

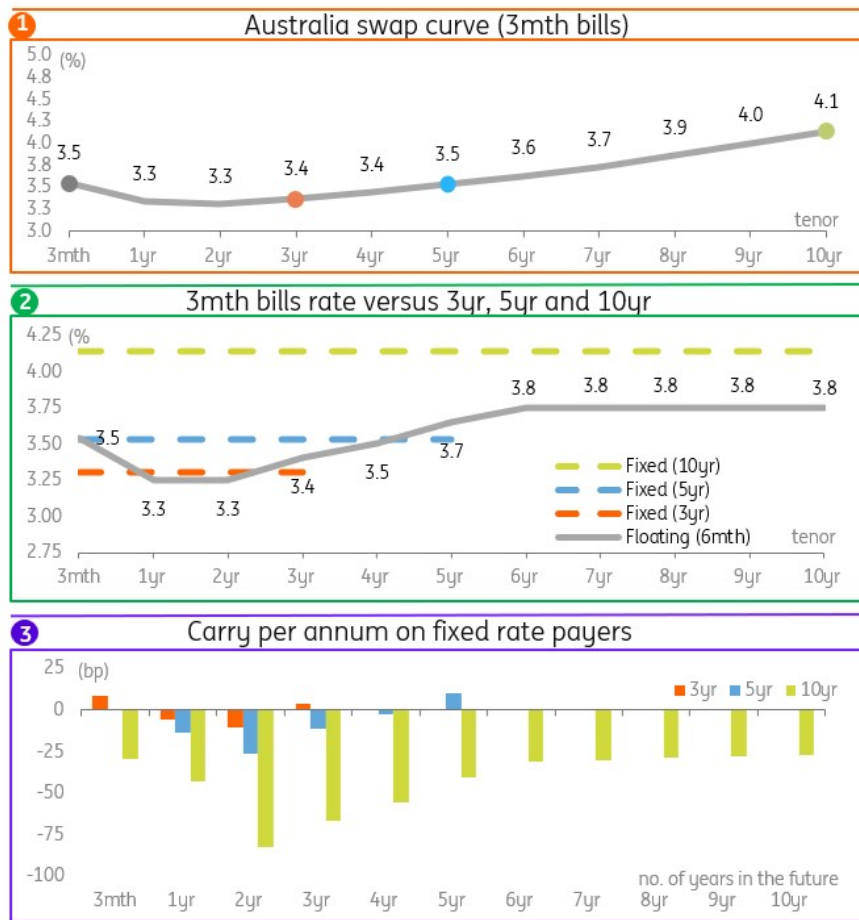
Australia on a slower rate cut trajectory - what to do now

The RBA is on a slow 'cut' trend while the Fed is on a faster one. We find that the Australian 10yr looks like a rate that can be received from a domestic standpoint, but also when viewed relative to the US. In short tenors, we find that lock-ins in Aussie rates (out to 3yrs) look good. And swapping short tenor AUD liabilities to USD look good on our FX view



Take a look at these charts. The top one shows the bills curve, the second shows the ING forecast for the 6-month bills vs selected fixed rates, and the third shows carry outcomes for lock-ins on selected tenors.

Confronting our profile for the 3mth bills rate with the current bills curve



Dealing with a slower process

The 3yr bills rate breaks even versus our forecast for 3mth bills, while the 10yr rate generates a decent spread on swaps to floating.

The Reserve Bank of Australia cut to 3.6% in August, and while the rate-cutting agenda is ongoing, we're dealing with a slower process. [Deepali Bhargava](#) (our Regional Head of Research, Asia Pacific) notes that the RBA appears as uncertain as markets regarding the disinflation path, and our call remains for only one additional cut by year-end, making us slightly more hawkish than market pricing. See more on the RBA/macro story [here](#).

We continue to identify a neutral RBA rate at around 3.6%, centred on a tolerance for CPI inflation up to (but ideally below) 3%, with a moderate real rate added to that. It is also in line with the average RBA rate over the past three decades, a period long enough to back out numerous cycles and extremes on both ends.

The vision is for an RBA move down to 3.1% in the coming quarters, and then to slowly revert towards neutrality in the 3.6% area. Translating that into a profile for 3mth bills (now at 3.55%), the path is down to 3.25% in the coming quarters, a hold in that area for another number of quarters, and then a subsequent reversion back up towards the 3.75% area.

The charts below confront our profile for the 6mth bills rate with the current curve. The main outcomes show that a 3yr lock-in broadly breaks even with the floating profile (avg. -1bp pa). The 5yr lock-in has cumulative negative carry (avg. -7bp pa), but moderate. The 10yr lock-in has a more pronounced negative carry profile, impact and cumulative (avg. -42bp pa). Doing the reverse (receiving fixed) in turn pays on average 42bp pa over 10 years.

Confronting the Australian curve with the United States SOFR curve

The top chart shows the US and Australian curve, the second shows spreads and the basis for each tenor, and the third shows the AUS/USD FX forward profile.



The RBA is ahead of the Fed in terms of absolute rate levels

In short tenors, our projections point to swapping AUD liabilities into USD. And we project tighter spreads in longer tenors

The ratchet lower in the SOFR curve by some 40bp in recent months has correlated with a similar reaction along the Australian curve, but with some underperformance. This has resulted in wider spreads right along the curve, but not dramatically so; all in all, by some 10–20 bp. The wider spreads are reflective of a bigger rate-cutting agenda out of the US, and a remarkable comfort factor in longer-dated SFR rates despite the tendency for core inflation to go higher.

All-in spreads (including the basis, albeit moderate) widen from virtually zero on the front end to some 70bp on the 10yr. The narrow spread on the front end reflects the fact that the RBA is ahead

of the Federal Reserve in terms of the absolute level of rates. The rates differential on progression out the curve translates to a forward FX profile that prices a weakening in the AUD vs USD, all the way to 0.63 on the 10yr FX forward rate. Our FX strategists are more bullish on AUD, looking for a trend to the 0.68 area in the next year or so. The strategy in short tenors (out to 3yrs) then is to swap AUD liabilities into USD, and benefit from the AUS/USD rate path outperforming the forwards (USD weakness).

For longer tenors (aka the 10yr), we maintain the notion that the 10yr SOFR rate looks structurally low at 3.5%. As it rises, the spread to Australia should narrow. There is the likelihood that the 10yr SOFR rate could test lower to begin with as we go through the very early phase of the Fed's rate-cutting process. But beyond that, we expect US inflation to bite back, pulling US longer tenor rates higher. See more [here](#).

Author

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.