QUEENSLAND TREASURY CORPORATION

WHAT IS THE OUTLOOK FOR BONDS?

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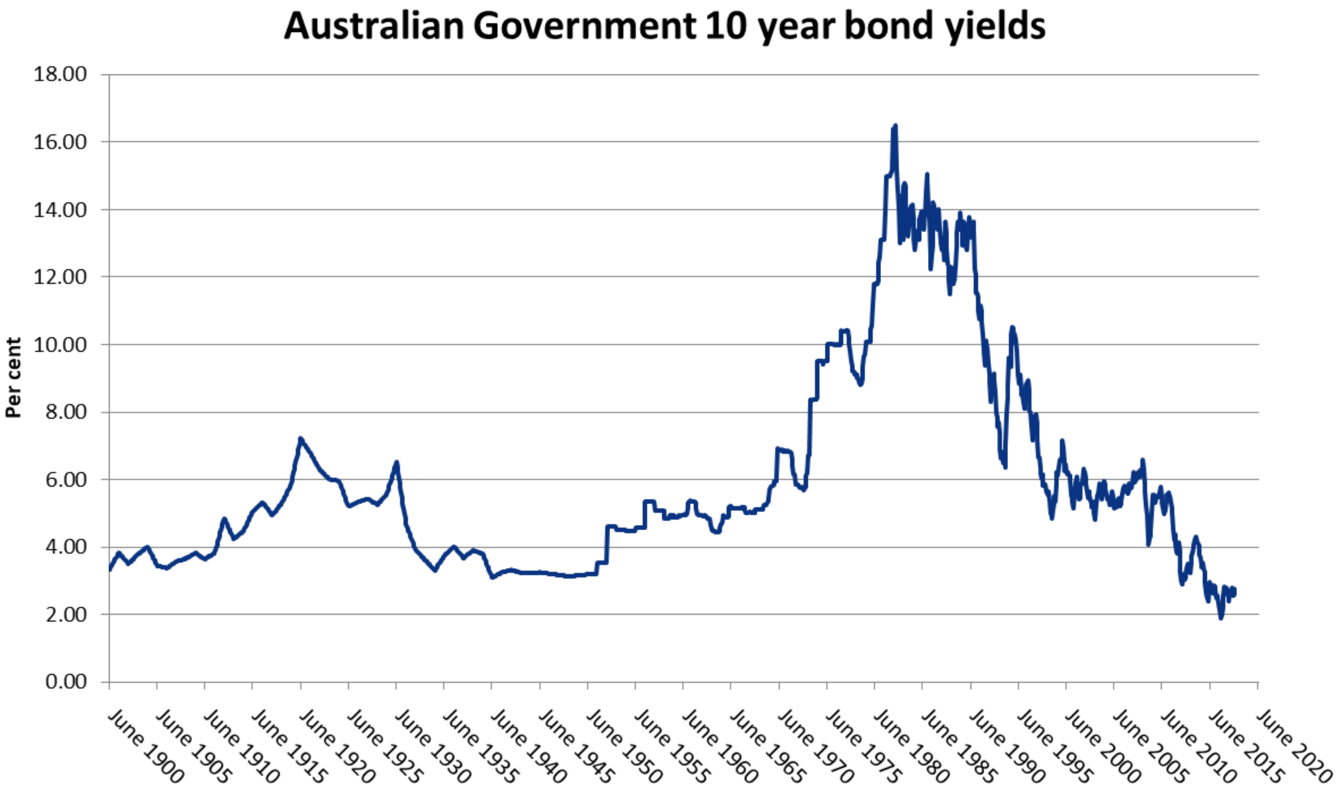
What is the outlook for bonds?

Yields close to record lows



- Australian Government 10 year bond yields are low…very low in fact.
- This chart goes all the way back to 1900 and shows that yields are now very close to the lowest seen over that entire period.

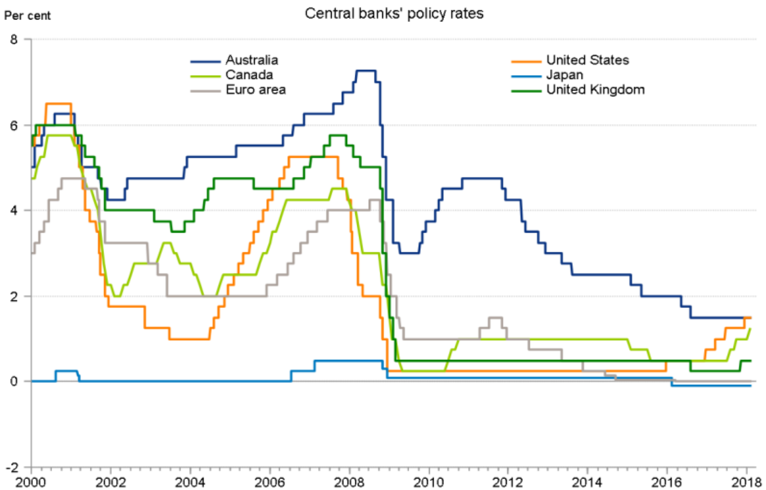
Source: QTC, Bloomberg, RBA.

What is the outlook for bonds?

Why might any move higher in yields be modest in size and gradual in pace

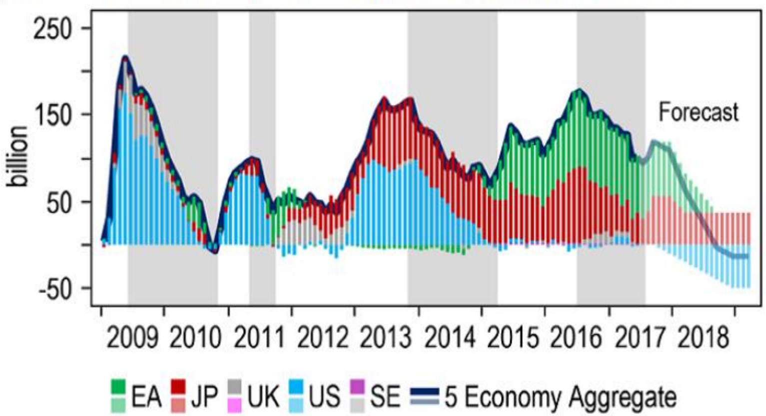
- The possibility that global growth might slow a touch from its current brisk pace and inflation remains modest.
- Continued political and geopolitical risks.
- Both the ‘equilibrium’ short-term interest rate in the economy and the compensation that investors get paid for holding longer-term bonds remains low.

What is the outlook for bonds?
Global central banks normalising policy



Source: QTC. This chart has been created in Thomson Reuters Datastream.

Figure 1. Selected Countries – Net Central Bank Asset Purchases (US$ bn), 2009-19F



Note: 3m rolling sum of change in domestic currency securities holdings expressed in USD at market exchange rates. EA: euro area, SE: Sweden. Citi forecasts Source: Haver and Citi Research

Global central banks have started normalising monetary policy settings, whether this be via interest rates or moderation of QE, due to:

- Better activity data
- Output gaps closed
- Full employment reached
- Downside risks abated
- Inflation steady
- Financial stability risks building due to easy policy

Sources: Citi, QTC.

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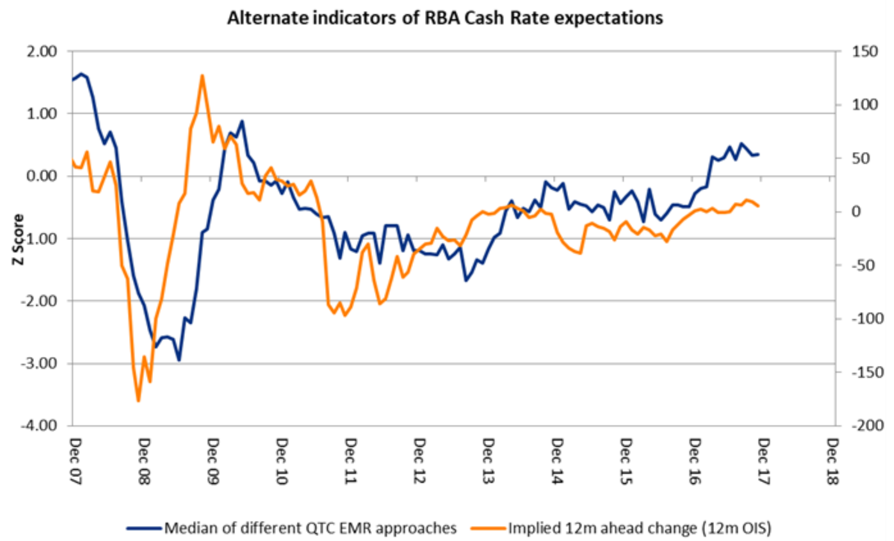
What is the outlook for bonds?

The RBA normalising policy?

Qualitative analysis

Why have easing bias?	Why be neutral?	Why have tightening bias?	Why hike?
N/a	Labour market momentum might fade	Labour markets strengthening	Better global backdrop
N/a	Property market is rolling over	Outlook for non-mining business investment better	Business conditions and confidence strong
N/a	Mining investment fall-away almost complete	Public infrastructure spending supportive	Want to remove high degree of policy accommodation
N/a	High debt and real wages weigh on consumption	N/a	N/a
N/a	Economy won't cope with hikes (high debt)	N/a	N/a
N/a	Unclear how fast wages and inflation will pick-up	N/a	N/a

Quantitative analysis

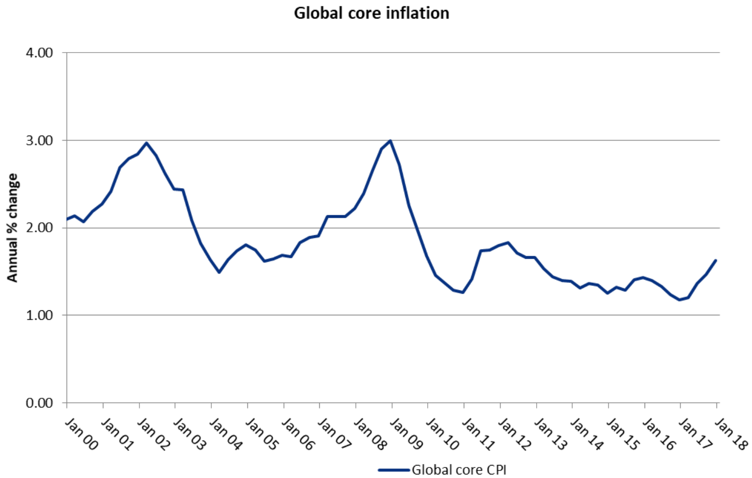


- Could the RBA follow global central banks and start hiking?
- While a series of quantitative tools employed by QTC's Economic and Market Research team suggest an increasing likelihood of higher rates, this conclusion is not replicated by a qualitative assessment of things.
- In any case it's hard to see anything before the end of this year, could even be quite a deal later.

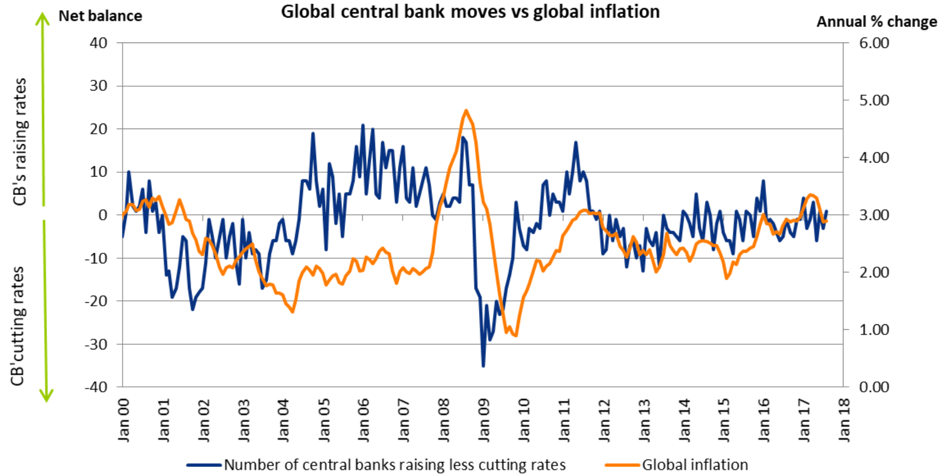
Source: QTC. This chart has been created in Thomson Reuters Datastream.

What is the outlook for bonds?

But how high can yields go…if inflation remains low?



Source: Bloomberg, QTC calculations.



Source: QTC, Bloomberg.

- There are reasons to think that any increase in yields following central bank tightening won't be significant.
- This includes that the likelihood that inflation remains relatively subdued…

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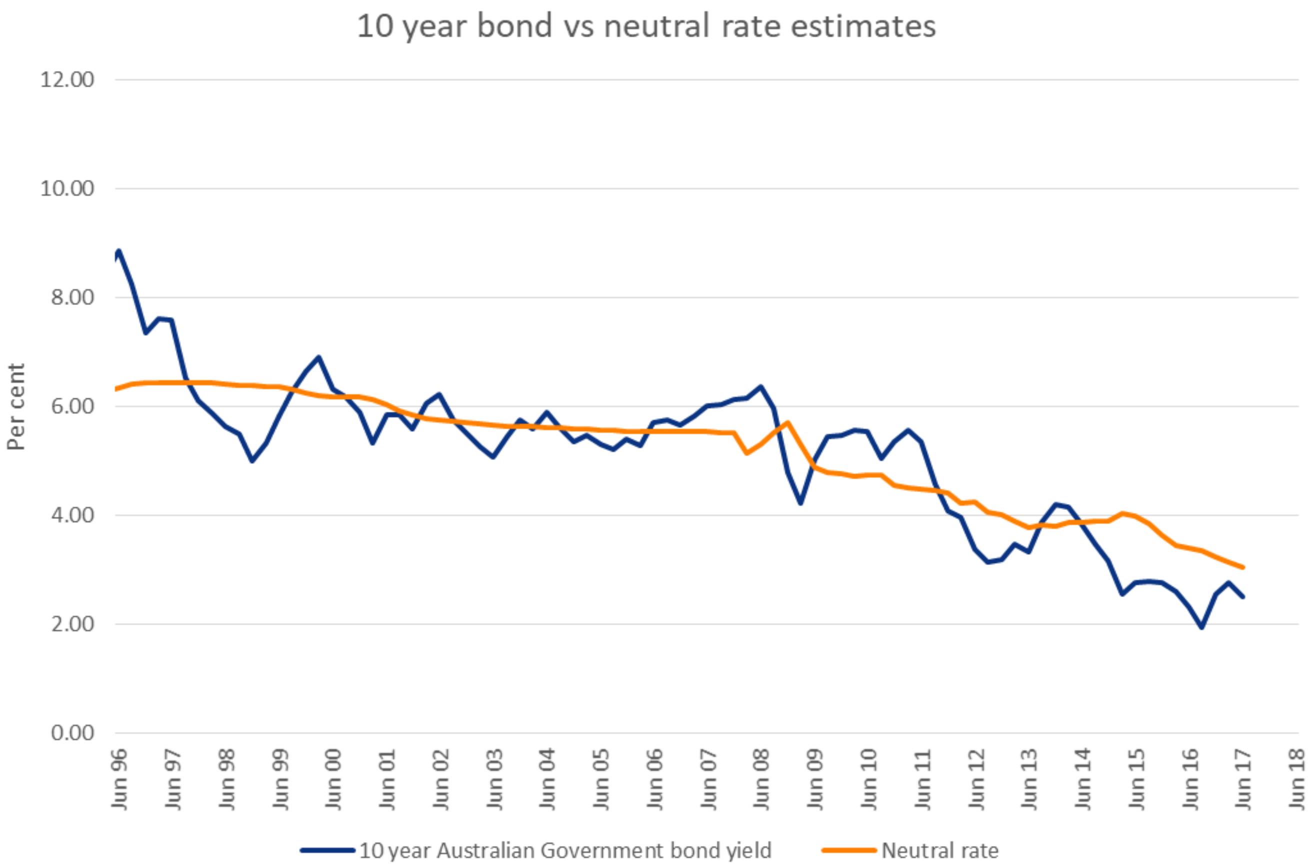
What is the outlook for bonds?

Neutral rates lower so hiking cycles shallow

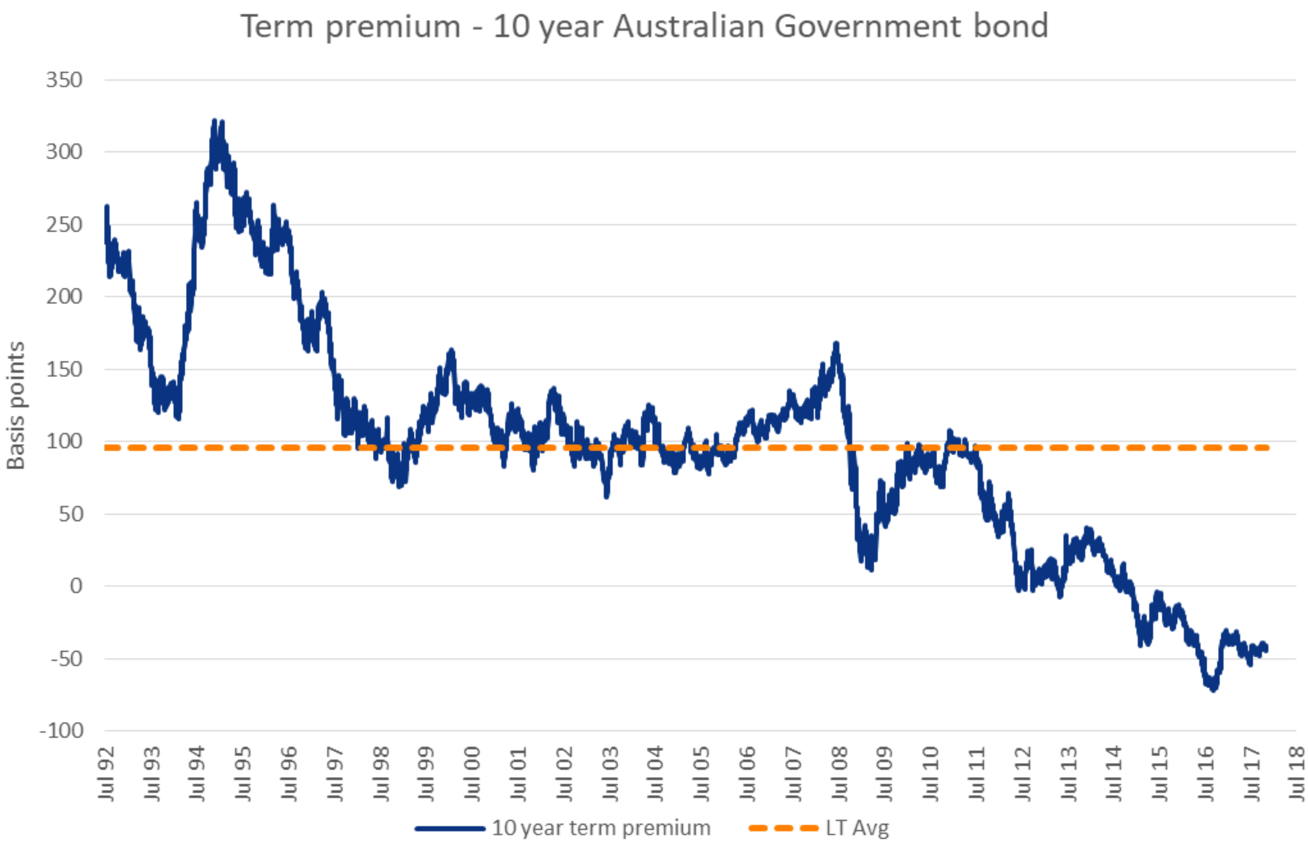


…that the equilibrium short-term interest rate in the economy remains low.

Source: QTC

What is the outlook for bonds?

Term premium to normalise (somewhat)



…and that the compensation that investors get paid for holding longer-term bonds is also low, even if it does increase a touch.

Source: AoFM (BC method).

What is the outlook for bonds?

Qualitatively yields look set to rise modestly, risks skewed to downside

Yields higher (Criticality)	Yields lower (Criticality)
1	1
2	2
3	3
4	4
5	5

Downside Risks (Criticality)	Upside Risks (Criticality))
1	1
2	2
3	3
4	4
5	5

Drivers

Short-term (0-6 months)

Criticality	Yields higher	*Criticality*	Yields lower
1	AU bonds don't offer value this being this close to USTs	1	Data surprise indices have rolled over
1	A$ too high to attract new unhedged buyers		
1	Key technical levels broken in USTs		
1	Easy financial conditions to prompt more aggressive Fed		

Medium-term (6-24 months)

Criticality	Yields higher	*Criticality*	Yields lower
1	Global growth stays strong	1	Aussie property market slows
1	Term premia in Europe still very low	2	China lets economy slow after leadership transition
1	US fiscal position worsening	2	No deal on Brexit
2	Aggregate impact of liquidity withdrawal gains steam	2	US equities roll-over
3	The inflation genie awakens		

Long-term (>24 months)

Criticality	Yields higher	*Criticality*	Yields lower
1	Higher productivity to lift potential growth and yields	1	Deleveraging
2	Inflation needs to be brought under control	2	Low potential growth (incl. demographics, productivity)
		3	Maturing economic and credit cycle
		3	Global imbalances (external, fiscal, asset)

Risks

Short-term (0-6 months)

Criticality	Upside Risks	*Criticality*	Downside Risks
3	Inflation rises faster than expected	2	Trade war

Medium-term (6-24 months)

Criticality	Upside Risks	*Criticality*	Downside Risks
2	RBA moves toward rate hikes	3	Geopolitical risks (North Korea)
2	Change to central bank policy frameworks	4	The music stops for global risk assets
4	Inflation really surprises, central banks scramble	4	China financial risks materialise

Long-term (>24 months)

Criticality	Upside Risks	*Criticality*	Downside Risks
3	Questions over US fiscal position	4	Global recession
4	Bond vilgilantes return as debt rises	4	Sovereign debt concerns flare up again
5	Helicopter Money	5	Central Banks lose credibility with markets

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