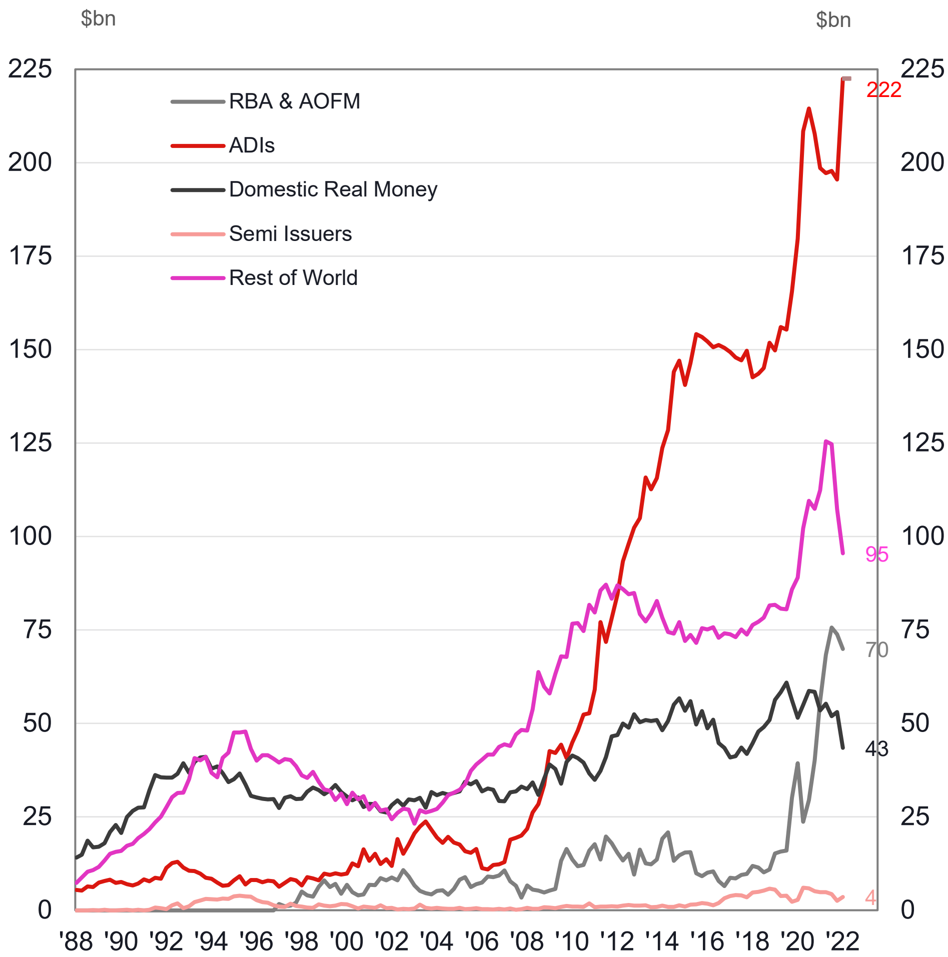
ACGB Ownership Profile - % of Total



Source: ABS, Westpac ; Latest data as at 2Q2022

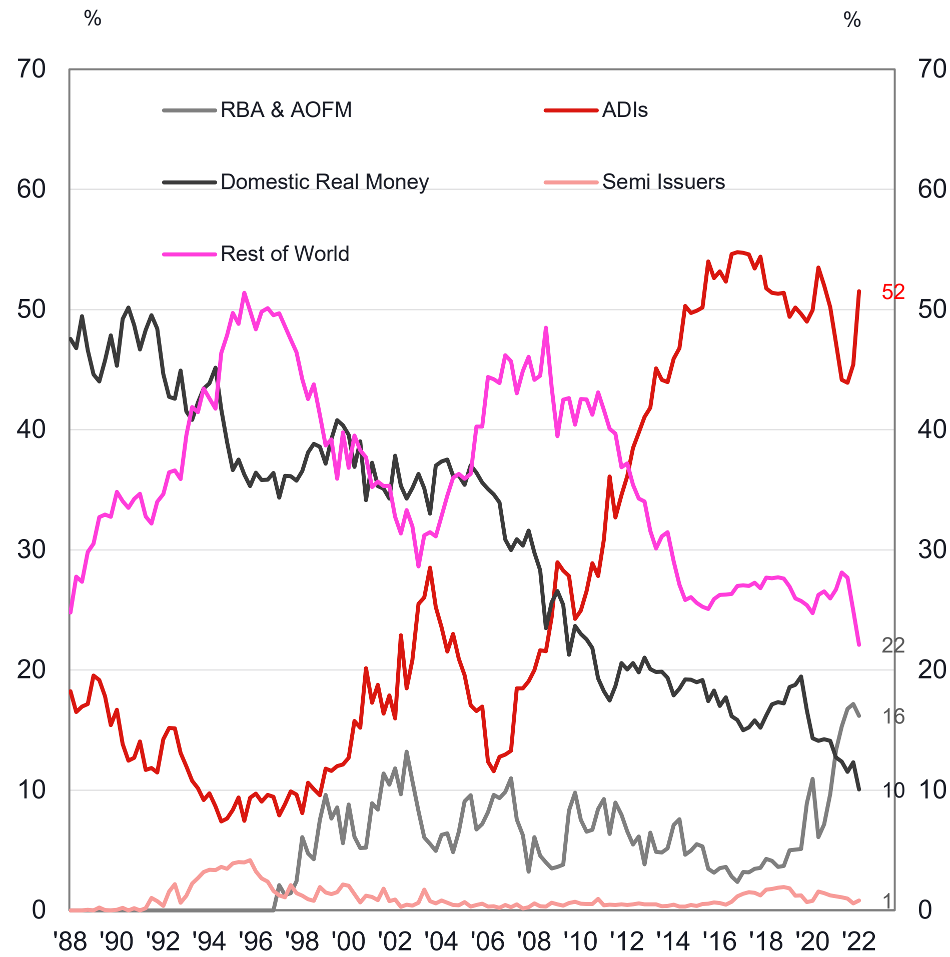
SEMI Ownership Profile

SEMI Ownership Profile – Billions ($A, MV)



Source: ABS, Westpac ; Latest data as at 2Q2022

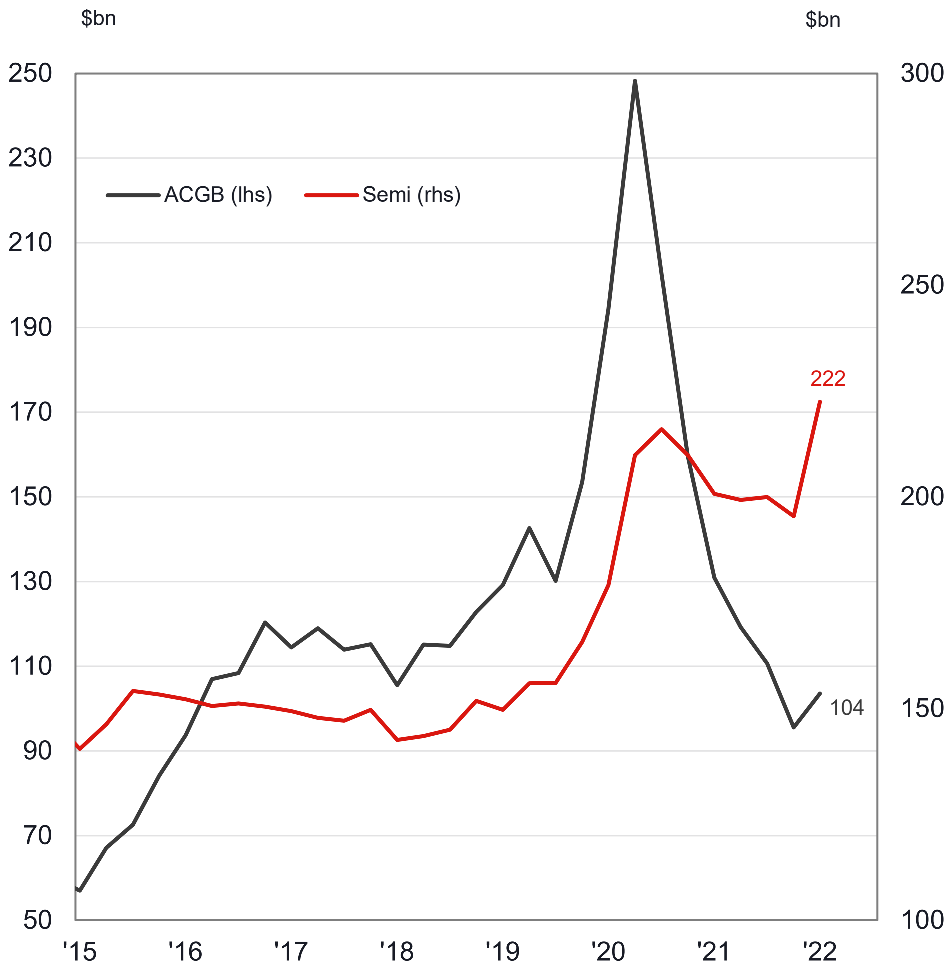
SEMI Ownership Profile - % of Total



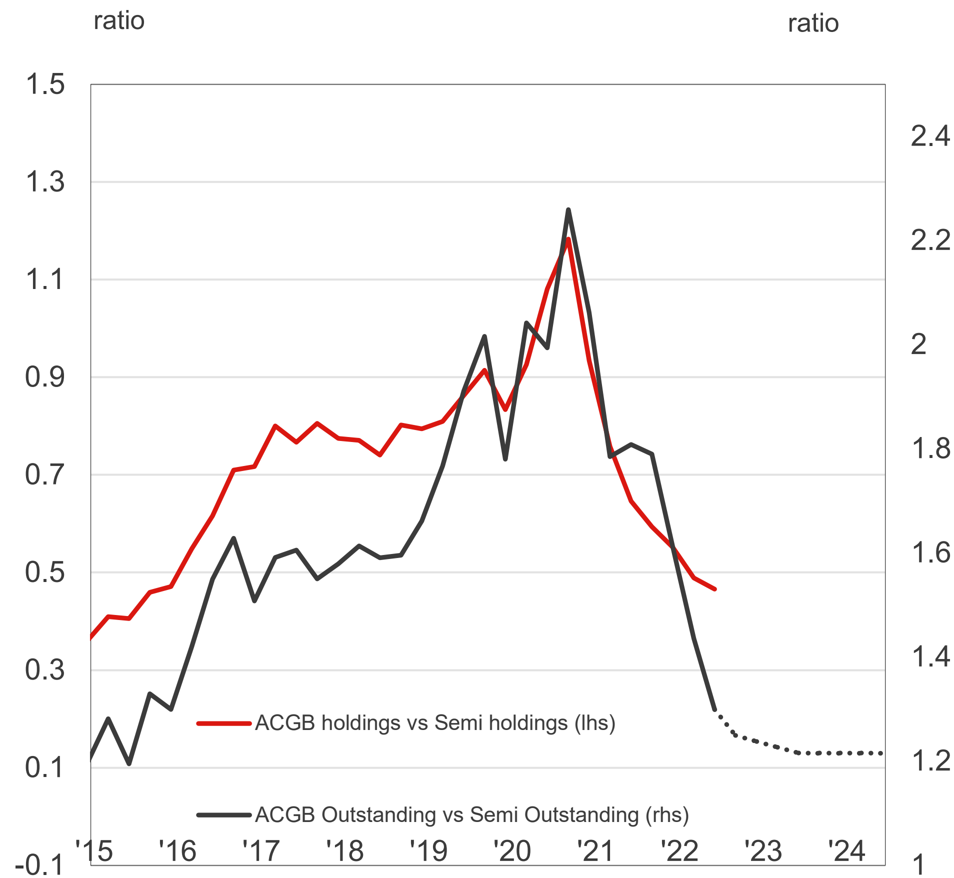
Source: ABS, Westpac ; Latest data as at 3Q2021

ADI Semi holdings have surged as supply begets demand.

ADI holdings of ACGB & Semis*



ADI holdings vs ACGB & Semi Outstandings*

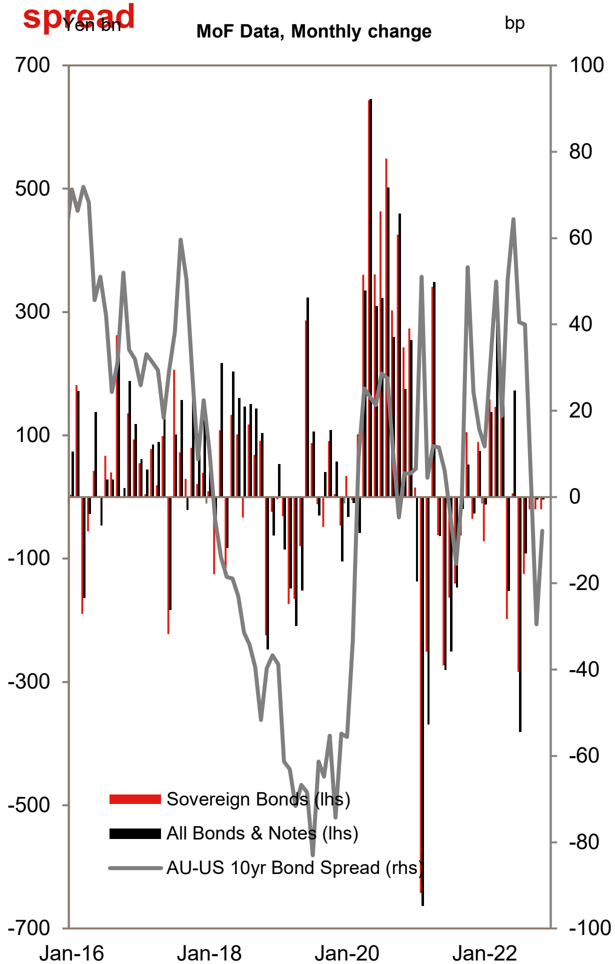


Source: RBA, ABS, Westpac Latest data as at 2Q2022

*Market value

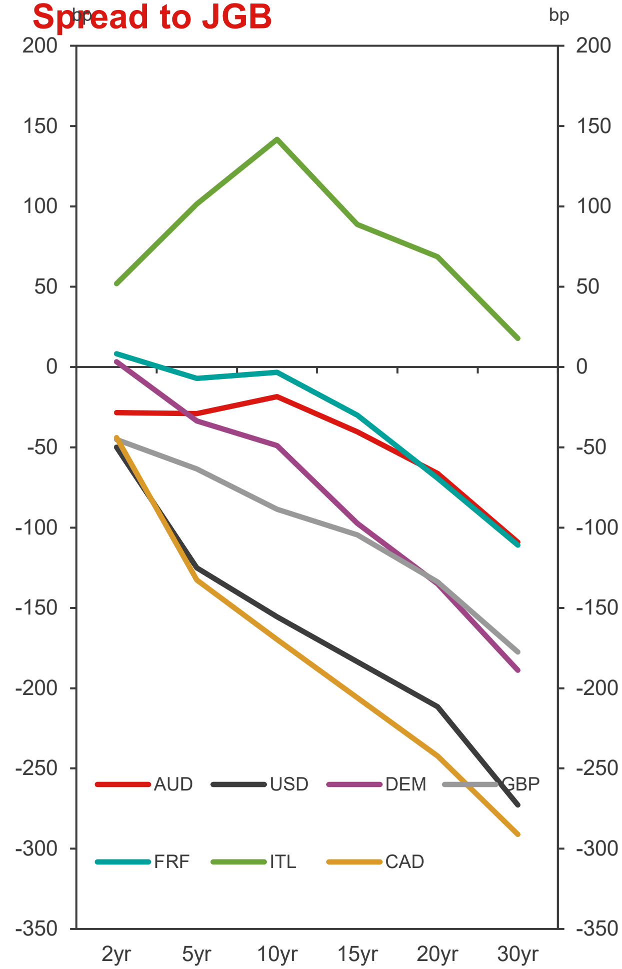
Japanese FX-hedged yields remain a deterent

Monthly flow vs AU-US 10yr bond spread



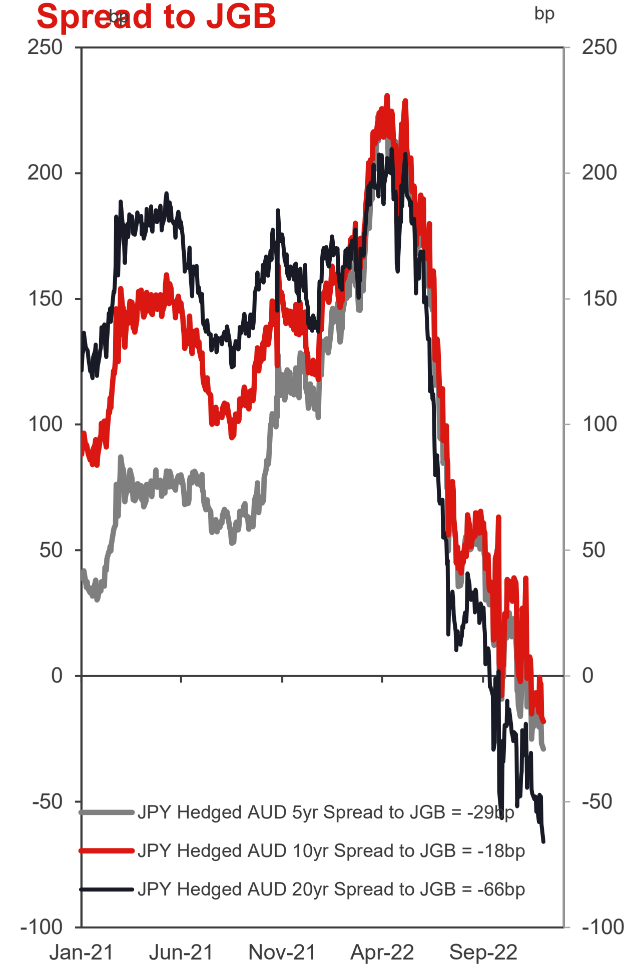
Source: MoF, Bloomberg, Westpac

JPY-Hedged Sovereign Curves – Spread to JGB



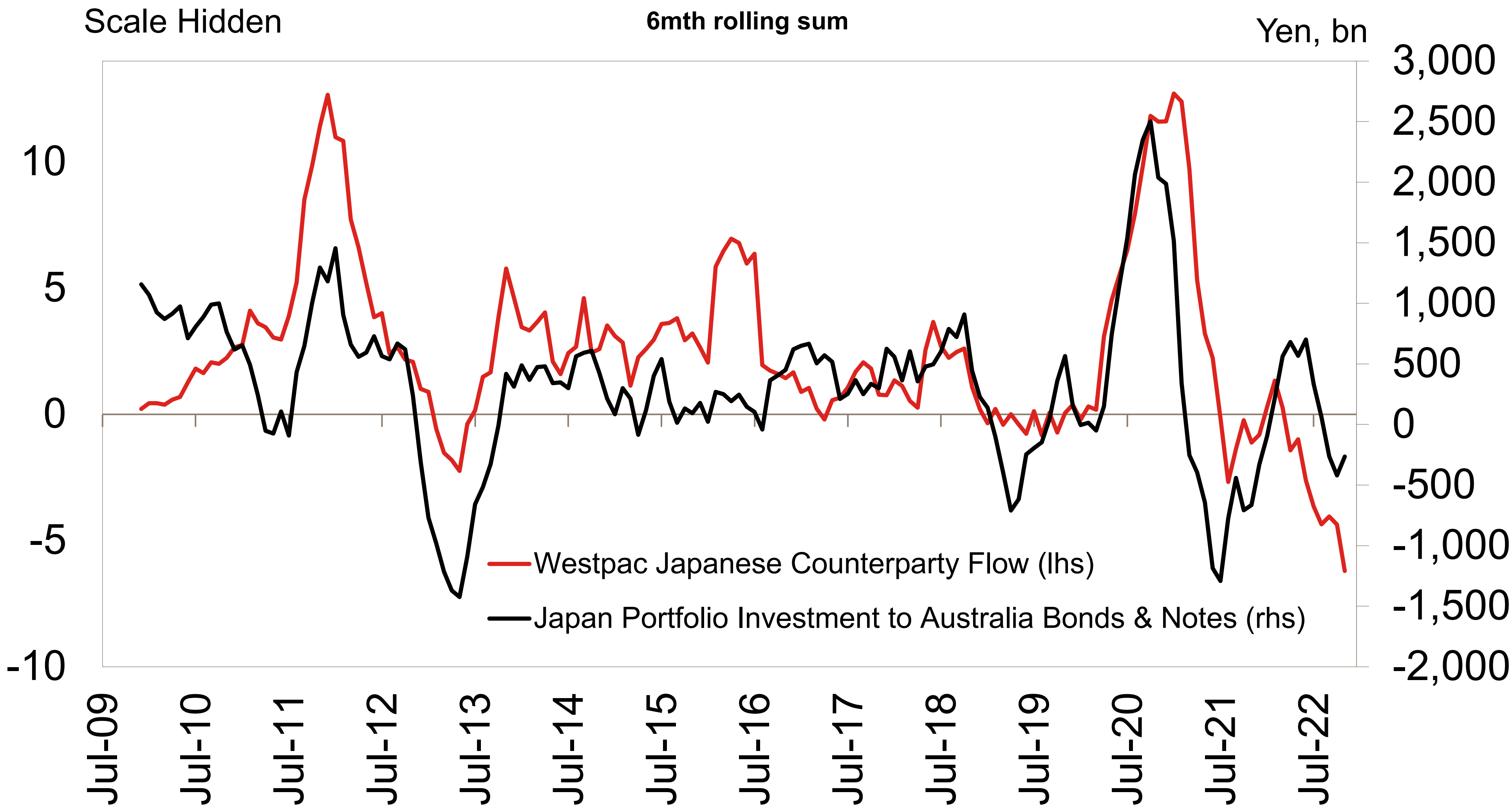
Source: Bloomberg, Westpac

JPY Hedged AU Bond Yields: Spread to JGB



Source: Bloomberg, Westpac

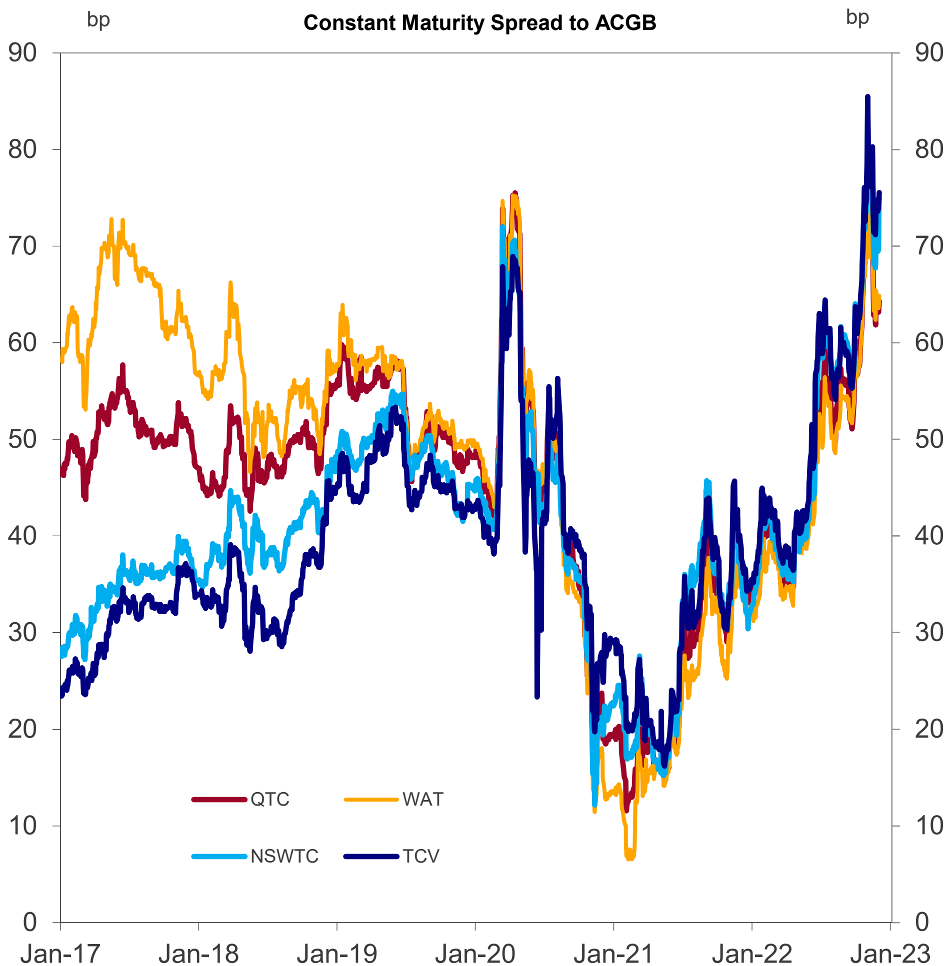
WBC Japanese Flows vs Monthly MoF data



Source: MoF; Bloomberg; Westpac

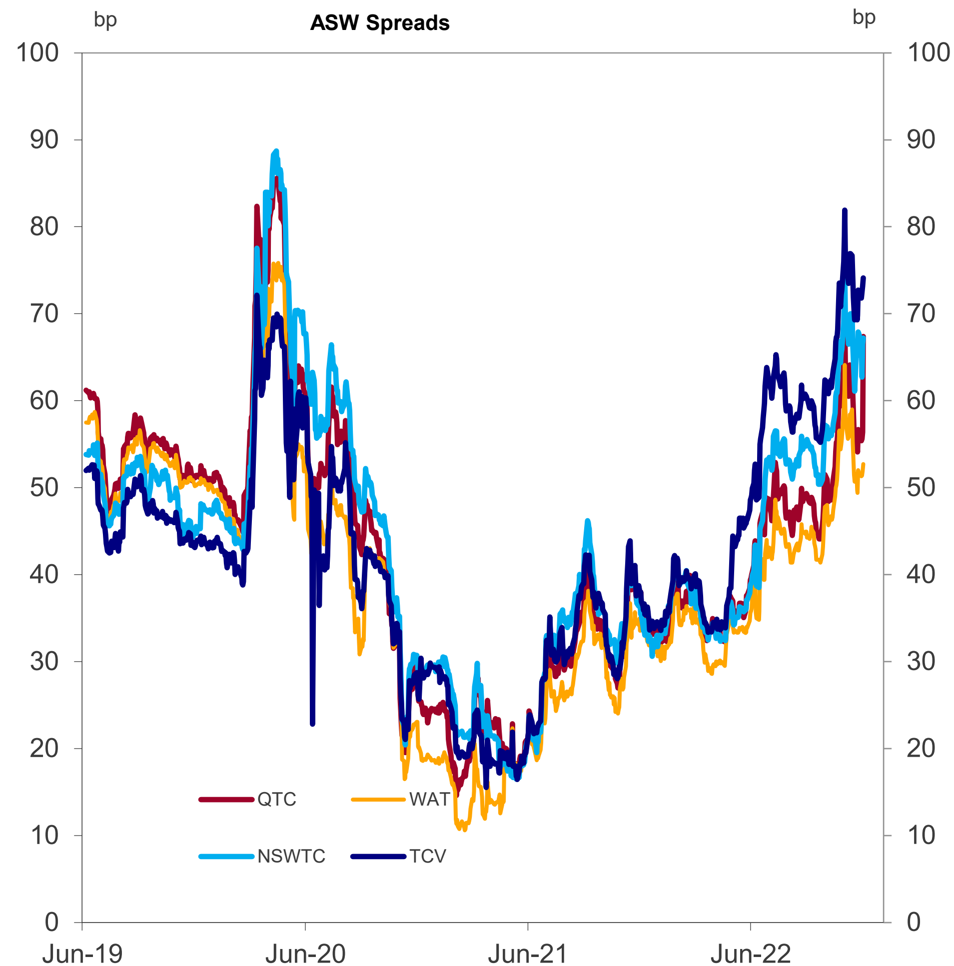
Have semi-spreads peaked?

10yr Semi-Bond Spreads



Source: Westpac

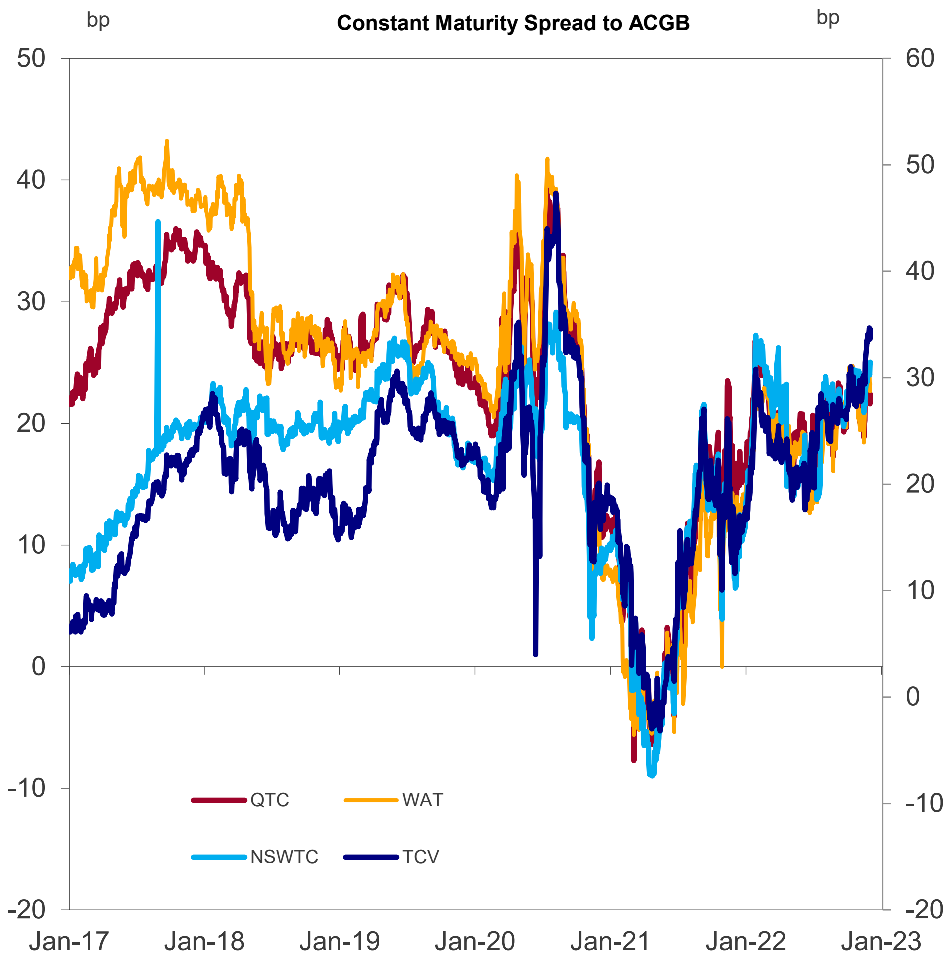
10yr Semi-Swap Spreads (ASW)



Source: Westpac

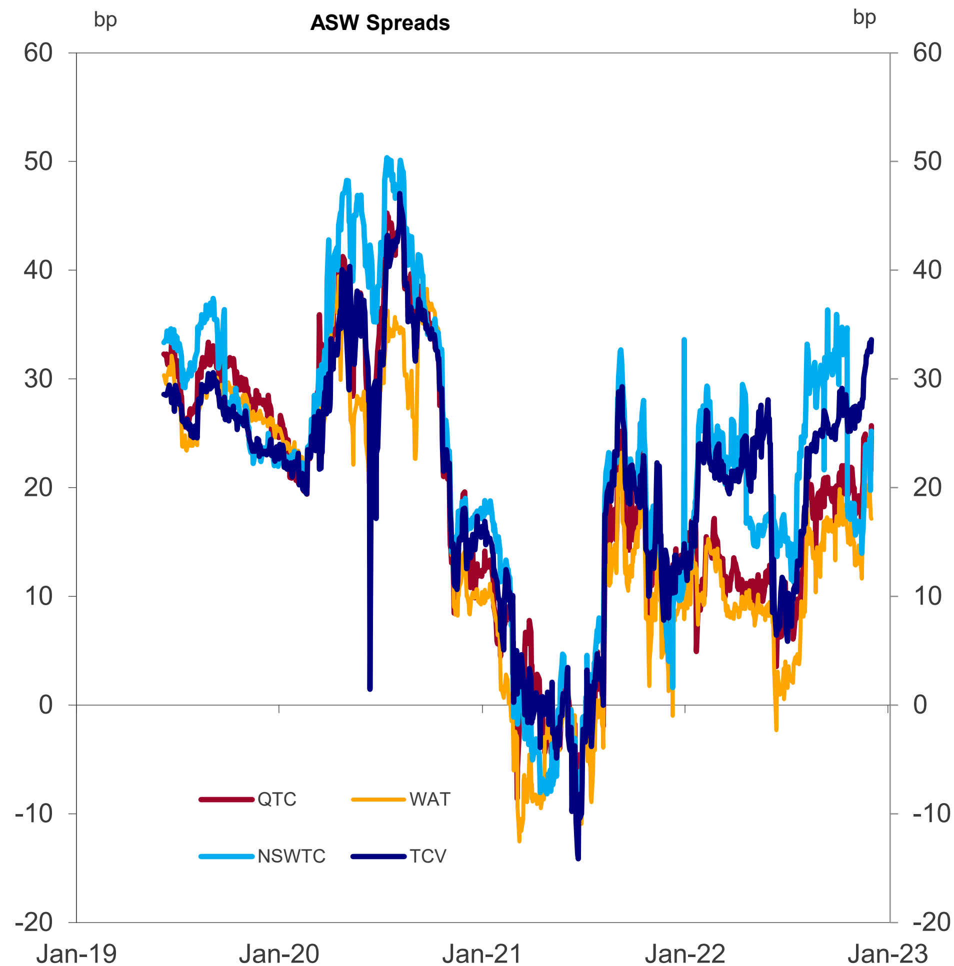
Will we start to see more idiosyncratic differentiation

3-10yr Semi-Bond Box



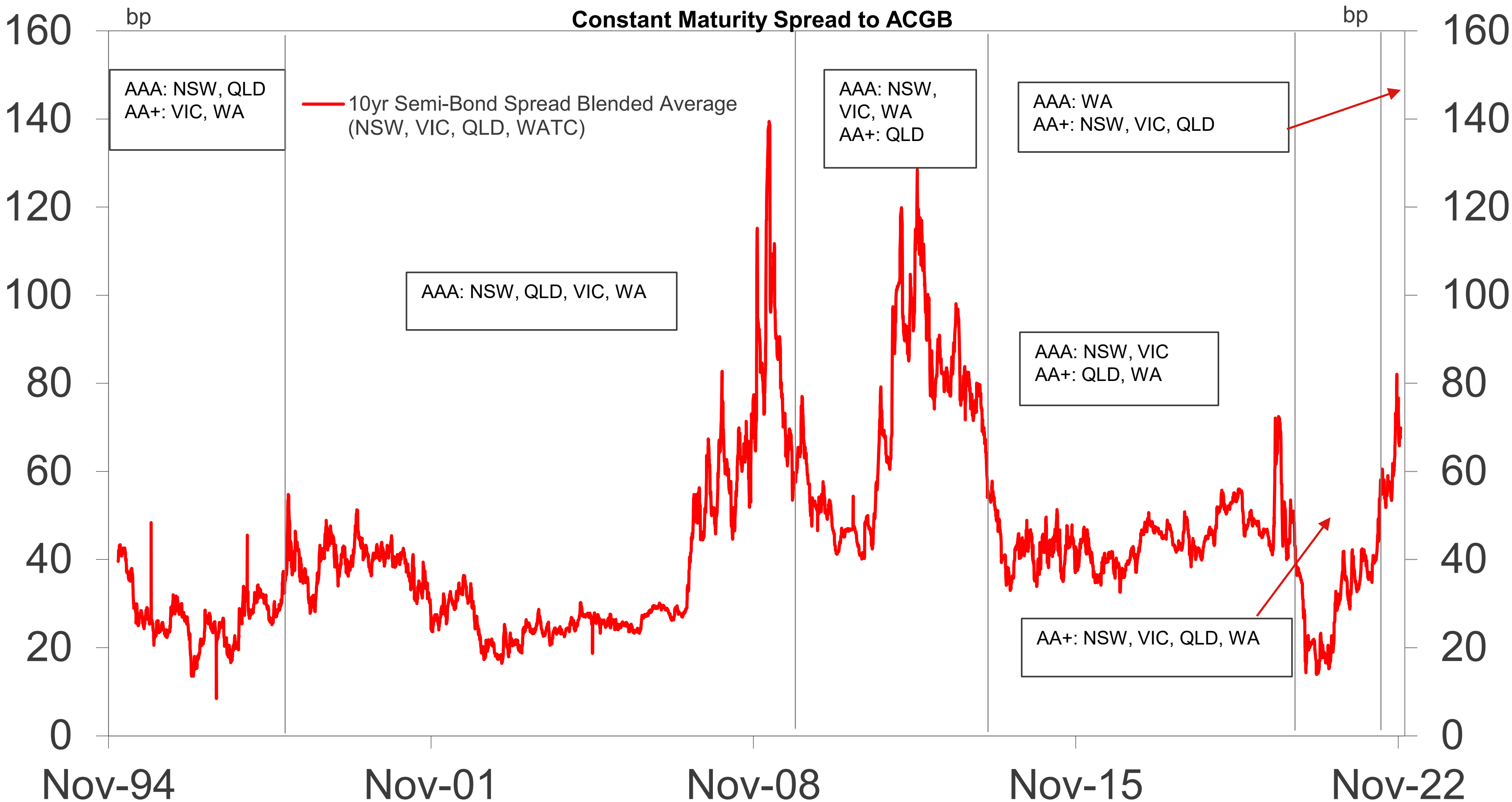
Source: Westpac

3-10yr Semi-Swap Spreads Box (ASW)



Source: Westpac

10yr Semi-Bond Spreads – Blended Averages

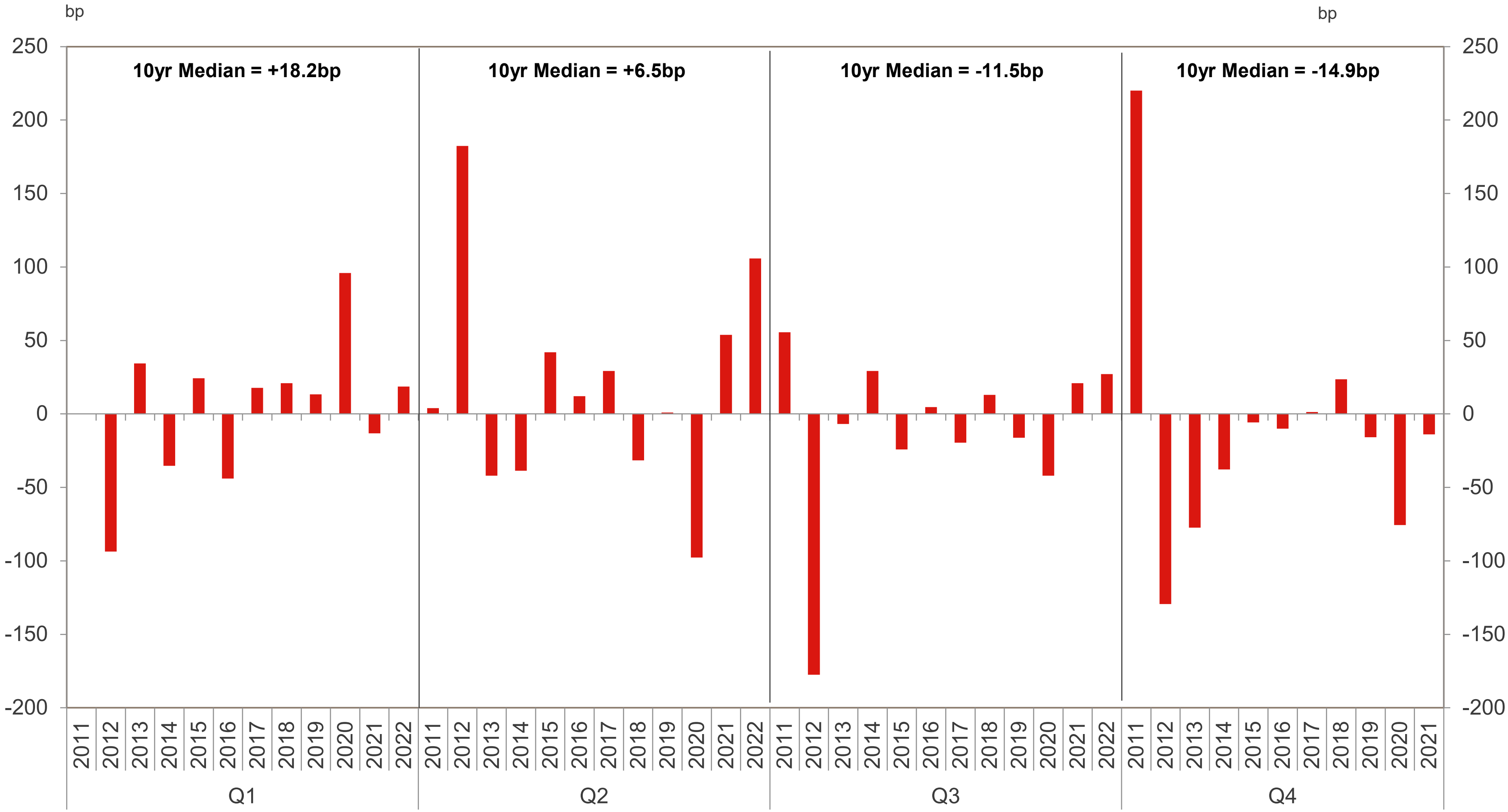


Source: Westpac

Damien McColough | Head of Rates Strategy; Jessica Ren | Rates Strategist

Quarterly 10yr Semi-Bond Spread Changes

All States Aggregate – 4th quarter has the best median performance over last decade

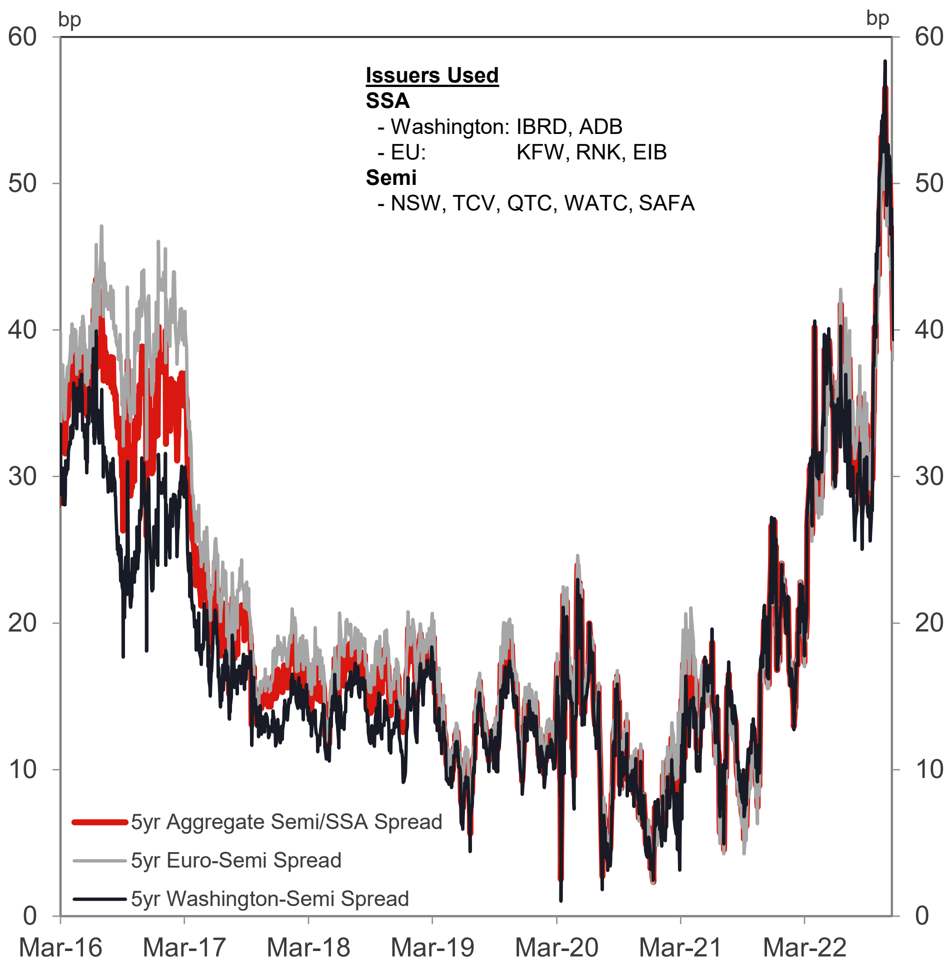


Source: Westpac

Semi-SSA spreads remain wide …

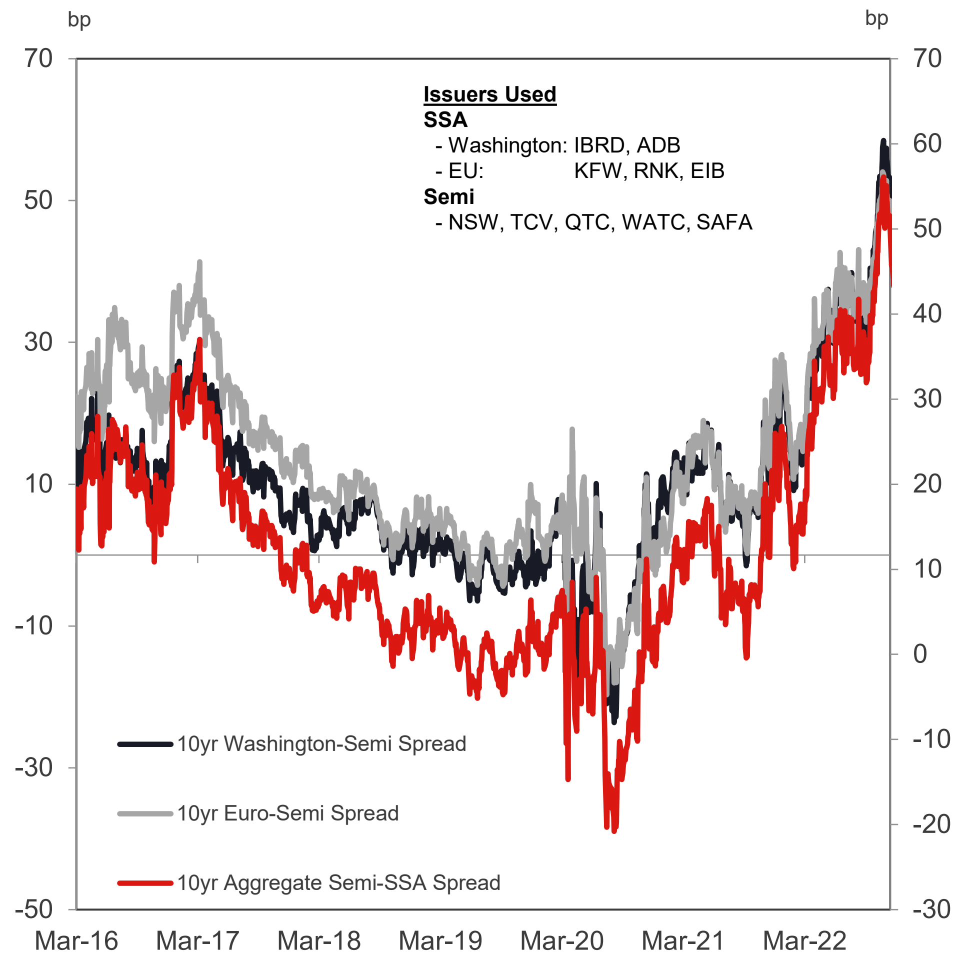
… but it is difficult in this environment to assess what the SSA illiquidity discount should be.

Benchmark 5yr SSA-Semi Spreads



Source: Bloomberg, Westpac

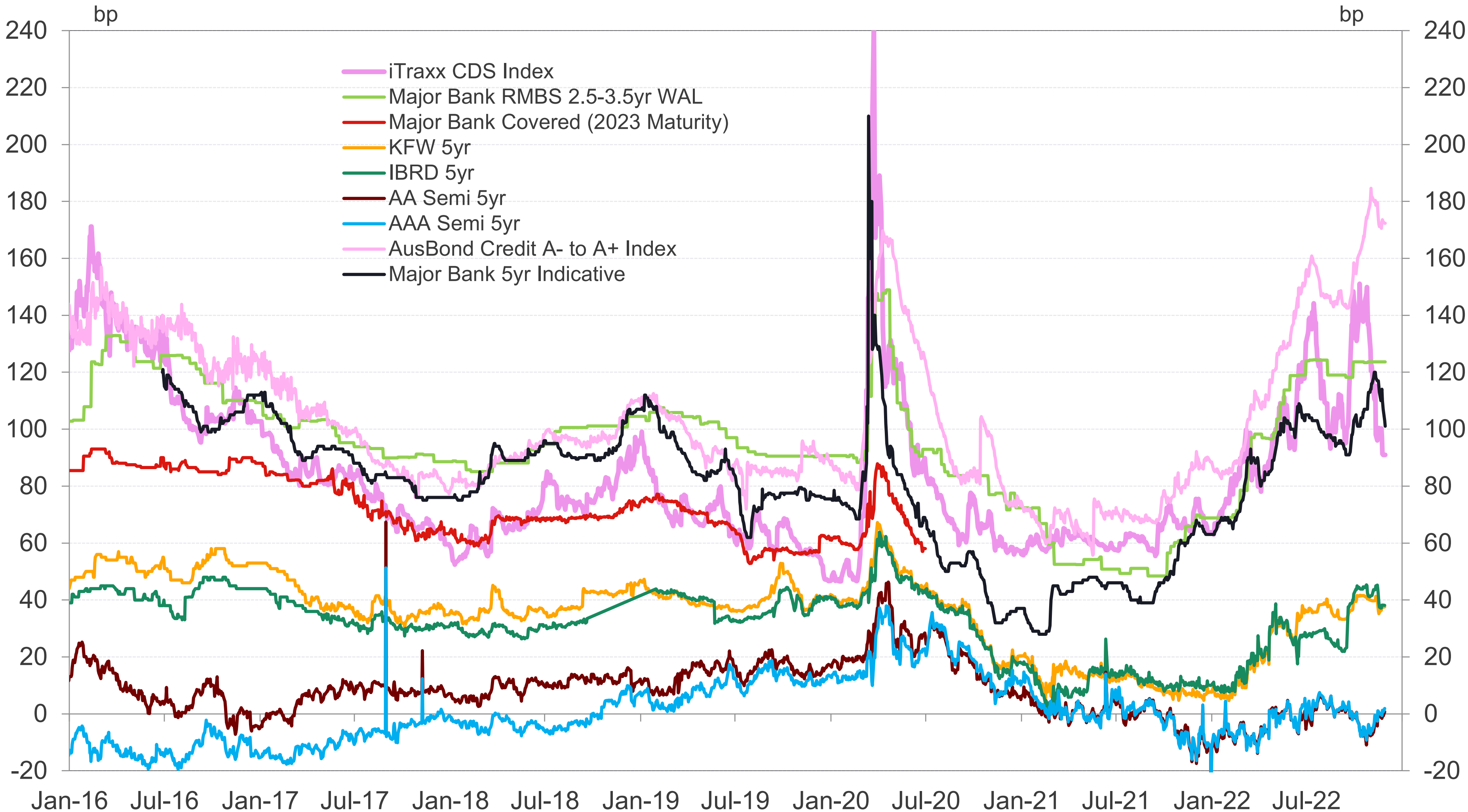
Benchmark 10yr SSA-Semi Spreads



Source: Bloomberg, Westpac

Damien McColough | Head of Rates Strategy; Jessica Ren | Rates Strategist

Credit Fan – 5yr ASW spreads

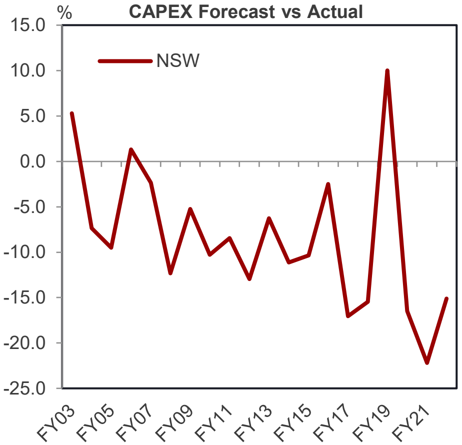


Source: Bloomberg; Westpac

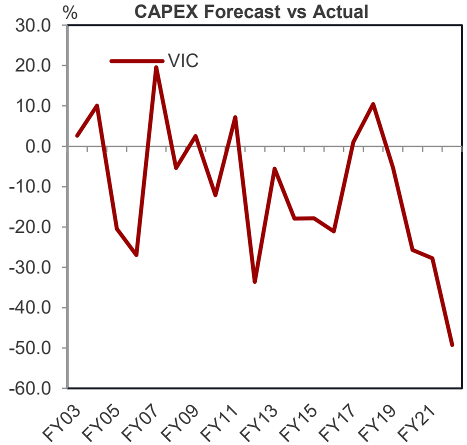
Damien McColough | Head of Rates Strategy; Jessica Ren | Rates Strategist

Semi Budgets – CAPEX spending vs actual

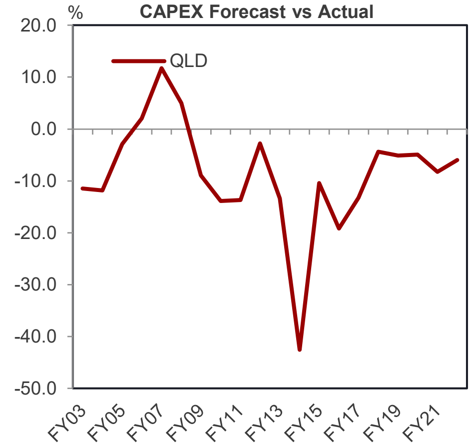
New South Wales



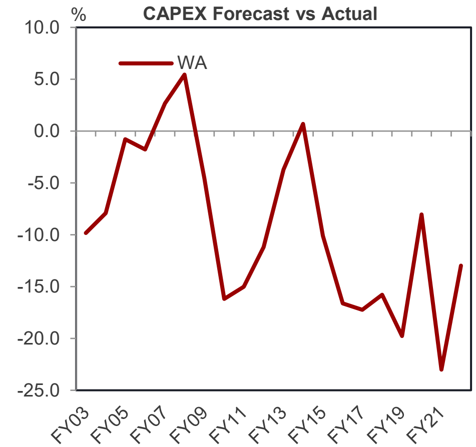
Victoria



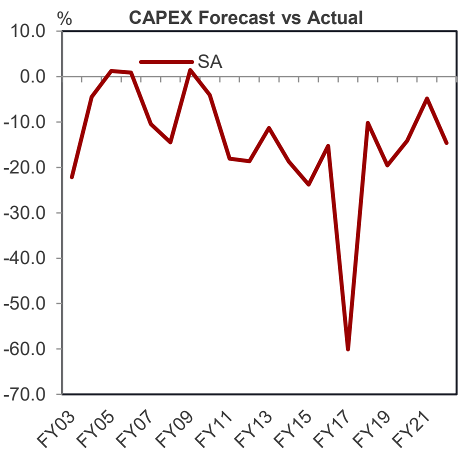
Queensland



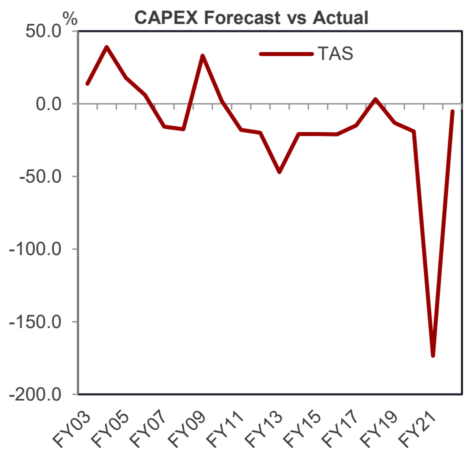
Western Australia



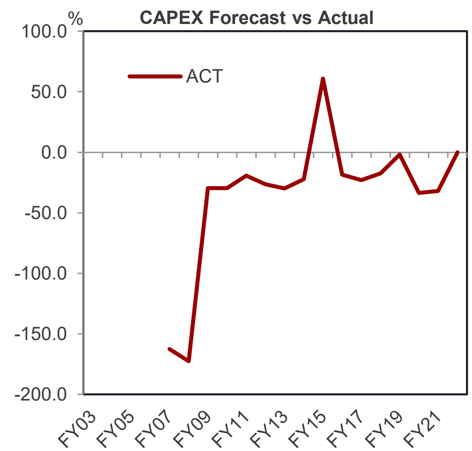
South Australia



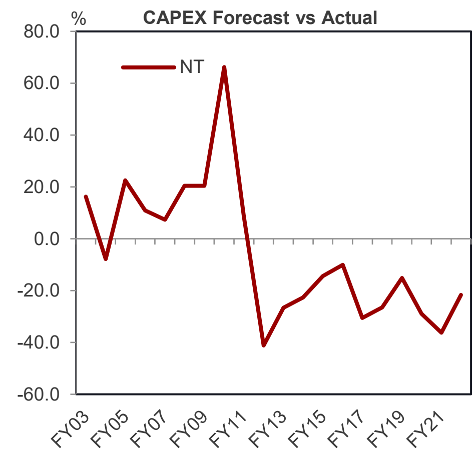
Tasmania



Australian Capital Territory



Northern Territory

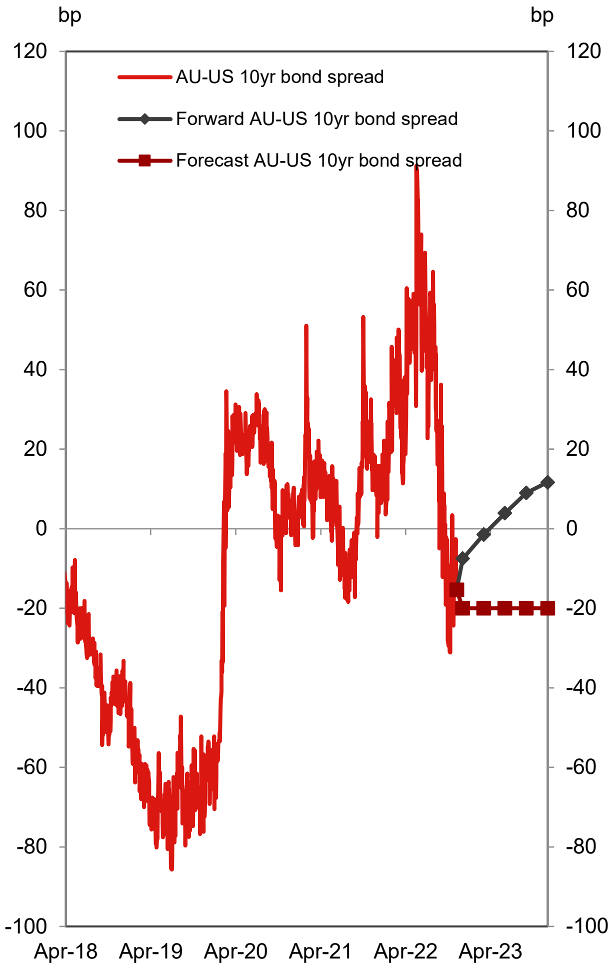


Sources: State Government Budget Updates, Westpac

*FY2022-23 Budgets not yet released

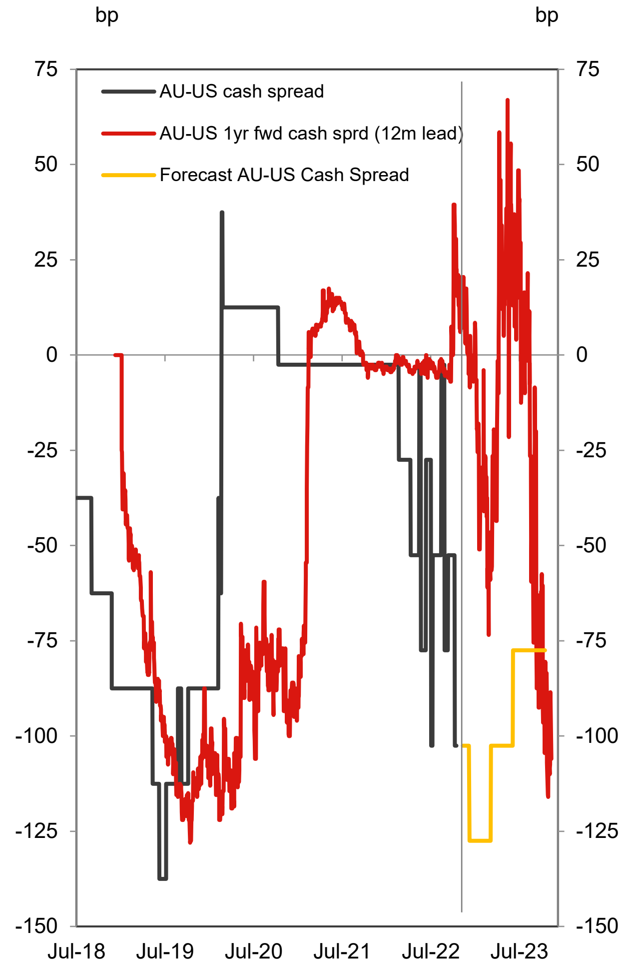
A case can be made for a materially inverse AU-US 10yr

AU-US 10yr Bond Spread



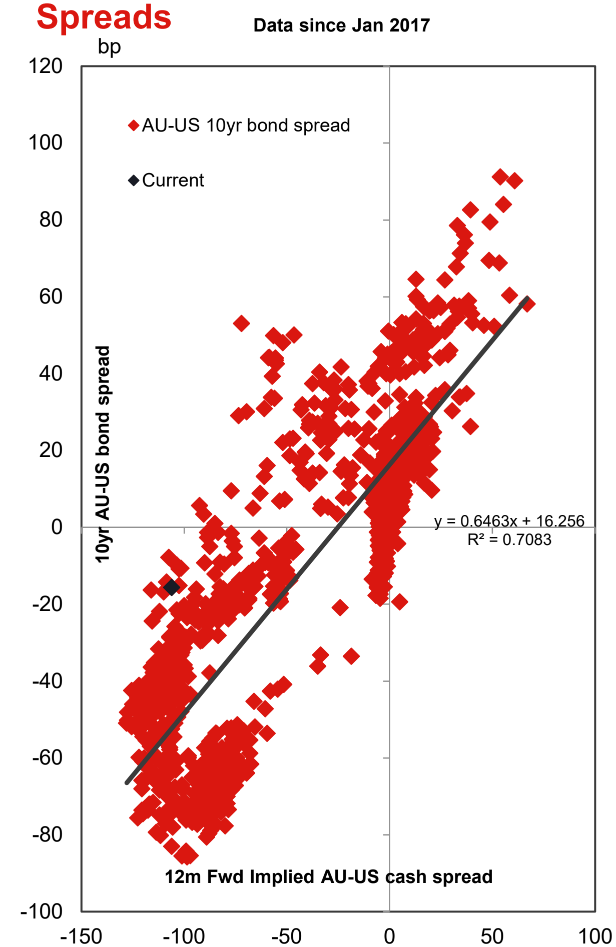
Source: Bloomberg, Westpac

Cash Spread Fwds vs Forecasts



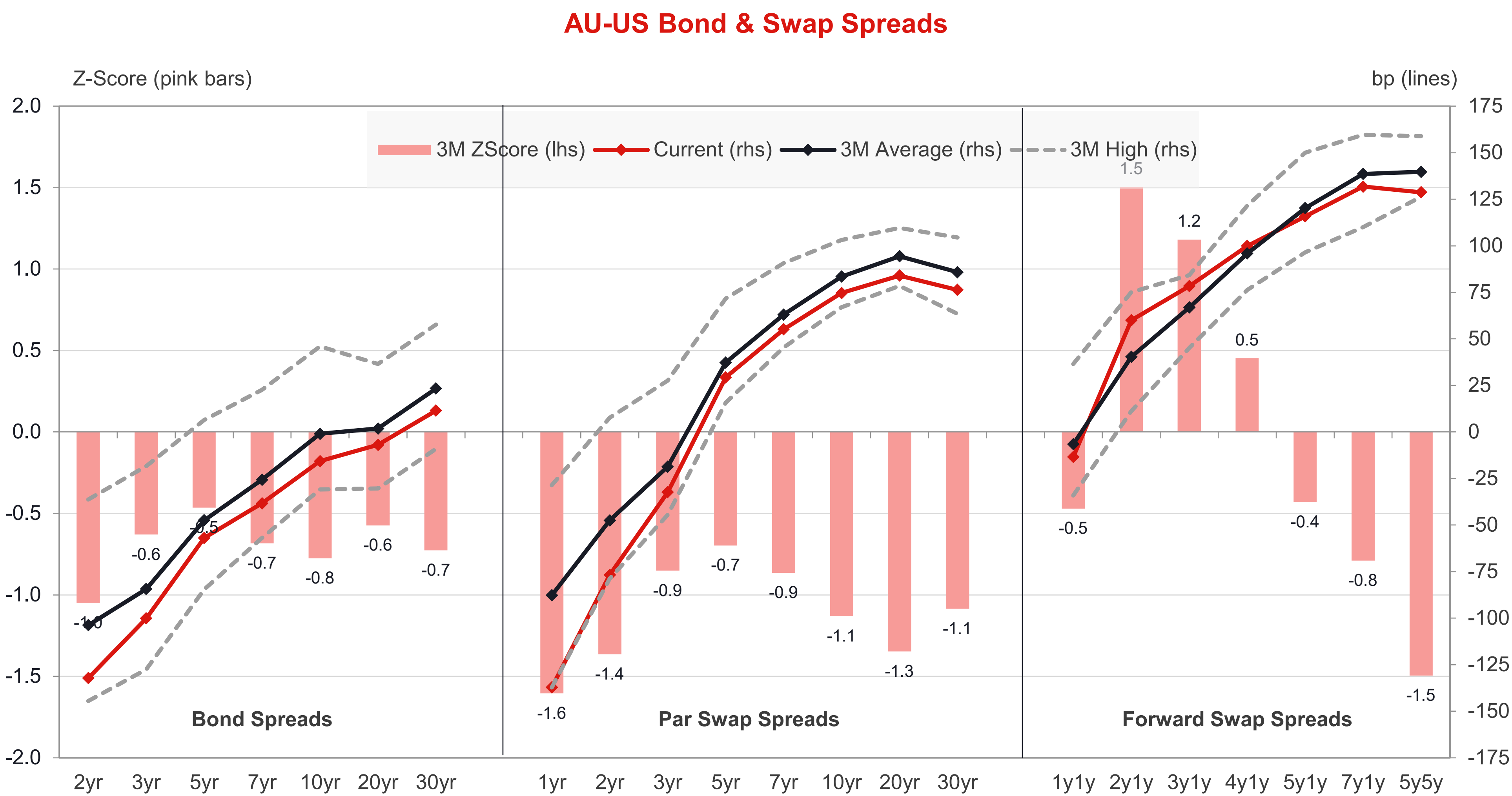
Source: Bloomberg, Westpac

AU-US 10yr Bond v 12m Fwd Cash Spreads

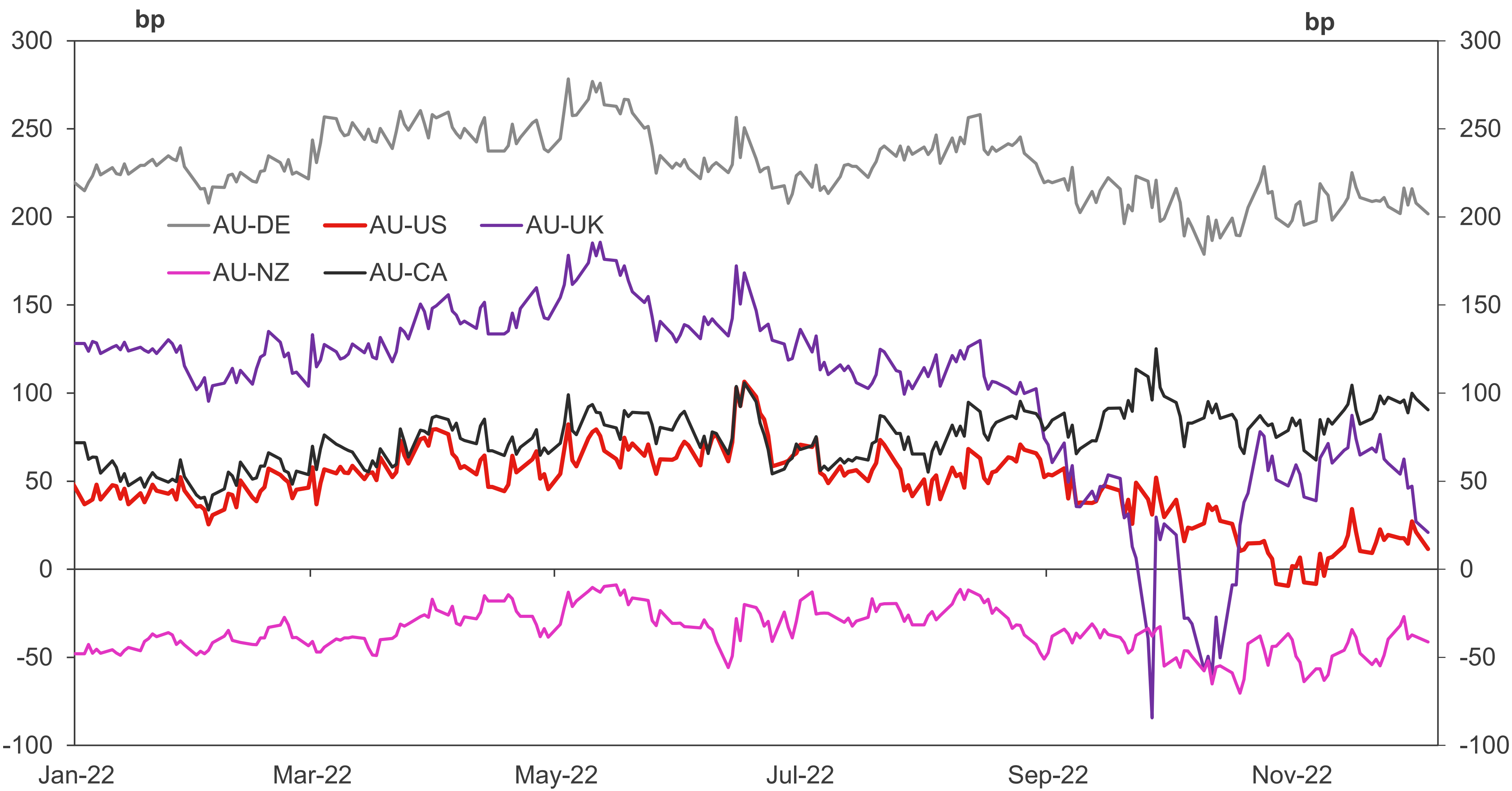


Source: Bloomberg, Westpac

Where is the AU-US cross market opportunity?



AU vs Global 30yr Bond Spreads



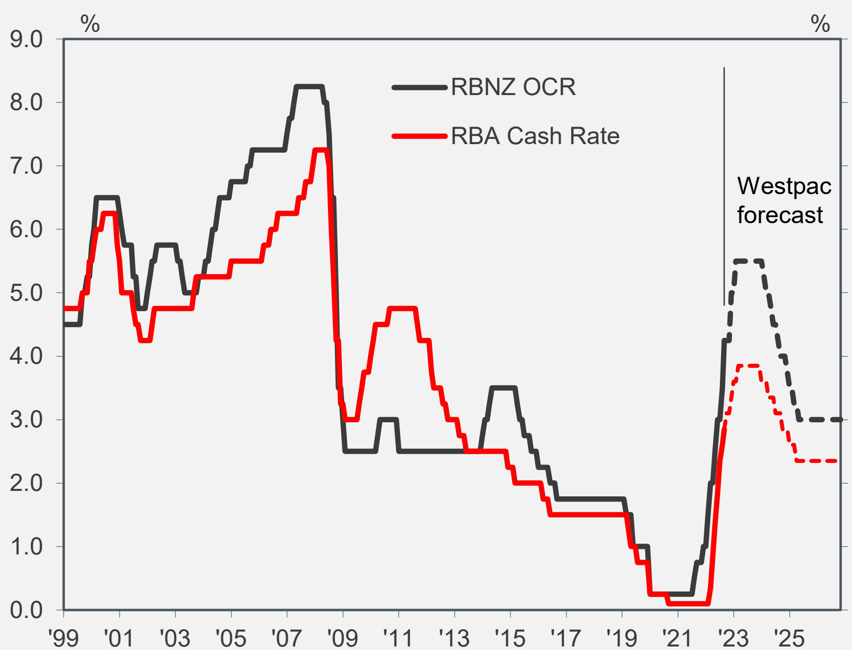
Source: Bloomberg, Westpac

RBNZ vs RBA

RBNZ-RBA cash rate spread is expected to widen to a near record

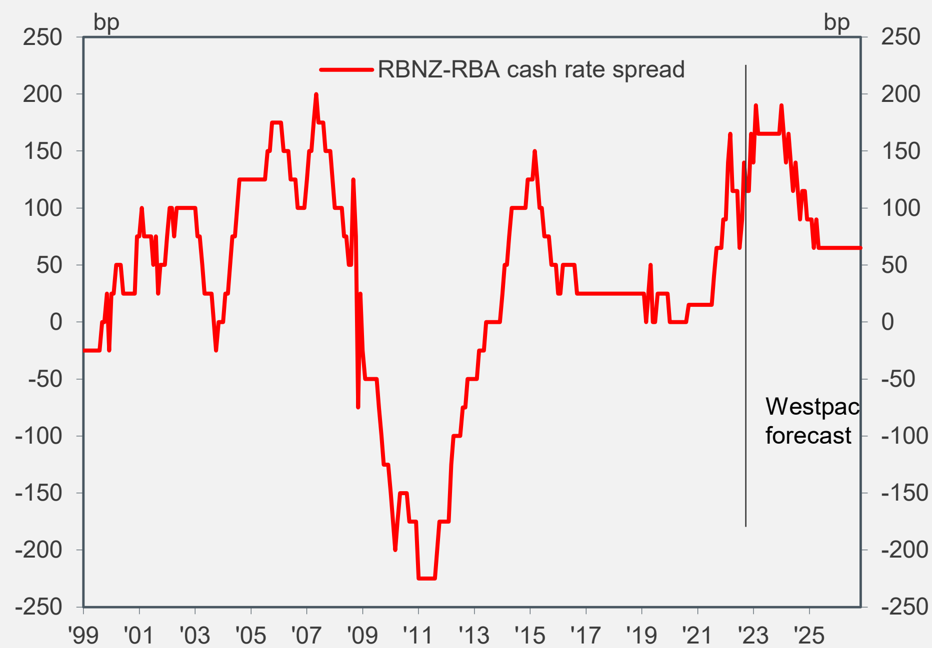
In the wake of the November meetings for the RBNZ and RBA, where the former delivered a hawkish surprise and caused markets to elevate their expectation of the peak OCR to 5.5%, while the latter delivered a dovish surprise (by hiking by 25bp rather than 50bp) and signalled a more gradual path towards its peak (which Westpac expects to be 3.85%), the contrast between the two stances has become even starker. Based on Westpac's forecasts for the respective cash rates, the spread between the two could reach 190bp in April 2023, and that would be the widest since the record of 200bp in 2007 (second chart below). From early 2024, we expect this spread to decline sharply to around 65bp. Given this, we explore market pricing for these two paths and consider potential trading opportunities.

Westpac forecasts for RBNZ and RBA



Source: Bloomberg, Westpac

RBNZ-RBA cash rate spread



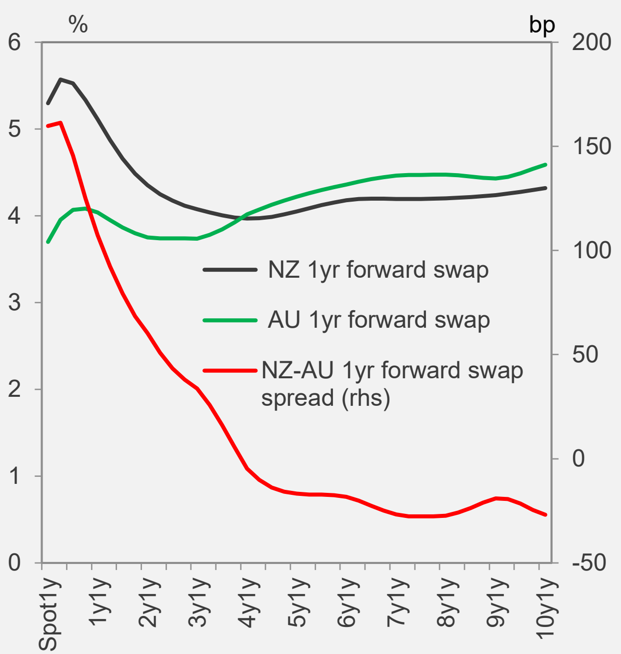
Source: Bloomberg, Westpac

NZ-AU swap spreads

Market pricing for spreads is below that implied by Westpac's RBNZ & RBA forecasts

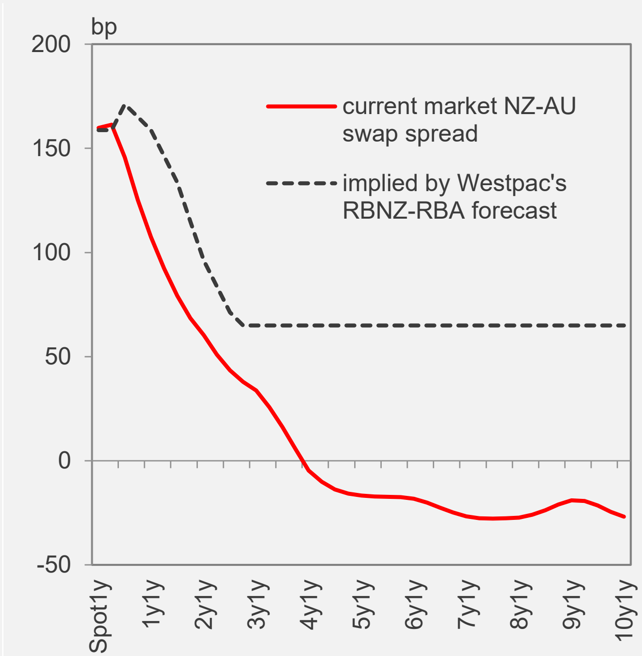
An inspection of the 1yr swap forwards for NZ and AU (first chart) shows that NZ markets have priced a decline, probably due to the aggressive RBNZ tightening path which is expected to cause a recession, which the RBA's more gradual approach is seen as less disturbing to the economy. The net result is an extremely inverted 1yr forward spread curve. A comparable 1yr forward spread curve based on Westpac's cash rate forecasts is shown in the second chart. The two are in line at the 3m1y point, but beyond that the market is slightly below Westpac out to 3y1y but significantly below thereafter. Looking at spreads from a historical perspective (third chart), we see that the 5y5y is near the range low but shorter spreads are near the high. The 3m1y at 145bp is at a high since April, is relatively the closest among 1yr forward spreads to its record high of 200bp, is in line with Westpac's cash rate forecasts (rather than below), and would be worthy of consideration as a receive NZ-AU trade in the 155bp-165bp zone which marked the post-GFC high.

NZ-AU spread curve extremely inverted



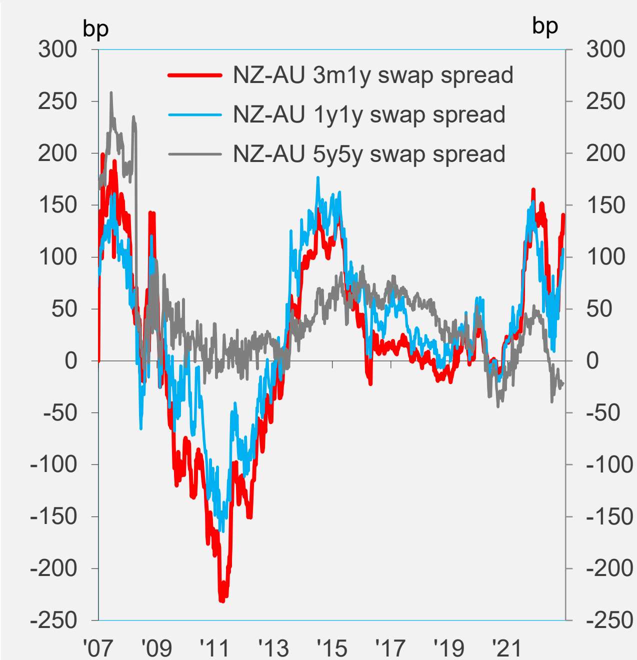
Source: RBNZ, Bloomberg, Westpac

NZ-AU spreads are below WBC forecasts



Source: Bloomberg, Westpac

NZ-AU 3m1y potentially near a peak

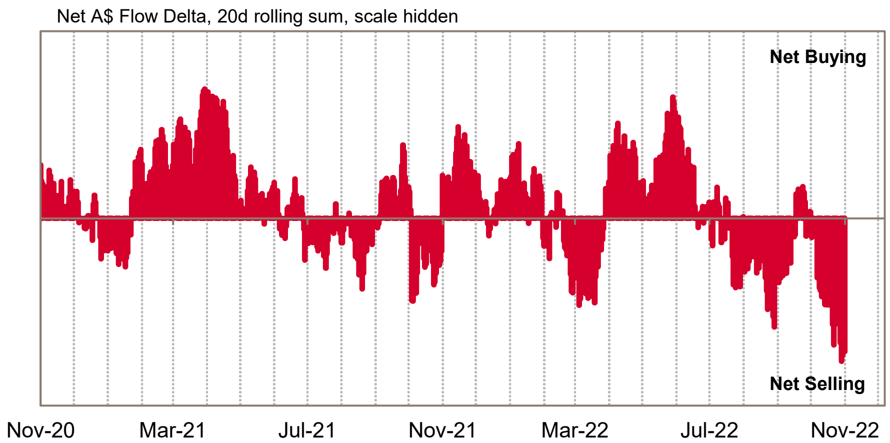


Source: Bloomberg, Westpac

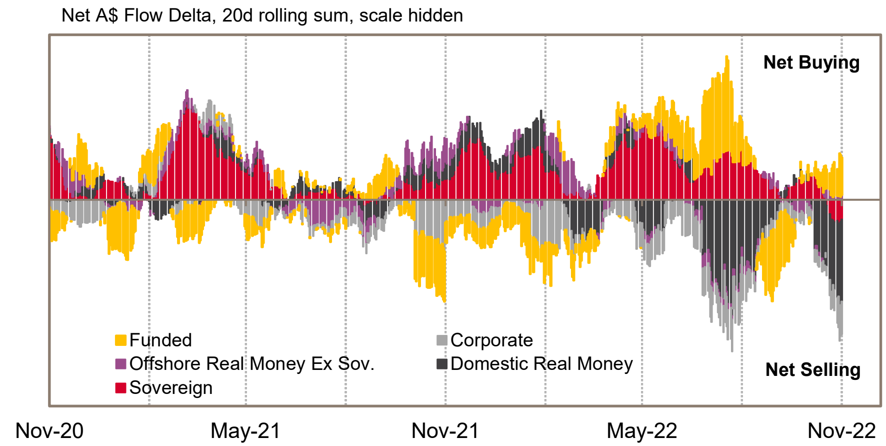
A$ net 20day delta accelerates into sell-side territory

Swap payers returned after rate hike slowdown talks saw markets rally to attractive levels.

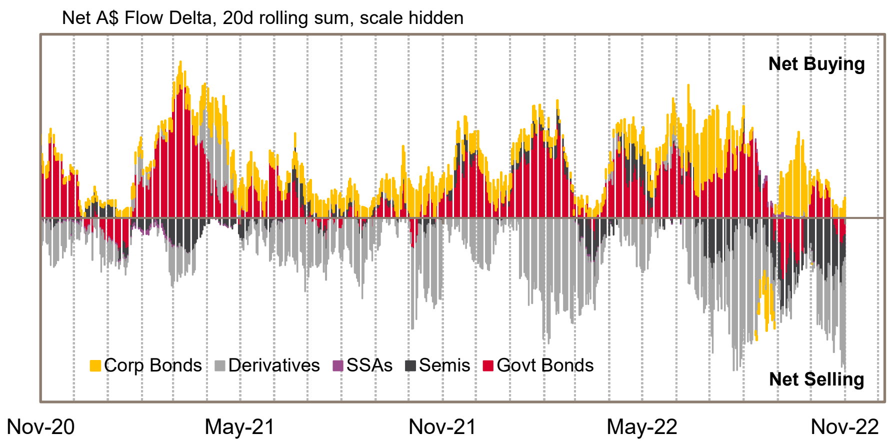
All Flows – All Securities, Mkt Participants & Maturities



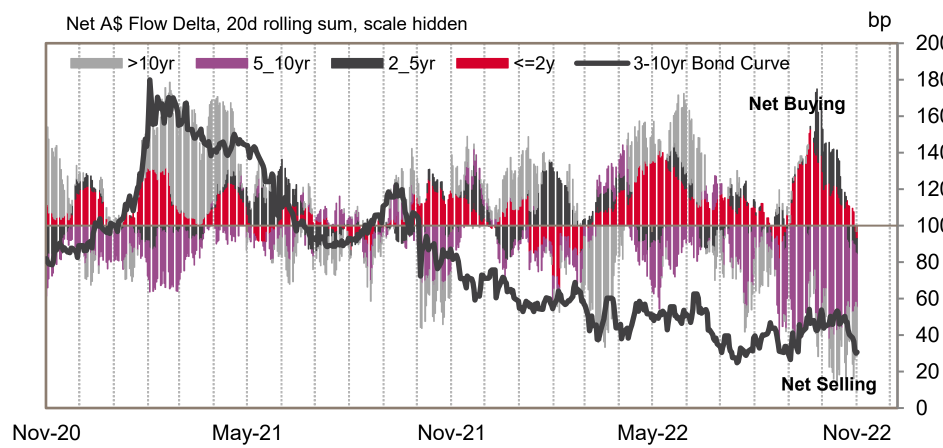
All Flows by Market Participant



All Flows by Product Class



All Flows by Maturity vs 3-10yr Bond Curve



Source: Westpac

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