RBA Recap

- RBA caught the market by surprise with their decision on monetary policy at their September meeting
- That was despite the shift in approach being flagged in the previous month's post meeting statement
- The decision reverberated around markets leaving the yield curve markedly changed
- It sets the tone for next month with a near term pause looking increasingly likely in the months ahead

Market Dynamics

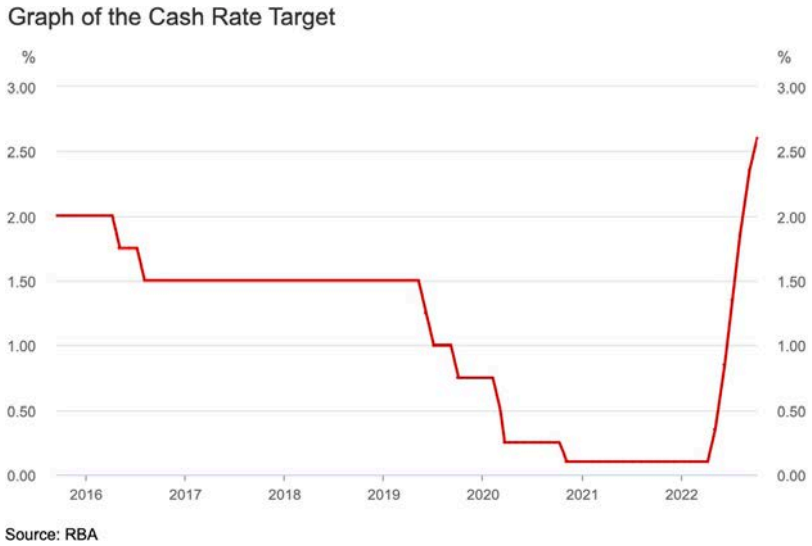
- Market liquidity has become less volatile, with ADIs not experiencing such extremes in funding pressures.
- Term deposit and NCD rates have continued to increase, in line with reference rates and market expectations.

The Australian Economy

- The Australian Dollar losing strength is presenting a 'Mining Boom' like environment for the Australian economy.
- The consumer has remained resilient and continues to drive the economy forward.
- With mortgages repricing in the middle to back end of 2023, households will be in for a rude shock as their disposable income decreases.
- Uncertainty plagues the path ahead for Australia.

RBA Recap

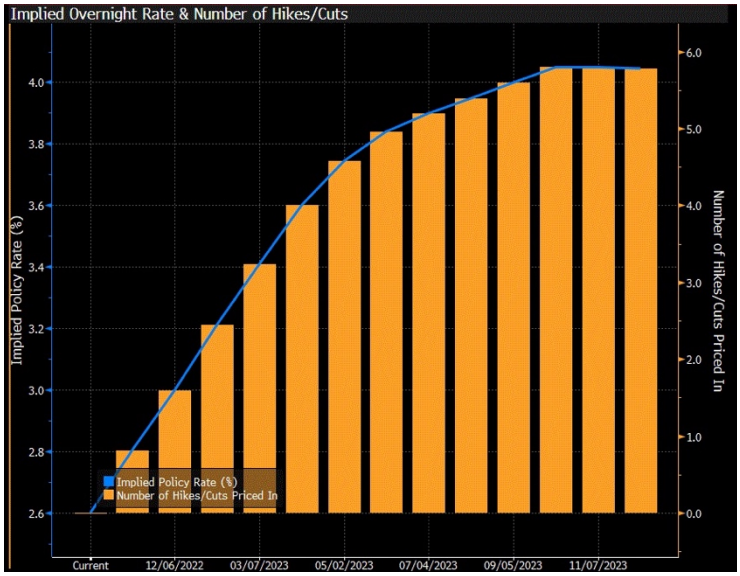
RBA: Normalisation Complete, What Next?



The RBA's October board meeting was a highly anticipated one There was considerable uncertainty over the outlook for policy following the September meeting, where the RBA made some significant changes to their rhetoric. We expected following the September meeting that 50bp moves were now done and the RBA would revert to 25bp moves as the tightening cycle continued. This was largely signalled by the RBA removing the word 'normalisation' from their accompany statement to the September 50bp increase. This suggested that with the policy rate swiftly moved back to something considered around neutral, future moves would be more measured.

Market pricing over the month heading into the meeting was largely split down the middle, placing a 50/50 chance on whether we would see a 25bp or 50bp move. The closer the meeting got, the further the market leaned towards a 50bp move. When the RBA ultimately opted for a more measured 25bp move there was a swift reaction across markets with the yield curve moving sharply lower. This move was entirely appropriate as future expectations for the cash rate were adjusted.

In their accompanying statement to the decision to lift the cash rate 25bp in October the RBA said that:



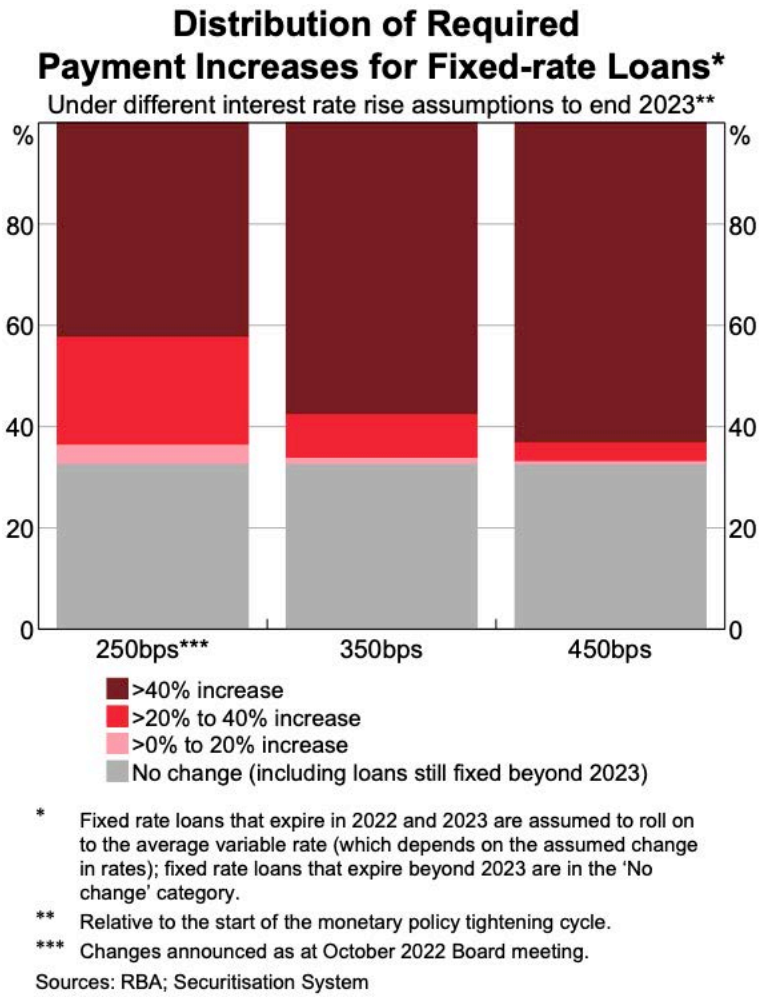
"The cash rate has been increased substantially in a short period of time. Reflecting this, the Board decided to increase the cash rate by 25 basis points this month as it assesses the outlook for inflation and economic growth in Australia."

We have now had the cash rate lifted by 250bp over the past six months, and more extremely 200bp of that crammed into a 4 month window. Given the sheer velocity of that move it was entirely appropriate for the RBA to slow the pace of the tightening

cycle. This tightening cycle also differs to previous ones we have witnessed. There will be considerably more lag to these changes in monetary policy in this tightening cycle compared to past tightening cycles.

As has been stated many times by the RBA in the past, it can take 9 to 12 months for a single monetary policy shift to fully flow through the economy. While the behavioural change is immediate as consumers psyche recalibrates on the RBA's actions, changes in the price of money take much longer to take full effect.

Last Friday the RBA released their latest Statement on Financial Stability and it further highlighted why this tightening cycle differs to most. When the cash rate went to 0.10% during the pandemic and banks were offered large amount of 3 year fixed price, cheap funding, we saw a record surge in fixed rate lending. This made sense as borrower rushed to lock in rates that they might not see again for a very long time. What this means is that the RBA's cash rate moves will be having little effect on borrowers who locked their mortgage in during that period.



Crucially what the RBA's analysis from the Statement on Financial Stability showed is that by the end of next year, 80% of those fixed rate mortgages will mature. They will either revert to the current variable rate on offer or the borrower may elect to re-fix at current fixed rates. Either way, borrowers will be paying more. So even if the RBA doesn't move the ash rate again in this cycle, the effect of the current moves will still be filtering though for some time.

Even with that in mind, the RBA still see more room for further interest rate moves over the months ahead. In the concluding paragraph to the post meeting statement they said:

"The Board expects to increase interest rates further over the period ahead. It is closely monitoring the global economy, household spending and wage and price-setting behaviour. The size and timing of future interest rate increases will continue to be determined by the incoming data and the Board's assessment of the outlook for inflation and the labour market."

A further 25bp increase is still expected for November. A short pause in December ahead of the next meeting in February, still seems like the prudent approach. If the latest inflation data globally is anything to go by, inflation could slow quicker than expected. Inflation in the US over the past three months is now running at an annualised rate of 2%. We are unlikely to see such an abrupt shift here but it will give the RBA food for thought given inflationary pressures in Australia aren't as acute or engrained as we have seen in other jurisdictions. Ultimately it means that we are getting closer to the terminal rate in this tightening cycle.

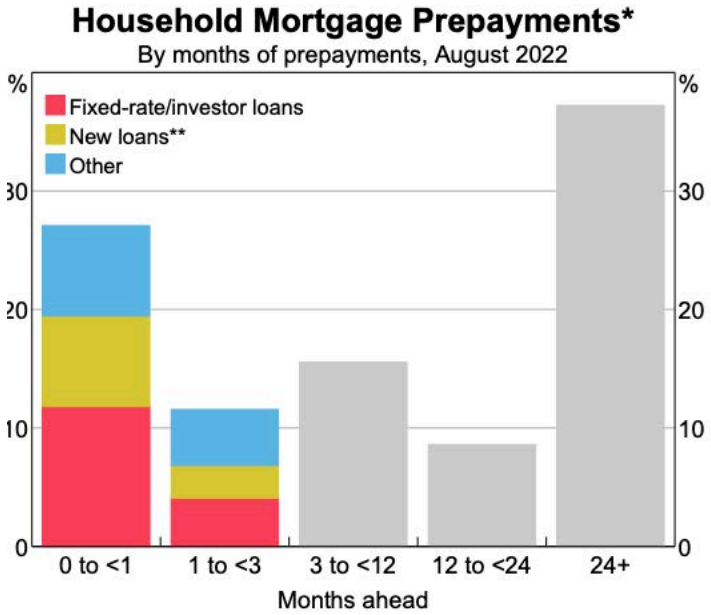
David Flanagan – Head of Money Markets

Markets Recap

Funding Dynamic

Bank appetite remained stable over the course of the month. The extreme funding pressure which had been seen previously did not present this month. There is no real rhyme or reason to this but there are underlying factors which could cause disruptions in the funding dynamic moving forward.

As written about in the past few monthly reports, the amortisation rate of loans has started to decrease as households have less disposable income to prepay their mortgages. There are two major reasons for this. The first of which is quite clear, that due to inflation the price of goods is eating away at household saving ratios. The second of which is less clear, is that consumer psychology after Covid is yet to change materially. Households are enjoying freedoms that they didn't have during the past 2 years, whether that be travelling within Australia or internationally, visiting friends and family and dining out.



* Months ahead expressed as number of months that prepayments (including offset and redraw balances) can cover minimum scheduled payments. Includes split loans. Only loans with less than 3 months of prepayments are broken down by loan type.

** New loans are those originated during 2021 and 2022. These are somewhat under-represented in the Securitisation data as new loans can take some time to be securitised.

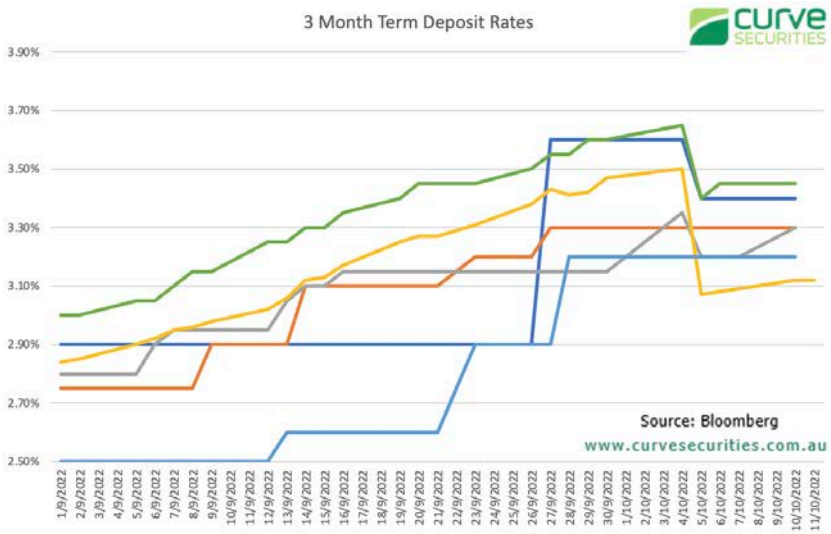
Sources: RBA; Securitisation System

Previously, ADIs have received large sums of money mid-month from self-securitisation top ups. What this means, is that banks pool mortgages together and use it as collateral for liquidity from the Reserve Bank. The flow on effect is that a large proportion of the banks have had funds at the same time. Liquidity is abundant and the desire for funds is limited. As this cash is depleted from normal cash flow requirements, these ADIs who have participated in self securitisation, have turned to other forms of funding, normally within the wholesale market. This has placed upward pressure on rates, with banks playing the game of 'leapfrog' to secure their funding needs. The wave of liquidity repeated month on month.

However, with the volumes of mortgages starting to fall and APRA changes to the size of these self-securitisation facilities, self-securitisation top ups have fallen. The wave of liquidity has become shallower, and funding requirements have been more mellow. Banks are open to funds but no longer desperate, and their funding requirements have tapered alongside securitisation flows.

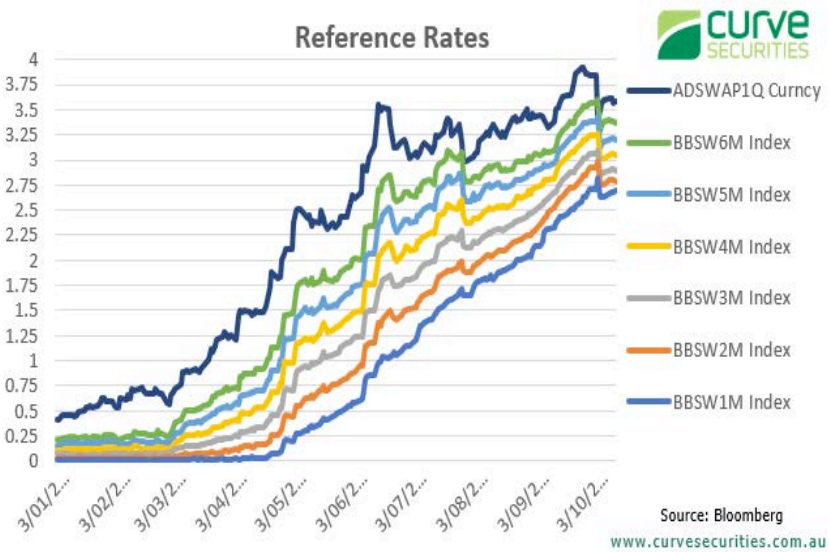
TDs and NCDs

TDs rates have continued to creep up over the past month, but not to the same degree as previous months. Whilst the RBA did hike by 50 basis points in September, markets were expecting this and the increase was priced in. As such, no drastic increase resulted from the hike itself. Rather, the increase came from reference rates continuing to price in future hikes.



This is clearly seen from the steep decrease in term deposit rates in early October, as the RBA increased the cash rate by 0.25%, whereas the market was expecting 0.50%.

In the back end of the curve, term deposit rates have traded within a channel throughout the month of September. We started the month with 12 month term deposits returning just over 4%. This hit highs of around 4.50% in the middle of the month. Since then, rates have fallen to some degree, but remain well above 4%.



Some BBB rated banks had large funding requirements and offered rates as high as 4.70% for 12 months. Rates to this degree could be expected to be shown on occasion in line with reference rate increases.

NCD Margins have remained stable over the course of the September and have shown on average traded between +30 to +35 for the course of the month. Judo bank have continued to lead the pack and offered +40.

The Australian Economy

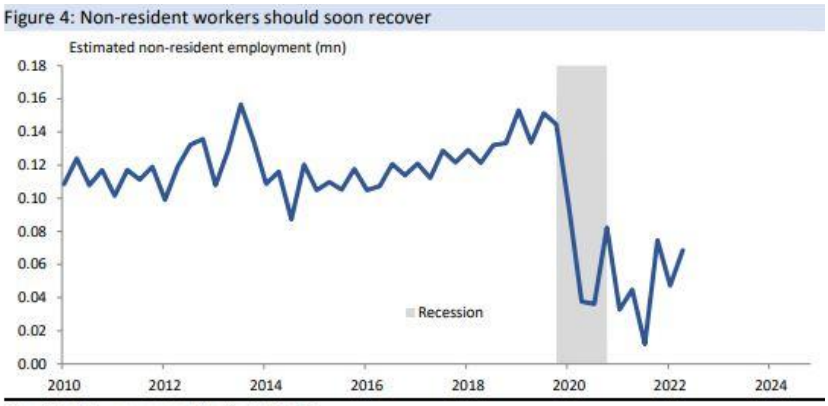
Australian Economy – A Lower Dollar and Return of Immigration

The Australian Economy, like most economies, has shown no real signs of fractures despite slower economic activity. The Australian Dollar is weakening and whilst that may proove difficult for Australians wishing to travel internationally, it will support Australia's backbone of commodities and exports.

Monthly Data

	Period	Value/Index	MoM	YoY
TD-MI Inflation	September	126.51	0.5	5.0
TD-MI Trimmed Mean	September		0.4	5.4
Unemployment Rate (%)	August	3.5	0.1	-1.0
Total Employment ('000)	August	13,592	33.5	570.2
Full Time Employment ('000)	August	9,469	58.8	515.3
Part Time Employment ('000)	August	4,124	-25.3	55.1
ANZ Job Advertisements	September	240,000	-0.5	22.3
NAB Business Confidence	September	4.8	-5.1	11.0
NAB Business Conditions	September	24.7	3.1	10.9
NAB Employment Index	September	15.5	-1.7	7.7
Consumer Confidence	September	83.72	-0.7	-22.5
Retail Sales	August	$34,882	0.6	19.2
Trade Balance ($m)	August	$8,324	-$643	-$4,399
Exports ($m)	August	$56,774	2.6	21.6
Imports ($m)	August	$48,450	4.5	42.6
Housing Finance Ex-Refi ($m)	August	$27,393	-3.4	-12.5
Housing Finance O/O Ex -Refi ($m)	August	$18,539	-2.7	-15.1
Housing Finance Inv Ex-Refi ($m)	August	$8,854	-4.8	-6.4
Building Approvals Total	August	$17,497	28.1	-9.5

The Australian Dollar has fallen rapidly in the last month when the RBA surprised markets with a 25 basis point increase. Due to interest rate parity, the differential in interest rates resulted in the currency falling. Had the RBA carried through with a 50 basis point hike, the curreny would not have experienced the same pressure. However, this does place the economy is an attractive place, with Australian commodities and products appearing cheaper. Following on from the GFC, the Australian economy flourished on the back of a weak dollar. The period is now known as the 'Mining Boom'. Conditions in Australia are appearing very similar. Trade Balance in Australia fell slightly in August, largely due to an unexpected increase in imports. As the dollar falls, this figure is expected to fall with it. Exports increased over the last month and is expected to continue to rise.

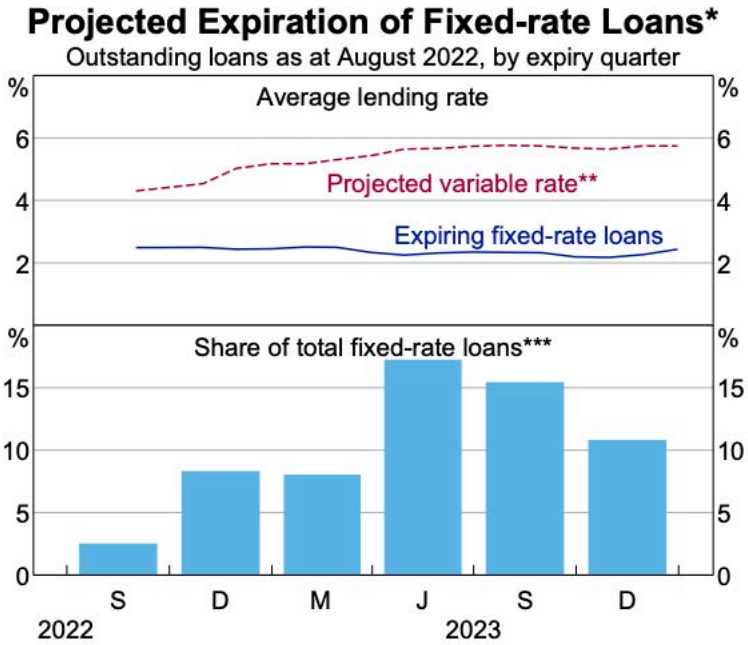


Note: The data were seasonally adjusted by CCI.
Source: Australian Bureau of Statistics, Coolabah Capital Investments

The labour market in Australia remains incredibly tight. The unemployment rate is now at 3.50%, and the trend of workers moving from part time to full time employment persists. One large variable at play is the return of overseas labour to Australia. Currently, there is a record surge of immigration to Australia, at a rate higher than pre-pandemic levels. In fact, the effect of immigration in Australia is so large that the population has grown by 1% since last year.

Currently, Australia had been facing employment shortages in the hospitality, tourism and construction industry. Overseas labour will ease this pain. The outcome of that is that less pressure will be placed on wages growth, as employers can more readily find workers. Flow on effects will be felt by the RBA, who are closely watching inflation and wages growth to determine the appropriate level of monetary policy intervention.

The consumer continues to spend, with retail sales increasing by 0.60% for the month of August. Although, this figure is measured in nominal, dollar terms. Given the level of inflation within the economy, the increase could be as a result of price increases. This is despite consumer confidence continuing to fall to considerable lows. That being said, business conditions remain elevated, as consumers continue to buy goods and price increases are still being well received. Business confidence fell for the month of September, but remains above long term averages. The largest factor which will affect consumers is the repricing of fixed rate mortgages in middle to back end to 2023. When mortgages start to reprice, households in Australia will be stunned by the rapid depletion of disposable income. Perhaps consumers will have the foresight to limit their spending between now and then.



* Assumes fixed-rate loans are not repaid early or refinanced.

** Based on OIS market path for the cash rate as at 4 October and assuming full pass through to variable mortgage rates.

*** Another 38 per cent of fixed-rate loans will expire in 2024 and beyond.

Sources: Bloomberg; RBA; Securitisation System

Overall, the Australian economy is faring well, and the path ahead looks … uncertain. There are so many global factors at play which could positively or negatively impact the Australian economy. The war in Ukraine could heavily disrupt commodity markets, oil prices and natural gas prices which could support the economy. On the other hand, the U.S. and European economy are suffering from more significant wages growth and inflation pressures along with social unrest. The way forward for Australia is very unclear.

Nicholas Allan – Senior Associate, Money Markets

This document is intended to provide you with general information only. It does not take into account your investment objectives, financial situation or particular needs. Before acting on this information, you need to consider the appropriateness of the information in lieu of your investment objectives, financial situation or needs.