

## Australian QE: A premature tapering?

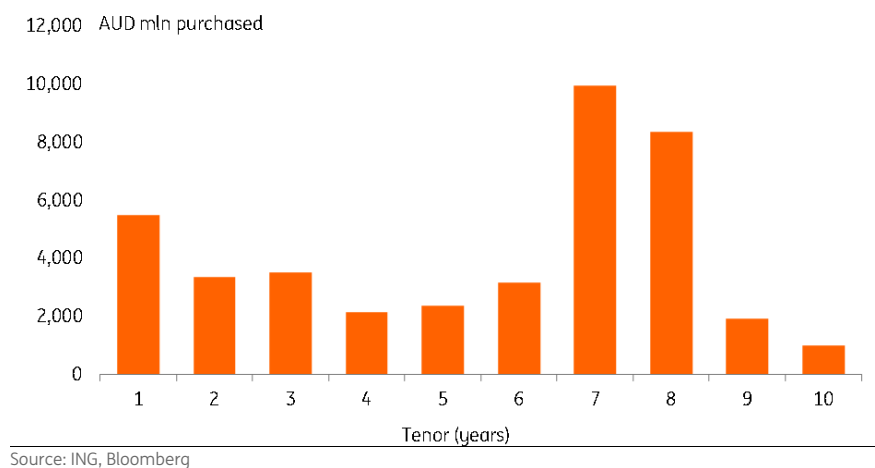
After hinting at tapering if conditions improve, Australia's central bank actually trimmed its daily bond-buying today. However, an excessive steepening of the yield curve may act as a deterrent to unwinding QE. Looking at AUD, we're not convinced the recent rally is an initiation of a sustained recovery just yet



### Impact on the yield curve so far

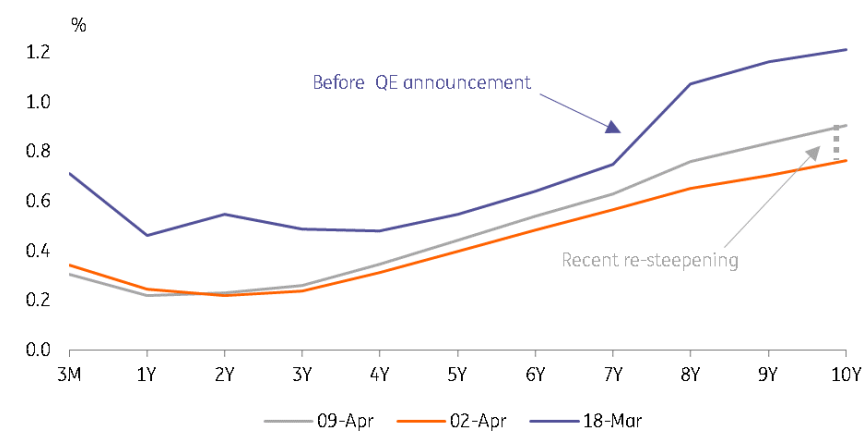
Since announcing a yield-curve-control scheme (keeping the 3-year yield at 0.25%) on 19 March, the Reserve Bank of Australia has purchased AUD 41.5 bn of government bonds on the secondary market. The breakdown of the bond purchases in terms of maturities (Figure 1) shows the Bank has intervened in various segments of the curve, especially in the 7- 8-year tenors.

**Fig. 1 - Breakdown of RBA bond purchase by tenor**



Whilst largely succeeding in keeping the 3-year yield at the 0.25% target, the whole AU yield curve has understandably shifted lower since the start of the bond purchase scheme (Figure 2). Looking at the slope of the yield curve, an initial fierce steepening around the QE announcement was followed by some stabilisation in the 10Y-2Y differential.

**Fig. 2 - Australian sovereign yield curve (before and after QE)**



However, the curve has started to steepen again in the past few days. This has largely been the result of the more upbeat global risk sentiment and consequent UST 10-year underperformance. However, the RBA policy statement on 7 March has likely come into play too lifting Australian 10-year yields as the central bank surprisingly hinted at some tapering “if conditions continue to improve”.

### RBA trimming bond purchases

With only three weeks into the QE programme and – above all – with still little material evidence of the actual economic impact of Covid-19 on the global (and Australian) economy, the prospect of

tapering may look a bit premature.

---

*It must be noted that tapering likely poses a risk of an extreme steepening of the yield curve*

---

However, the RBA seemed to put words into action today and made the smallest daily purchase of securities so far: AUD 1.5 bn. Surely, we would need to see a trend in lower purchases to conclude the Bank is actually starting to unwind its QE scheme. Next week is likely to be crucial in this sense.

It must be noted that tapering likely poses a risk of an extreme steepening of the yield curve, especially if global risk sentiment keeps improving and US 10-year yields rise. The central bank may stick to its stated objective to control the short-end of the curve (also given the limited ability to control the UST-driven back-end), but recent buying of longer-dated bonds suggest that the Bank may not be entirely at ease with surging back-end yield.

This is understandable considering that supply is set to pick up soon as the government builds debt to finance its anti-pandemic fiscal stimulus plan.

## **AUD: Don't get too excited**

The recovery in risk sentiment, accompanied by the hawkish wording in the RBA statement set the AUD for a substantial rebound this week. If indeed the RBA is determined to scale back its bond purchase, this would inevitably provide additional steam to the AUD.

However, we are still not convinced that the recent rally is an initiation of a more sustained recovery just yet. And this is largely because, despite the encouraging signals in terms of slowing contagion in Europe, lingering uncertainty around the depth of the upcoming global recession suggests a big deal of caution when betting on procyclical currencies.

Looking more specifically into AUD, a plunge in trade flows and a slowdown in Chinese demand doesn't bode too well for the export-dependent Australian economy, which may see the impact of the Covid-19 extending well beyond the lockdown-related disruptions. Commodity prices may also remain quite depressed, in particular iron ore (Australia's main export), whose price prospects were already gloomy on the back of an increase in supply from Brazil.

Finally, it is important to remember how the AUD has historically been the key shock absorber in turbulent times for the Australian economy, which suggests the RBA (and, even more, the government) may not be content with a large recovery in AUD as the country deals with the big hit. While direct FX interventions don't seem to be on the cards just yet, an appreciating AUD may be another disincentive to scale back QE.

As the USD appears to be bearing most of the brunt for the fall in risk aversion, we still expect defensive currencies JPY and EUR to be a safer bet than the procyclical currencies such as AUD in the near future.

## Author

**Francesco Pesole**

FX Strategist

[francesco.pesole@ing.com](mailto:francesco.pesole@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](http://www.ing.com).