Australia's green bond to drive price action near term.

Key Thoughts for the Week

US Rates:

- Our long-held belief that current economic, policy and market conditions imply an extended range trade for longer maturities is playing out and can be expected to continue for some time. The view behind that remains the "higher for longer" and "patience" message from the Fed, ongoing economic resilience and market valuations that remain pre-emptive of an eventual easing cycle, albeit after a longer pause than was expected only a few weeks ago. In that environment sentiment will be variable and directional momentum prone to rapid turnarounds. That was evident in last week's price action where, after a rapid surge higher on poor auction demand, the PCE data and month-end buying saw USTs rally into week-end. 10yr yields are only 3bp higher than they were to begin the week and are now back in the middle of our oft-stated 4.25-4.75% range. That implies that directional risk rewards are relatively evenly balanced as we begin the week, although the PCE data did consolidate Fed pricing, with around 35bp of cuts factored-in by year end. We would not expect those expectations to shift too much and that informs our view that, from a demand perspective, any ventures to the upper end of the range likely to be relatively short-lived.

AU Rates:

- While the quarterly GDP release will clearly have an impact, this week's price action will be dominated by the syndication of the first green ACGB bond, a June 2034 maturity. While the bond will be heavily oversubscribed, the market will be focused on the contours of the demand profile as well as the pricing of any "greenium". Ahead of launch there is likely to be a concession made, which will see AU bonds underperform slightly and the curve to steepen, although we expect that to be quickly unwound after the deal is priced. Looking more medium term, while the April CPI certainly increased near term rate hike possibilities, the general consensus is that there is a high bar for a hike to be delivered and any shift in the RBA's reaction function and messaging will largely come down to the quarterly inflation print in July. Hence, while pricing reflects some small hike risk, the central thematic expressed is for unchanged policy for the foreseeable future, more than anything else. Looking forward, with the front end anchored for now, longer maturities will be heavily influenced by global shifts, as will curve direction, steepening on sell-offs and vice versa. AU bonds have underperformed on a cross market basis, and have moved back to the top of the -10 to -20bp range in the AU-US 10yr bond spread. We continue to recommend fading any near term underperformance so the current level looks attractive. Swap EFPs have slowed their recent narrowing but remain at their tightest levels of the year. The key drivers remain extra bond supply next FY, a lack of payside out of a well-hedged corporate community which can wait for better levels, and an increase in carry-style positioning and yield enhancement trades. While the market is focused on where a near term bottom in spreads might be, there is also not much expectation that they will re-widen anytime soon. Until payside flows can be more confidently expected, perhaps as asset swappers step back into the market (there has been some small "toe-dipping" in recent sessions), we are neutral on EFPs at current levels. Following the CPI, BEIs did react, widening as much as 5bps, however inflation expectations remain well contained across the curve at or near the 2.5% level.

Current Trades & Key Risk Events

Key Data & Risk Events:

- AU: Q1 GDP and partials (4 Jun – 5 Jun)
- NZ: NZ GDP (20 June), RBNZ MPR (10 July)
- US: May non farm payrolls (7 Jun), May unemployment rate (7 Jun)
- EU: ECB policy decision (6 Jun)

Recommended Research:

- Fair Value: ACGB 4.25% 21-Jun-2034 Green Bond

Current Trade Recommendations – entered, pending or monitoring:

Description	Curr	Entry	Target	Status
TCV Oct 2029/Nov 2034 flattener	+64.28	+66.75	+50	Live
ACGB Apr 2029/ May 2034 flattener	+28	+35	+18	Live
Rec AU 10s15s20s Swap fly	+12	+14	+10.5	Live
Sell NZGB 26-31-41 butterfly	-57	-58	-35+	Live
Sell EIB 28/Buy NSWTC 28	+8	+19.5	+30	Live
Sell IBRD 28/Buy TCV 28	+2	+7	+22	Live
Sell IBRD 33/Buy WATC 33	+3	+16.5	+30	Live
NZGB 2031-2054 flattener vs 5-15yr swap steepener	+23	+26	+10bp-	Live
3m3y/3m10y Swaption Conditional Bull Steepener	+0			Live
Sell NZGB Apr-27 vs buy ACGB Apr-27	+76	+68	+85	Live
Buy AU 3m10y IRS receiver spread		+5.5		Live
AU-US 1 year forward 4-year IRS receiver	+16	+27		Live
Sell ACGB 27-31-34 butterfly	+1.75	+1.75	+10	Live
Pay AU 3s7s10s Swap fly	+10	+10	+22	Live
pay 2y2y-5y5y-10y10y Swap fly	+50	+50-	+70	Monitor

This Week's Highlights: **Page:**

Trade Recommendation Summary & Update

Live & Pending Trades:

Trade (links to published trade idea in title)	Status	Entry Date	Entry Level	Current Level	Target Level	Stop Loss Level^	P&L	Horizon*
AU: TCV Oct 2029/ Nov 2034 Spread Flattener	HOLD	9-Feb-24	+66.75bp	+69.01bp	+50bp	+78bp	-2.3bp	3 months
In Semis, supply will be ongoing from the issuers, but the higher rates structure in the outright terms do offer attractive starting levels for yields. As such, we recommend a flattener in Semis via a simple lengthening on the curve, rather than a box spread curve trade. We would use the TCV Oct-29/Nov-34 curve at 66.75bp as the bonds to look at. Note here that the cash price of the 34s is substantially lower than the 29s. There is a directional element to this view and its performance, as well as a view on the issuer and supply, but a slightly more hawkish RBA stance, should help flatten the curve. Beyond this, the reduced issuance (in the short term) should be a benefit to TCV or Semis more broadly in a world still searching for end of cycle yield/duration calls.								
AU: ACGB April 2029/ May 2034 Spread Flattener	HOLD	9-Feb-24	+35bp	+30bp	+18bp	+43bp	+5bp	3 months
In ACGBs, the Apr-29/May-34 curve at 35bp has a slightly positive carry and roll of 0.3bp per month. The RBA's more hawkish stance, pushing against near term cuts in policy, while delivering a modest reduction in timing and scope of inflation forecasts, should ultimately keep the Australian curve from steepening too much. It already sits steep to other markets, where negative carry has forced some unwinds. We already hold the ACGB May-34 via a Jun-31/May-34/Apr-37 fly RV trade and would add the bond flattener here at 35bp with a target of 18bp and a stop loss at 43bp.								
AU: Rec 10s15s20s Swap Fly	HOLD	9-Feb-24	+14bp	+12.5bp	+10.5bp	+6.5bp	+1.5bp	3 months
In swaps, the 10s/15s/20s swap fly has pushed higher in recent weeks, with the likely driver being the supply of 15 year Semis and the associated asset swap flow to hedge. While issuance will still come in this popular tenor, the reduction in issuance and position of the borrowers should mean there is some respite. At 14bp, we would receive the 10s/15s/20s swap fly, as a micro RV trade, with a target of 10.5bp and stop at 6.5bp. Carry is slightly positive.								
NZ: NZGB 2031-2054 flattener vs 5-15yr swap steepener	HOLD	20-Mar-24	+26bp	+20bp	10bp-	40bp	+6bp	6 months
The NZGB 10-30y curve has steepened sharply since November 2023, partly due to NZGB supply, and partly to RBNZ easing expectations. With the 2054 syndication concluded but the 2035 yet to come, we entered an ultra curve flattener near a 12mth high.. We expect the ultra long end to gradually reverse its recent cheapening, while any lingering supply concerns will most likely be focussed on the belly of the curve. We chose the 2031 and 2054 lines (the 2031 is the richest line in our curve fitting model), and boxed that with a 5-15yr swap, to insure against the ripple effect of further monetary policy driven bull steepening. We chose the 15yr swap, because liquidity beyond that point is inconsistent. The NZGB ultra curve is slightly steeper than its US counterpart but not as steep as the AU. However, it has outsteepened both over the past year.								
AU: 3m3y/3m10y Swaption Conditional Bull Steepener	HOLD	07-May-24	+0bp					3 months
A sharp flattening in the AUD rates curve in recent months has come as the markets have interpreted a more hawkish RBA or made assumptions that underlying inflation is running at higher pace. The 3 year swap has jumped from 3.8% at the start of April, to 4.32% and sits at 4.22% currently. For corporates, this late cycle jump would present a concern to those rolling off hedges, but equally to those who remain hedged, the asymmetry of risks augurs for banking some of the hedge gains and looking at downside moves. The last few days have seen yields come back down, and we see an opportunity for a tactical trade to take advantage of the flat AUD rates curve. In the 3m3y/3m10y IRS curve, we use 30bp out of the money (OTM) strikes of 3.9% and 4.3% which puts a steepener on at 41bp, vs the spot curve at 37bp. The vol curve allows for a 1bp pick up, (3m3y normal vol at 101 and 3m10y at 105) so the allin package cost for a 3s/10s conditional bull steepener is 40bp. The structure, using two strikes at 30bp OTM is a net zero premium outlay. We'd would look for a move of 20-30bp in the forwards.								

*^Trailing stop/take profit may be shifted. *Horizon refers to how much time the trade has left based on our original expected time horizon for trade performance to be achieved.*

Trade Recommendation Summary & Update

Live & Pending Trades:

<table>
<tr><th>Trade (links to published trade idea in title)</th><th>Status</th><th>Entry Date</th><th>Entry Level</th><th>Current Level</th><th>Target Level</th><th>Stop Loss Level^</th><th>P&L</th><th>Horizon*</th></tr>
<tr><td>Sell NZGB 26-31-41 butterfly</td><td>HOLD</td><td>13-Feb-24</td><td>-58bp</td><td>-55bp</td><td>-35bp+</td><td>-70bp</td><td>+3bp</td><td>6 months</td></tr>
<tr><td colspan="9">The micro attribute of this trade is that the wings are very cheap and the belly is very rich, according to our Nelson-Siegel based fitted curve model. If all three lines were to revert to fitted value, the trade would earn around 12bp. A macro attribute is that the fly is trading around the bottom of its three year range, having fallen sharply since early November. It also mimics curve slope over the long run, tantamount to a steepener, which we are biased towards at present. Curve steepeners should perform during the year ahead as markets increasingly pre-empt the next RBNZ easing cycle, with NZGB supply this year also a potential factor.</td></tr>
<tr><td>Sell NZGB Apr-27 vs buy ACGB Apr-27</td><td>HOLD</td><td>10-May-24</td><td>+68bp</td><td>+72bp</td><td>+85bp</td><td>+60bp</td><td>+4.4bp</td><td>3 months</td></tr>
<tr><td colspan="9">NZGBs have performed well vs Australia since mid-April, as the Australian CPI data put rate hikes back on the agenda. Our house view remains one that suggests the rate hikes are done, notwithstanding the vigilance from the RBA to the upside risks. OIS has pared back sharply in recent days and this should concertina out the curve. While ACGB supply does pick up in the new FY with the budget due next week, it comes from a position of a wholesale lack of net supply in ACGBs, and new supply will be absorbed easily. Moreover, issuance tends to be focused further out the curve, so it is less dilutive of the front end. In the case of NZGBs, supply is increasing again, and the NZDM is set to bring a syndicated tap of the May-28 line. This will be the fourth syndication so far this calendar year). With government receipts looking at a worsening fiscal story, the near-term supply in this part of the curve, and the broader supply story argues for a tactical cross market trade. As such we enter a cross-market trade to sell the NZGB Apr-27 at a spread of 68bp over ACGB Apr-27. Our target is for a move to 85bp and a stop loss would be at the recent lows of 60bp. Carry and roll is -2bp on the ACGB leg and 5.5bp on the NZGB leg, which gives a monthly C&R of 3.5bp.</td></tr>
<tr><td>Sell EIB 4.2% Aug-28 green bond/ buy NSWTC 3% Nov-28 green</td><td>HOLD</td><td>14-Mar-24</td><td>+19.5bp</td><td>+8.0bp</td><td>+30bp</td><td></td><td>-11.5bp</td><td>3 months</td></tr>
<tr><td colspan="9">This keeps investors in green bonds, while selling a A$1.5bn line into a A$3bn line. It also sees cash proceeds of approx. $99.86 into $95.73. The spread is marked at the recent lows of 19.5bp. We would enter at these levels with a target of 30bp. We entered into three switches out of SSAs into Semis in mid-March. Initially these trades worked, but slippage in Semi budgets have seen sharp under-performance in the Semis over the last month, putting these trades out of the money. With the start of the state budget reporting this week, we'd be reluctant to close these trades lest the 'bad news' is in the price. But we acknowledge the impact on portfolios.</td></tr>
<tr><td>Sell IBRD 4.4% Jan-28 sust/ buy TCV 3% Oct-28</td><td>HOLD</td><td>14-Mar-24</td><td>+7bp</td><td>+3bp</td><td>+22bp</td><td></td><td>-4bp</td><td>3 months</td></tr>
<tr><td colspan="9">While this doesn't stay in the labelled bonds, this is also a cash flow positive trade, selling a $100.75 bond into a $95.35 bond. Again, the entry level is around 7bp, with a target of 22bp. We entered into three switches out of SSAs into Semis in mid-March. Initially these trades worked, but slippage in Semi budgets have seen sharp under-performance in the Semis over the last month, putting these trades out of the money. With the start of the state budget reporting this week, we'd be reluctant to close these trades lest the 'bad news' is in the price. But we acknowledge the impact on portfolios.</td></tr>
<tr><td>Sell IBRD 4.2% Apr-33 sust/ buy WATC 4.25% Jul-33.</td><td>HOLD</td><td>14-Mar-24</td><td>+16.5bp</td><td>-1.7bp</td><td>+30bp</td><td></td><td>-18.2bp</td><td>3 months</td></tr>
<tr><td colspan="9">This trade stays in labelled bonds and shifts out of a A$1.6bn IBRD into a A$2bn WATC line. The spread is around 16.5bp with a target of 30bp. Cash flows are similar. We entered into three switches out of SSAs into Semis in mid-March. Initially these trades worked, but slippage in Semi budgets have seen sharp under-performance in the Semis over the last month, putting these trades out of the money. With the start of the state budget reporting this week, we'd be reluctant to close these trades lest the 'bad news' is in the price. But we acknowledge the impact on portfolios.</td></tr>
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Trade Recommendation Summary & Update

Live & Pending Trades:

Trade (links to published trade idea in title)	Status	Entry Date	Entry Level	Current Level	Target Level	Stop Loss Level^	P&L	Horizon*
AU: Buy 3m10y IRS receiver spread	HOLD	15-May-24	+5.5bp					3 months
In the A$ swaption market, we add an idea to buy a call spread in 10-year swaps. Ostensibly, this trade looks at a way to play for a lower rate environment in an outright sense, rather than via the conditional steepener. The trade sees a purchase of a 3m10y receiver spread. Spot 3m10y IRS sits at 4.54%, we buy a 20bp OTM call and sell a 40bp OTM call to fund it. The premium for this is 5.5bp. We use strikes of 4.34% and 4.14% respectively. This is a reasonably linear expression with a payoff of around 4:1x. Maturity is 15 August for the 3m fwd.								
AU-US 1 year forward 4-year IRS receiver	HOLD	15-May-24	+27bp	+25bp			+2bp	3 months
This trade looks for lower rates in the A$ market but takes advantage of the differential between spot and forward curves. Investor buys an A$ 1 year forward 4-year receiver to sell a US$ 1 year forward 4-year receiver. Note we use s/s convention on the A$ leg. Striking at 4% in the A$ leg, this is a 24bp OTM strike at 4.24% to sell a 3.58% in US$, which is 40bp OTM. This puts the buyer of the structure to the 1 year forward 4-year spread at 42bp if struck. The spot rate for the A$ leg is 4.24%, while the USD leg is at 3.97%. The spot IRS spread is -3bp for the 4-year tenor and the forward implied of 1 year forward 4-year spread sits at 27bp, giving a roll up for the trade. If we look at the spot 4-year tenor, using 4.3% for the A$ leg and 4.33% for the US$ leg, the spread is at -3bp. In vol terms, A$ vol trades at a discount for this tenor, as this is buying the 1 year forward 4 year in A$ at 98.5 nvol, and selling the US$ structure at 114 nvol, giving a funded pick up to do this trade. This can be seen in the second chart as the discount to buy A$ vol. Over the 3-month period, this trade rolls positively by around 7.5bp, or 2.5bp per month.								
AU: sell ACGB Nov-27/June-31/Dec-34 fly	NEW	24-May-24	+1.75bp	+3.6bp	+10bp	-2bp	0bp	3 months
With the flattening of the Australian curves, we see two areas that stand out as rich. The first, is the ACGB Nov-27/Jun31/Dec-34 fly. It has moved to the lowest level (richer belly) in the last year as the curve has flattened. In fact, it has richened more than the underlying 3s/10s curve. While the higher for longer mantra has delivered the curve flatter (and this would account for a few bp of this move), the ACGB Jun-31 line strikes us as rich on the fly. As a nuance, the Jun-31s are unlikely to see much more supply, given the A$38.1bn on issue. The Dec-34 will, with A$18bn, but as it moves to be the on-the-run 10 year it will hold its richness for some time. • We enter a trade to sell the fly (sell ACGB Jun-31) at 1.75bp with a target of 10bp and stop at -2bp. Carry and roll will be slightly negative on this trade.								
AU: pay 3s7s10s Swap fly	NEW	24-May-24	+10bp	+11.1bp	+22bp	+5bp	1.1bp	3 months
A second trade is the same expression as the trade above, but via IRS. This is the 3s/7s/10s (conventional basis).The flatter curve has driven this lower, with the 3- year held up by policy rates and the curve flattening through to the 7s. Year to date, 3s/7s has flattened around 14bp, while 7s/10s has flattened 4bp. To some extent it can be explained that high grade supply and ASW flow would have hindered performance of 10s, but the Kangaroo flow would also have helped the 10s given the hedging flow. Both dynamics will remain in play, though the clear supply channel is via the Semis. A steeper curve in a bullish environment should also steepen 3s/7s which would help this trade. We enter a trade to pay the belly of the fly at 10bp with a target of 22bp, and a stop 5bp. Carry and roll is 0.3bp per month positive.								
AU: pay 2y2y-5y5y-10y10y Swap fly	MONITOR	24-May-24	+50bp-	+52.3bp	+70bp		-	3 months
This is quite a leveraged expression, where the 5y5y is sitting low on the fly. Again, his has been driven by the flattening seen in the shorter leg. The 5y5y on a cross-market basis has dropped too, and the 10-year EFP is at the lowest level in two years. We discussed this in the charts section of the Antipodean Daily Wrap. If this trade dips below 50bp, we would look at entering a paid position in the belly, with a move towards 70bp.								

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A$ Rates Outlook & View Summary

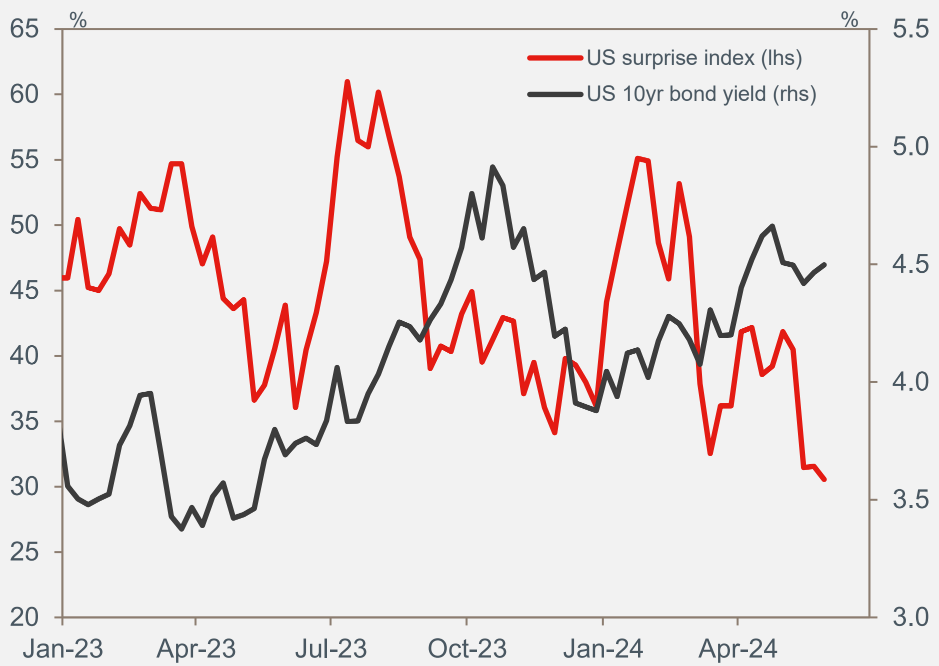
	Instrument	Curr	1w	3m	Comment
Cash & Short End Spreads	Cash @ Dec24	4.29	▶	▶	• While the April CPI certainly increased near term rate hike possibilities, the general consensus is that there is a high bar for a hike to be delivered and any shift in the RBA's reaction function and messaging will largely come down to the quarterly inflation print in July. Hence, while pricing reflects some small hike risk, the central thematic expressed is for unchanged policy for the foreseeable future, more than anything else.
	2nd BAB Future	95.61	▶	▶	
	3m BBSW-OIS	-0.08	▶/▲	▶/▲	
Outright Direction	3yr Bond Future	95.98	▶	▶	• We would maintain a tactical dip-buying framework as bonds will continue to gather yield seeking support, which will cap bearish impulses . We have recently been advocating a 3 month trading range for 10yr US yields of 4.25-4.75% and that remains our view, although we think any ventures to the upper end of the range will be short-lived.
	10yr Bond Future	95.62	▶	▶	
	US 10yr Bond Yield	4.48	▶/▲	▶	
Yield Curve	3m-3yr Swap	-18.17	▶/▲	▶	• Despite a recent flattening impulse, the domestic curve remains one of the steepest in the world and we continue to hold relative curve flatteners. • However, our own modelling suggests that on an absolute basis, the curve is more fairly priced at a level that is only marginally lower than its long-term average. Also an increase in ACGB issuance should have a steepening influence, also else equal. • Even so, we are neutral at current levels given that yield enhancement trades will see greater demand at the longer maturities.
	3-10yr Futures	+37	▶	▶/▲	
	10-30yr Bond Curve	+35.64	▶/▼	▶/▼	
Swap Spreads	3yr EFP	14.50	▶/▼	▶	• We continue to see swap spreads as tightly range-bound, albeit with little reason for them to widen significantly near term. As with the curve, a faster pace of ACGB issuance over coming months should also cap any widening impulses. • In addition, more medium term macro thematics such as “end of cycle” trades are likely to cap any widening for now, especially at the longer maturities. And, while the EOFY is nearing, we do not think corporate payside is likely to have a significant influence at the shorter maturities. • All up, we would be more confident fading 10yr widening, as receive-side flows could be encouraged on carry, curve and cross market considerations.
	10yr EFP	15.59	▶	▶	
	3-10yr EFP Box	1.09	▶/▲	▶	
Semi Spreads	10yr TCorp-Bond	5.18	▶	▶	• Despite a higher borrowing requirement for TCV arising out of Victoria’s budget, and significant supply from NSWTC and QTC, the recent widening in semi-bond spreads appears to have reached a level where domestic and global investor demand is more forthcoming. • That is especially positive given the recent prevalence of alternative issuance such as from the CA provinces and the prior expectation, which was the consensus as recently as the Victorian budget, that we will have to get through the upcoming budget season before any major new risk will be undertaken within the sector.
	10yr TCorp ASW	59.6	▶	▶	
SSA Spreads	5yr IBRD-Bond		▶	▼	• In SSAs, the performance to Semis has broad the RV back into a trade-off which implies semis have a better risk reward characteristics.
	5yr EIB-Bond		▶	▼	
XCCY Spreads	5yr Bills-SOFR	5.50	▶/▲	▶	• In the Xccy market, the curve is higher overall, but the front break has popped notably higher, which is good timing for month end flow from the super funds who are hedging back into A$. We would expect to see a last bout of SSA supply before the northern hemisphere summer slows the flow down, and we may see some Australian banks head to offshore markets, beyond the recent flurry of 1 year deals in various currencies.
Indexed Linked	ACGBi 2032 Yield	1.87	▶/▼	▶	• Any upside CPI surprise could have large impacts on inflation expectations however recent inflation surprises have not put much upward pressure on BEIs from investors looking to access cover for the contingency of inflation remaining sticky for longer than was previously expected. • There will be encouragement for the AOFM to further offer buybacks of the 2025 maturity in order to access funds for the above purpose.
	5y5y BEI	2.48	▶	▼	
	5-10yr BEI Curve	0.92	▼	▼	
Cross Market Spreads	AU-US 10yr Bond	-11.59	▶/▼	▼	• We have been consistently advocating maintaining exposure to AU outperformance trades, which will continue on US-led sell-offs. • We maintain that view, however the re-calibration of the RBA outlook is likely to keep the spread wider than it might otherwise have been. • So wait for cheaper levels before re-entering these positions but begin averaging into the benchmark AU-US 10yr bond spread around the -10bp level. There are likely to be multiple opportunities to achieve that over coming weeks.
	AU-US 1y1y Swap	-22.19	▼	▼	
	AU-US 2-5yr Swap	+60.50	▶	▼	
	AU-US 2-10yr Bond	+65.98	▶	▼	

What do aggregate data trends in the US and AU tell us?

Risk rewards are skewed toward a test of higher yields with the broad range.

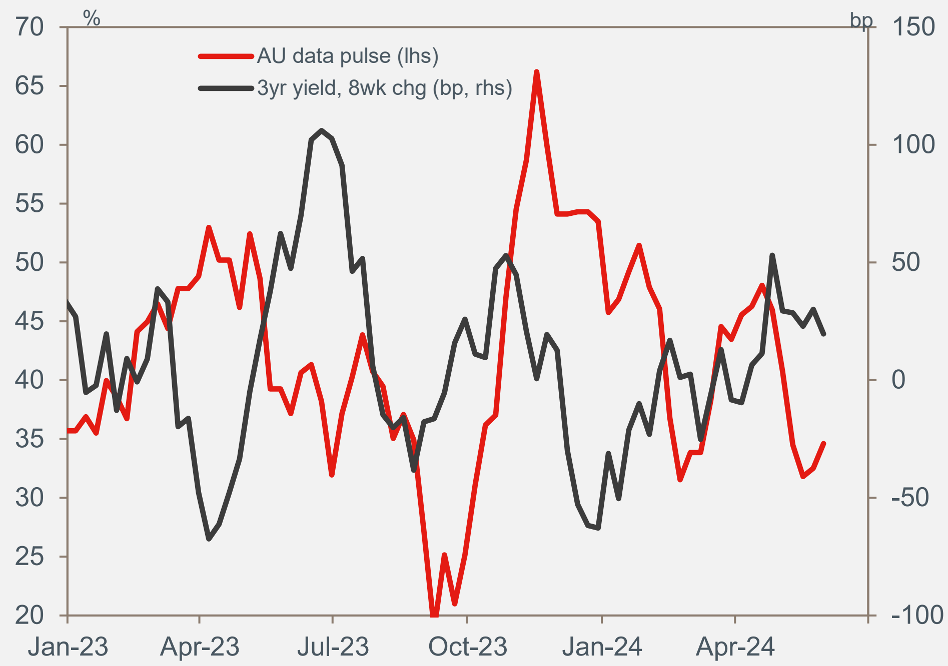
With RBA pricing is relatively anchored by the view that there is both a high hurdle to delivering a further rate hike and the fact that inflation is still some way from a sustainable move back within the target band, our oft-stated view is that outright bonds and market rates are largely range-bound for the foreseeable future. Even so, there will be inevitable volatility within the range as data outcomes and risk events spark swings in sentiment and shifts in momentum. So, while our preference remains to tactically "buy dips", assessing appropriate risk reward will be crucial to appropriately calibrating risk positions. The charts below place recent trends in US and AU yields in the context of recent data trends. The left chart plots US 10yr yields against the index of positive data surprises. As can be seen, the latter is at its lowest level in more than 18 months – a move that is not reflected in the trend in US yields. However, given that this is a surprise index, this can reflect a more consistent and accurate forecasting experience. Even so, from a risk reward perspective, should data outcomes positively surprise from current levels, then, all else equal, t suggests that a surge US yields risk rising more over coming weeks. The chart at left removes the forecasting surprise from the data and looks only at the data pulse over the past 8 weeks, this time for Australia, not too that data momentum has been weakening, and this has been partially reflected a slowdown in the sell-off in 3yr yields, however, should the recent data upturn continue we would expect a bias towards higher yields, all else equal.

US 10yr bond yield vs US Surprise Index



Source: Bloomberg, Westpac

AU Data Pulse vs changes in the AU 3yr bond yield

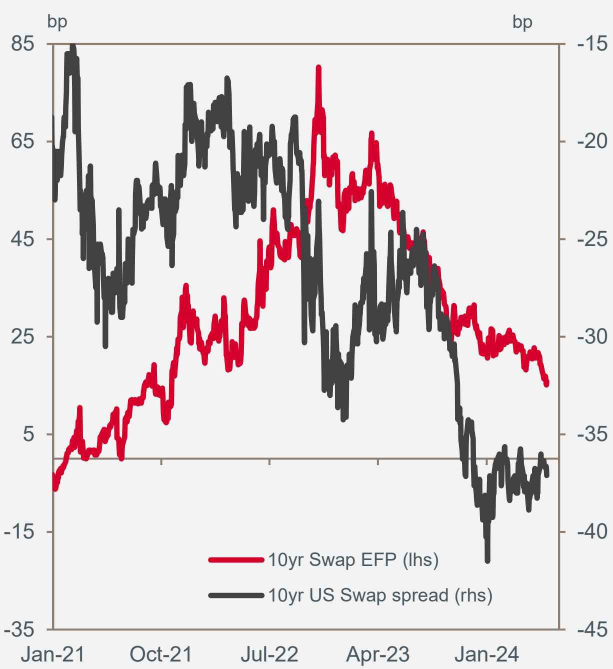


Source: Bloomberg, Westpac

We see little scope for swap spreads to push wider

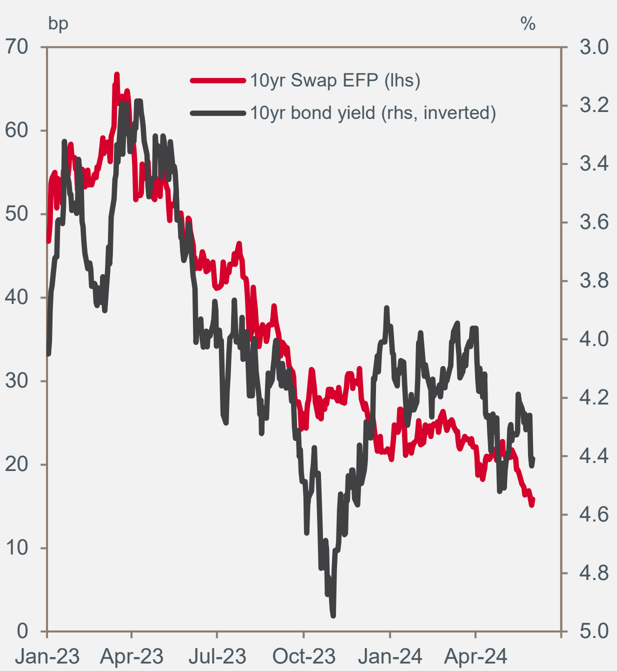
Swap EFPs have slowed their recent narrowing but remain at their tightest levels of the year. The key drivers remain extra bond supply next FY, a lack of payside out of a well-hedged corporate community which can wait for better levels, and an increase in carry-style positioning and yield enhancement trades. While the market is focused on where a near term bottom in spreads might be, there is also not much expectation that they will re-widen anytime soon. Until payside flows can be more confidently expected, perhaps as asset swappers step back into the market (there has been some small "toe-dipping" in recent sessions), we are neutral on EFPs at current levels. Apart from the abovementioned flow-based drivers, however, it is also worthwhile to examine some of the macro RV relationships that have a bearing on swap spread performance. The chart at left highlights the relationship between 10yr EFPs and US swap spreads. While the is a broadly direct relationship, the beta of co-movements is obviously highly variable as reflected in the fact that over recent months as the AU spread has achieved new lows, the US spread has been narrowly rangebound. The middle chart highlights the degree of directionality with underlying bond yields. Clearly, rising yields will lead to narrower spreads, and that is an obvious driver of recent spread performance. The right charts examines the relationship between 3yr and 10yr EFPs. As we have noted previously, there is little historical precedent for the box to push significantly inverse, and we do not believe that is likely to occur near term. That said, the focus on the AU-US 5y5y spread and other AU receive-side flows suggests the box will relatively flat for the foreseeable future.

10y swap EFP vs 10y US swap spread



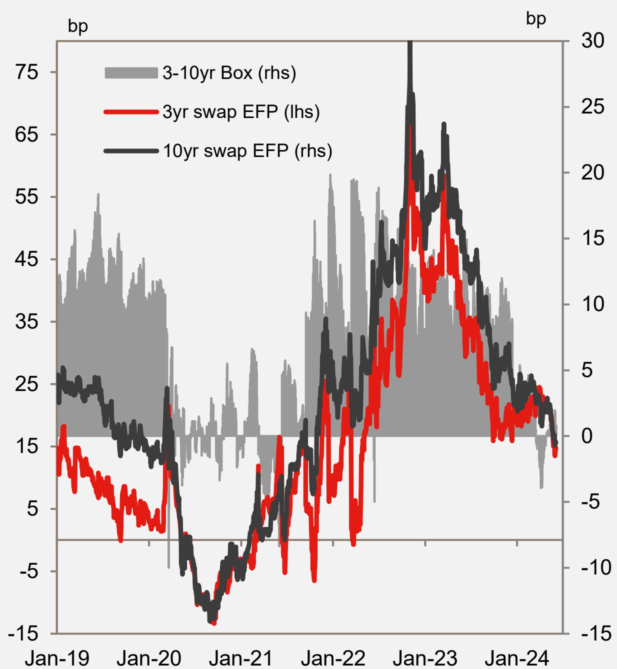
Source: Bloomberg, Westpac

Directionality



Source: Bloomberg, Westpac

3yr & 10yr swap EFP ranges



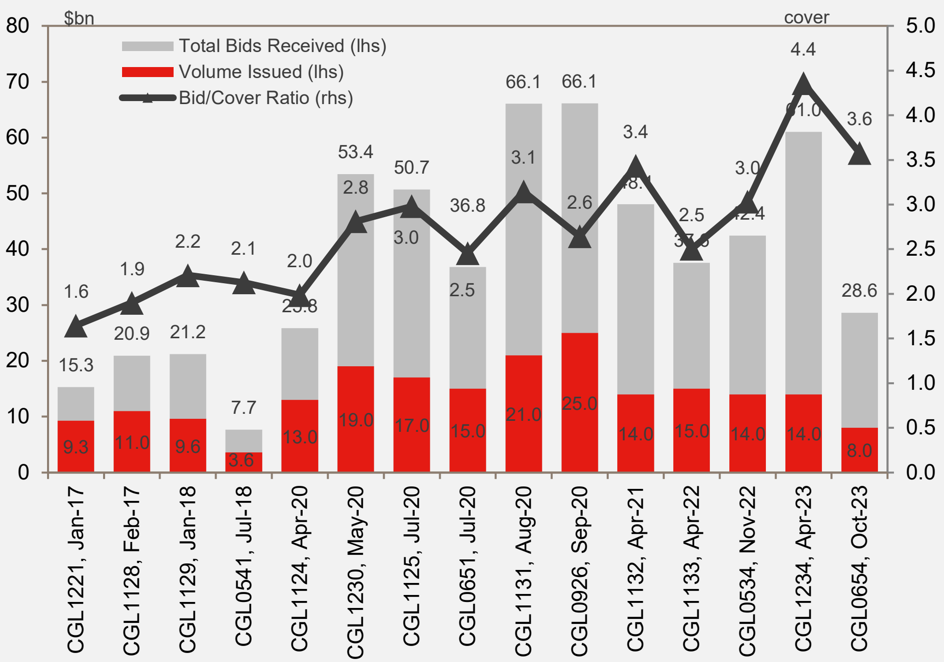
Source: Bloomberg, Westpac

AOFM launches its first green bond, a 4.25% June 2034

The issue will likely be a record coverage for an ACGB syndication

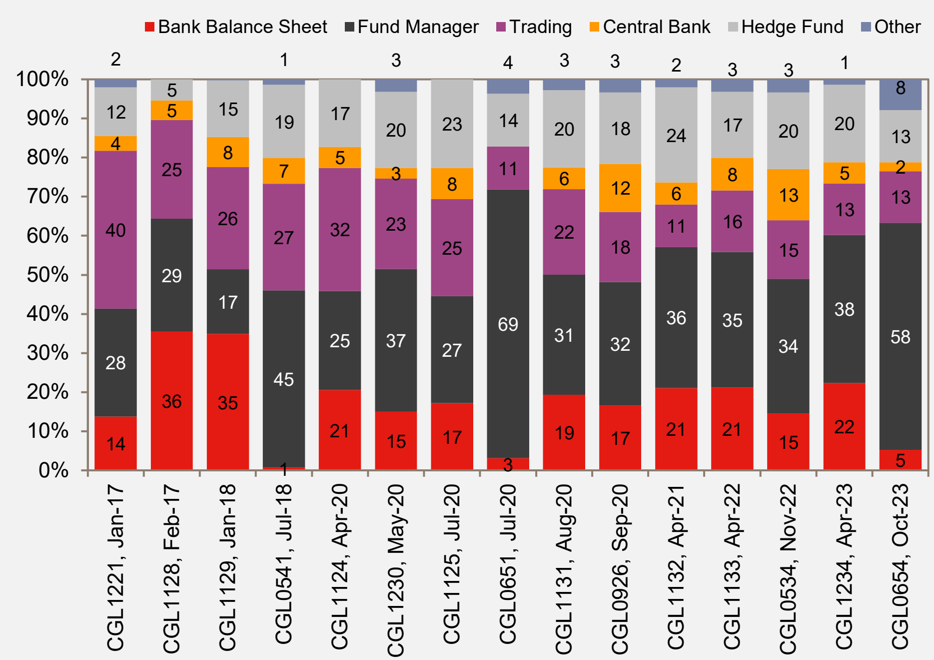
The AOFM today announced the issue by syndication of the 4.25% 21 June 2034 Green ACGB. The issue size is expected to be around $7bn. Westpac is one of the joint lead managers. The initial price guidance is a 10yr EFP spread of -5 to -1bp and the issue is expected to be priced on Tuesday, 4 June 2024 and settle on Friday, 14 June 2024. For an assessment of where we see "fair value" along the current nominal ACGB curve please refer to the following piece: https://www.westpaciq.com.au/markets/2024/06/fair-value-CGL0634-green-20240603. The issue is expected to be extremely oversubscribed. So it will go well and will probably have a record coverage ratio (left chart). Beyond that, the market will be very interested in the type and location of investors given that this is the first green issue. The right chart indicators that historically by far the largest investors have been fund managers, as you would expect, with varying support from bank balance sheets over the years. The charts on the next slide break this down by investor locales. At left we can see that domestic investors dominant, as would be expected, followed by Asia ex-Japan and then by UK investors to varying degrees depending on the maturity issued. Since 2011, the lowest offshore participation has been 15% for the CGL1128, issued in 2027, while the largest was for the 2051 long bond issued in 2020 (67%). The average offshore participation is around 40%.

Previous ACGB nominal syndications – coverage ratios



Source: AOFM, Westpac

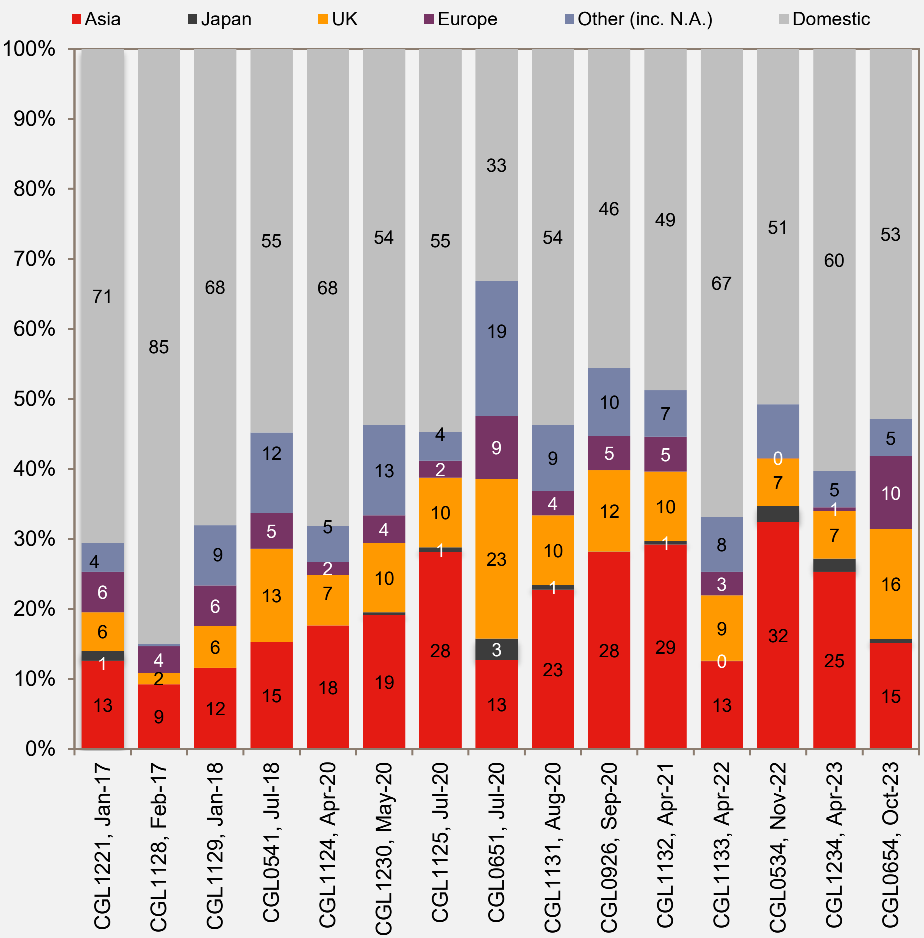
Previous syndications by Investor Type



Source: AOFM, Westpac

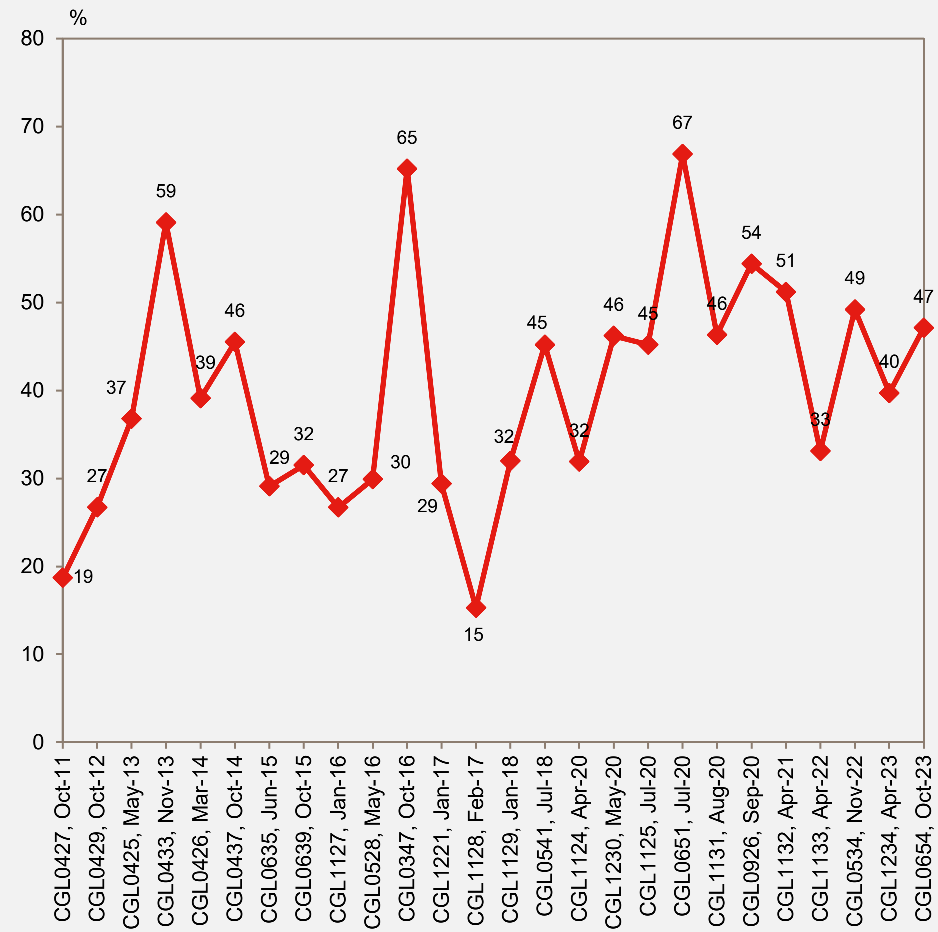
Previous ACGB breakdown by investor location

Previous syndications by Investor Region



Source: AOFM, Westpac

Previous ACGB nominal syndications – international participation



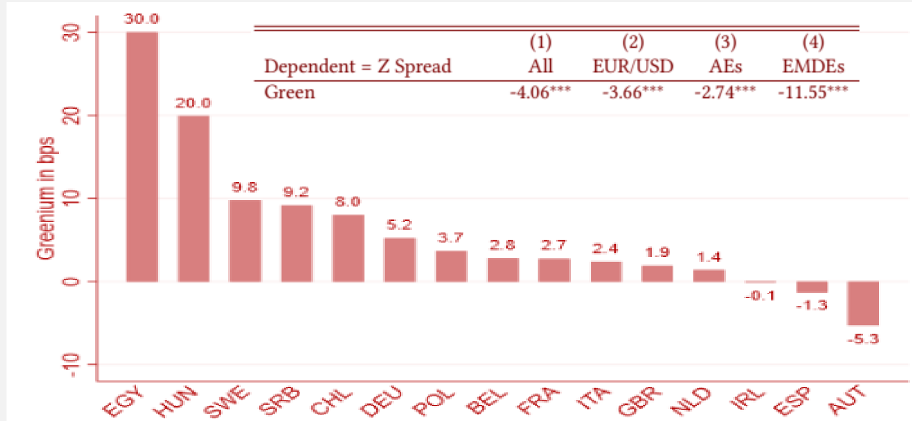
Source: AOFM, Westpac

What, if any, will be the ACGB “greenium” be?

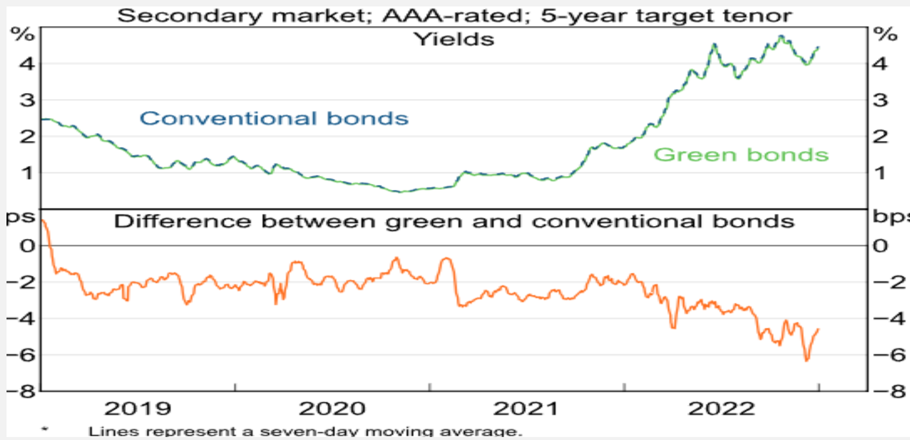
A brief survey of the literature on the topic.

- Our own “fair value” for the new green bond is an EFP of -1bp, which is at the upper end of the end of the AOFMs -5bp to -1bp launch range. Given that the issue is clear to be very well supported, the expectation would be that the deal will come toward the end of the range. And, given that our own fair value was calculated using the current nominal ACGB curve, then that might imply a “greenium” of as much as 4bps. We shall wait and see whether that is the case and what it might settle at over coming days.
- With that in mind it is timely to examine how sovereign green bonds have evolved in other markets. The top chart and its associated table shows the conclusions of an IMF study, published in April 2023 (link below). They note that “the estimated average “greenium” is 4.06 basis points“.
- The paper further notes that “While the estimated “greenium” in this paper is not large, it has been increasing over time alongside he level of sovereign green bond issuances.” but “whether the administrative costs associated with green bond issuance exceed the benefit is a country-specific question, but strengthening peer learning and climate information architecture could help reduce the costs and increase the benefits over time.” And further that “it remains an open question whether the purpose of the project associated with the green bond is a key determinant of the “greenium”, and whether green bonds have resulted in the climate outcomes they intended to achieve.” For now, however, those are issues for another day.
- The RBA has also published more broadly on “Green and Sustainable Finance in Australia” (link below). The paper made these points about pricing of these issues: Demand for green bonds might be higher than their conventional counterparts due to investor preference for socially responsible investments or lower exposure to climate-related risks. That said, investors’ fiduciary duty and the presence of arbitrage in competitive markets may tend to minimise any pricing difference between green and non-green securities.
- With regards the “greenium” they compared the secondary market pricing of green and nongreen bonds issued by AAA-rated kangaroo issuers. They noted “some evidence of a small greenium for AAA-rated kangaroo bonds (bottom chart) but added that “there is considerable scope for more rigorous exploration of the impact of a bond’s green label on its pricing, particularly as markets continue to evolve.
- So, while there is some evidence of a “greenium” in other markets, it will likely take some time before we can be confident about what it is in the Australian sovereign space.

IMF Greenium Estimation By Country



Kangaroo Bond Pricing



Sources: https://www.imf.org/en/Publications/WP/Issues/2023/04/07/How-Large-is-the-Sovereign-Greenium-530332; https://www.rba.gov.au/publications/bulletin/2023/sep/pdf/green-and-sustainable-finance-in-australia.pdf

NZ$ Rates Outlooks

	Instrument	Curr	1w	3m	1y	Comment
Yield Direction	2yr swap	5.10%	▶	▼	▼	• Ranging is likely during the month ahead, between 4.90% and 5.20%. Receivers appear willing to enter at 5.20%, while the hawkish RBNZ adds caution below 5.00%. There's also Q2 CPI to watch out for. • NZGB 10yr yields similarly attracting interest in the high 4s, but NZGB supply adds caution around 4.60%.
	10yr NZGB	4.81%	▶	▼	▼	
Curve Slope	2-10yr swap	-44bp	▼	▲	▲	• Near term potential for further flattening, led by the RBNZ's hawkish surprise as well as offshore yields. We expect an eventual opportunity to enter steepeners, with the 2-10yr attractive at -55bp.
Swap Spreads	10yr NZGB i-spread	15bp	▶	▶	▼	• NZGB i-spreads could take a few days to settle post-Budget. The $2bn increase for FY 2024/25 matched consensus, but tbill issuance was increased. Moreover, risks to future updates (HYEFU in December) lie towards further issuance increases.
XCCY Basis	5yr NZD/USD basis sw	-9bp	▶	▲	▲	• Multi-month we are biased to pay NZD, given H1 kauri issuance has been lower than usual, and further bank issuance offshore is likely given the winding down of the FLP programme and the need to replace that funding.
Break-Even Inflation	NZGBi 2040	2.14%	▲	▲	▲	• 2040 BEI is fair, assuming the RBNZ's 2.0% midpoint target remains credible, with any dips to the 1.90% area attractive. Running yields remain attractive relative to nominals, but less than they were a few months ago.
Cross Market Spreads	NZ-US 2yr OIS	19bp	▲	▲	▲	• NZ-US 2yr OIS spread bottomed at around +10bp, and could break above 20bp this week, catalysed by last week's hawkish RBNZ MPS. • The 10yr NZGB-UST spread is starting to rise off a 3-year low, still looking rich given relative monetary policy outlooks and looming NZGB supply.
	NZ-US 10yr govt. bond	27bp	▲	▲	▲	
	NZ-AU 2yr swap	84bp	▲	▲	▲	• NZ-AU 2yr swap spread bottomed at 66bp early May and is now 20bp higher, helped by the RBNZ. NZ pricing still has room to rise, while AU pricing can fall, towards Westpac's RBNZ and RBA forecasts. Has potential to reach 100bp multi-week. Multi-month, based on our economists' cash rate spread forecast of 140bp by end 2024, there is scope for significant upside. • NZGB-ACGB 10yr spread starting to rise off the bottom of the 38bp-100bp 18mth range. The AU and NZ Budgets are contrasts, in favour of ACGBs.
	NZ-AU 10yr govt. bond	41bp	▲	▲	▲	

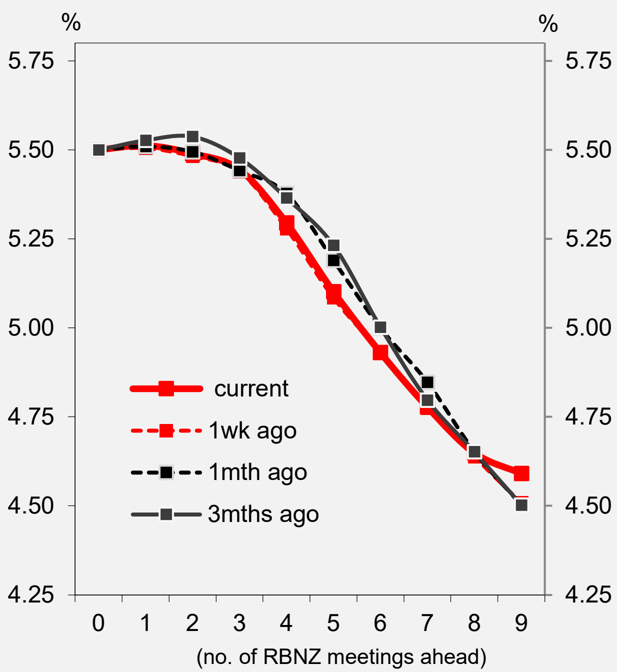
Damien McColough | Head of Rates Strategy; Imre Speizer | Head of NZ Strategy; Uma Choudhury | Associate

RBNZ monetary policy

NZ Budget probably unhelpful for RBNZ

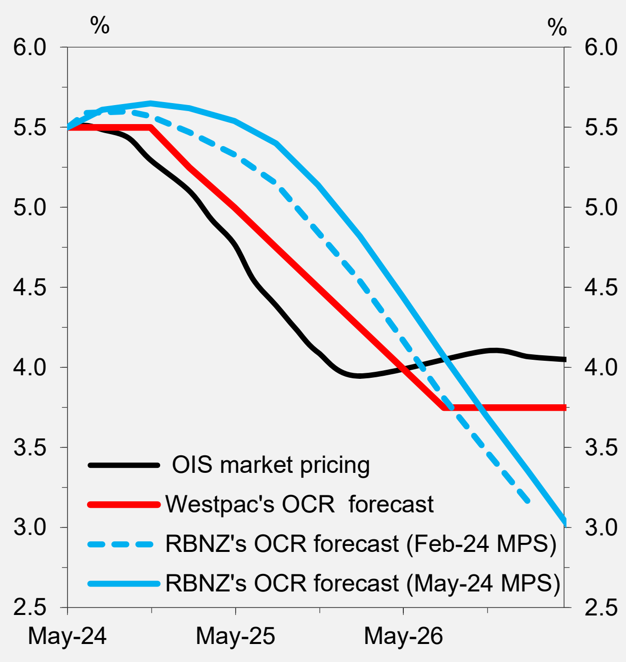
Ahead of Budget 2024, the RBNZ MPS in May appeared to assess the fiscal stance as slightly less disinflationary than forecast in the HYEFU, and we now see why. A rough proxy of the impact of fiscal policy on aggregate demand can be obtained from the Treasury's estimate of the Total Fiscal Impulse (third chart below). The stance over the coming year – probably of greatest interest to the RBNZ given current domestic inflation pressures – is no longer estimated to be significantly tighter. The RBNZ will formally incorporate Budget 2024 into its projections at the August MPS, although comments can be expected at the July MPR. Key judgments – such as the proportion of tax cuts that may be spent, rather than saved – will necessarily be made tentatively at first and refined as data on actual behaviour is observed. For now, our running assumption is that the RBNZ will regard Budget 2024 as somewhat unhelpful, although not a game changer for monetary policy. Much will depend on how indicators of consumer and business confidence and inflation expectations evolve as the tax cuts hit.

Market pricing for NZ OCR



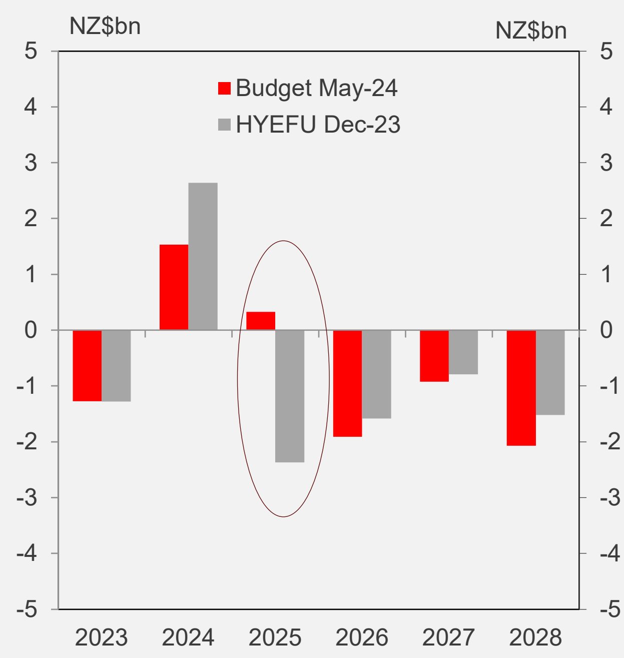
Source: Bloomberg, Westpac

RBNZ OCR track vs market



Source: RBNZ, Bloomberg, Westpac

Fiscal impulse in 2025.26 was upgraded



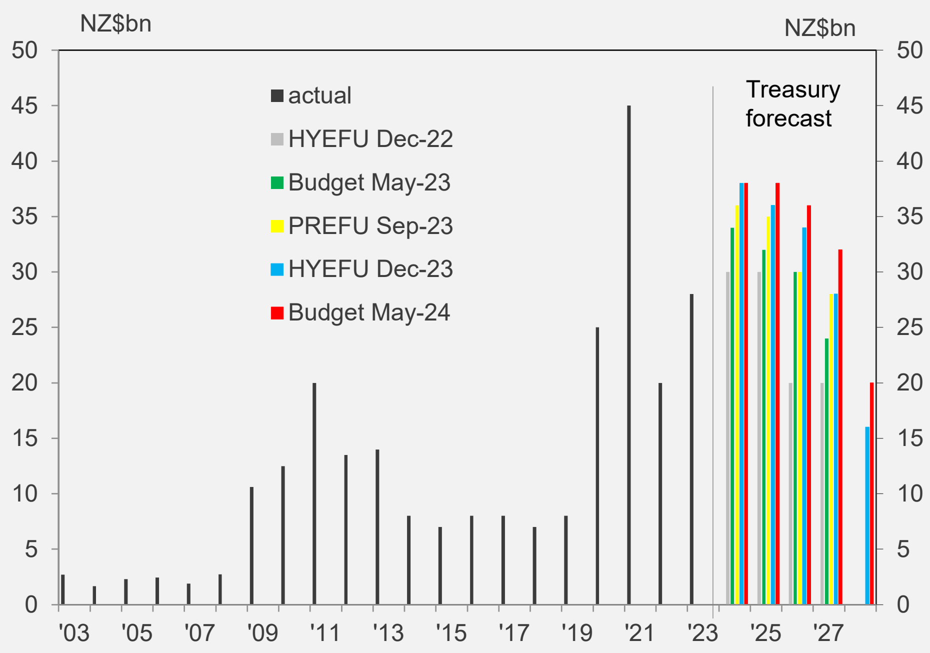
Source: NZ Treasury, Westpac

NZGB supply

Budget announced increased NZGB supply as expected

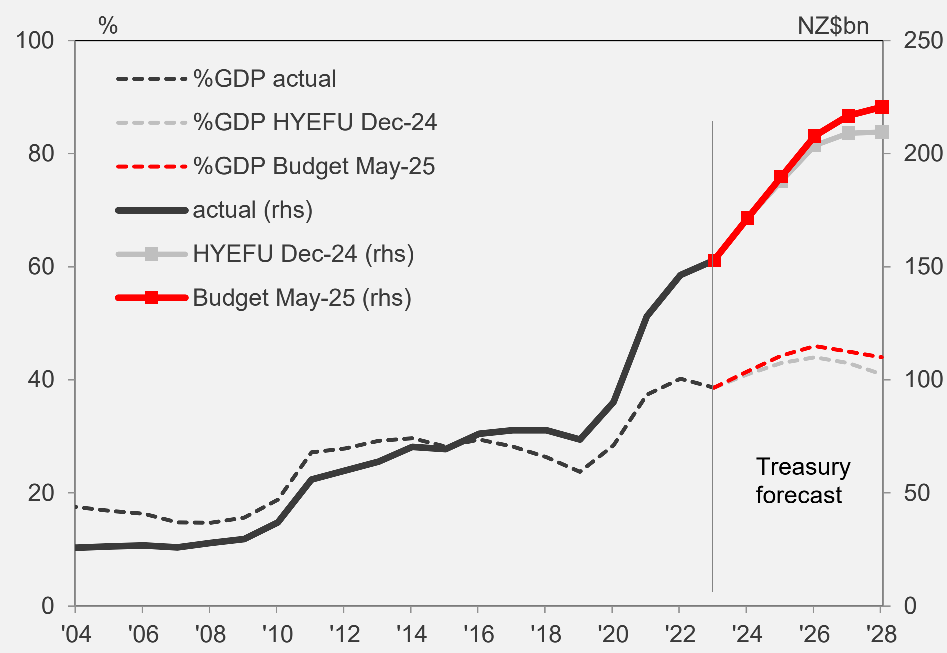
In line with market consensus, last week's Budget 2024 announcement revealed an NZGB issuance forecast for the four years ahead which is $12bn higher than that revealed at the December 2023 HYEFU. This is less than the $15bn increase we had expected, although short term borrowings were increased by $4bn. The 2024/25 year was increased by $2bn to $38bn - close to market expectations – and will include three syndications (two taps of existing lines, and one new line) in addition to the weekly tenders. This suggests syndication volumes will be slightly higher on average than this year, unless the looming new 2028 syndication (likely next week) achieves significant prefunding. NZGBs outstanding are forecast to peak in 2025/26 at 46% GDP – a record high. The initial response by markets was benign, with NZGB-swap spreads unchanged. As we write, though, they are 2bp higher. Overall, we remain biased to buying vs swaps at attractive levels, which for the 2034 would be above 25bp (currently 19bp).

NZGB issuance in FY 2024/25 increased by $2bn



Source: NZ Treasury, Westpac

NZGBs outstanding to rise to 46% GDP in FY 2025/26



Source: NZ Treasury, Westpac

Financial Markets Strategy

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