OVERVIEW

- No substantial change in debt market conditions and activity from last quarter.

- Markets and sentiment continue to be influenced by COVID-19 developments both globally and domestically with conditions improving marginally within the Australian market, but a generally cautious approach taken by borrowers, lenders and investors.

- Given the very low interest rate environment credit investors and ‘chasing yield’ and therefore appetite for sub-investment grade is strong, provided underlying industry fundamentals remain sound.

- With the debt markets and the economy more broadly still relying heavily on various forms of government intervention and stimulus, we are unlikely to understand the longer term implication for the markets until there is more tangible evidence of how things play out early in 2021.

AUSTRALIAN REFERENCE RATES

- Australian Reference Rates remained broadly unchanged during the quarter with a minor steepening of the curve driven by anticipated RBA Official Cash Rate changes pushing down the short-end of the curve.

- The Reserve Bank continues to support low rates to encourage further lending and spending in the economy to counter the economic impact of COVID-19 with a reduction of the cash rate to 0.10% in early November.

- The Australian swap curve edged lower at the shorter dated end of the curve due to continued monetary policy intervention and market sentiment.

- At the longer dated end of the curve, inversion persisted during Q3 2020 with 30-year rates falling remaining below 25-year AUD swap rates.

- Bank Bill Swap (BBSW) rates pushed ~10 bps lower from 6M-12M as the RBA continues to maintain its current monetary policy settings and drive down short-term lending rates.
CREDIT RISK INDICATORS

- The Markit iTraxx Australia Credit Default Swap (CDS) Index continued to track lower in Q3 2020 after spiking in Q1 2020 at the onset of COVID-19.
- The index closed at ~76 bps, up ~10 bps from 30 September 2019 and down ~11 bps from 30 June 2020.
- However, Australian CDS spreads began to widen towards the end of the quarter as markets began to price in more credit risk with an increasing number of risk factors, including a mixed corporate earnings season and continued state and international border closures.

- Victoria remained in lockdown for a large portion of Q3 2020 with restrictions continuing to impact the economy and corporate profitability.
- This coincided with news of revised government stimulus programs and the Federal Budget which was delivered by Treasurer Josh Frydenberg subsequent to quarter-end on 6 October.
- The KPMG Economics team led by Chief Economist Brendan Rynne has provided detailed commentary and analysis of the Federal Budget [here](#).

![Australia 5Y CDS Spread](#)

**Source:** Bloomberg (November 2020)

GOVERNMENT BONDS

- The Australian 10-year Treasury yield pushed lower towards the end of the quarter and fell below 0.80% p.a. for the first time since March.

![Australia 10Y Treasury Yield](#)

**Source:** Bloomberg (November 2020)

- The strong Treasury issuance continued in Q3 with the Australian Office of Financial Management issuing a further ~$116 billion via syndication or tender during Q3 2020.
- The weighted average yield and tenor of 2020 issuance has declined sharply due to targeted fiscal policy due to COVID-19.

![Australian Government Bond Issuance](#)

**Source:** AOFM (October 2020)
RBA POLICY RESPONSES

As part of its November meeting, the RBA announced a reduction in the cash rate, the three-year government bond yield target and the interest rate under the Term Funding Facility to 0.10%.

The RBA has also announced that it would purchase longer tenor government and semi-government bonds totalling $100 billion over the next 6 months to provide further stimulus and liquidity.

The asset purchase program or “quantitative easing” policy forms a key part of the RBA’s COVID-19 response and the central bank has significantly increased its government bond purchases in 2020.

Q3 2020 saw further government bond purchases as part of the targeted monetary policy to reduce effective interest rates and encourage lending and borrowing across the economy.

Exchange Settlement Account (ESA) balances have been dramatically increased during 2020 to provide additional liquidity to mitigate COVID-19 impacts.

That trend has persisted in Q3 2020 with an average ESA balance of $67 billion throughout 2020 compared to a maximum of ~$30 billion throughout 2019.

The RBA has publicly confirmed they are still prepared to scale-up its bond purchases and will do whatever is necessary to ensure bond markets remain functional and the target yield on 3-year Australian Government Bonds is met.

The RBA has gradually eased its daily bond purchases during the quarter, following commencement of its target yield policy in March.

Take-up of the RBA’s Term Funding Facility ramped up during Q3 2020 before levelling off towards the end of the quarter as volatility subsided in credit markets.

Lenders to both small and medium enterprise (SME) and large businesses have drawdown from the RBA facility, but stronger conditions and access to capital markets saw reduced drawdown from larger businesses in September.
SYNDICATED LOANS

Notable Q3 2020 Australian Syndicated Loan Issuance

### Syndicated Loan Volume

- There was increased M&A and LBO-based lending as stronger competitors emerged with tactical buyout opportunities in Q3.
- Scentre Group (A/A2) led the way after securing $3.4 billion in additional liquidity to weather the COVID-19 impact.

#### Australian Syndicated Loan Volume

<table>
<thead>
<tr>
<th>Amount (Ash)</th>
<th>Margin (bps)</th>
</tr>
</thead>
<tbody>
<tr>
<td>3,400</td>
<td>2.0</td>
</tr>
<tr>
<td>2,000</td>
<td>2.0</td>
</tr>
<tr>
<td>1,826</td>
<td>6.0</td>
</tr>
<tr>
<td>1,102</td>
<td>n/a</td>
</tr>
<tr>
<td>780</td>
<td>2.4</td>
</tr>
<tr>
<td>100</td>
<td>1.5</td>
</tr>
<tr>
<td>880</td>
<td>2.0</td>
</tr>
<tr>
<td>243</td>
<td>5.0</td>
</tr>
<tr>
<td>46.7</td>
<td>5.0</td>
</tr>
</tbody>
</table>

Source: LoanConnector (October 2020)

#### Australian Syndicated Loan Issuance

- Australian syndicated loan volumes fell sharply in Q3 2020 due to lack of need for refinancing after a strong uptick last quarter.
- Subdued activity saw LTM deal count edge lower to 195 while LTM volume was also down from Q2 2020 levels.

### CORPORATE BOND ISSUANCE

Notable Q3 2020 Australian Corporate Bond Issuance

- Australian dollar-denominated corporate bond issuances was subdued compared to Q2 2020 as the activity from refinancing and securing of additional liquidity subsided with relatively fewer corporates tapping into bond markets.
- Australian Corporate BBB spreads continued to track lower as sentiment over the economy continued to improve throughout Q3 2020 with easing of COVID-19 restrictions in many parts of the country and continued stimulus.

#### A$ Corporate Bond Issuance

<table>
<thead>
<tr>
<th>Amount (A$bn)</th>
<th>Margin (bps)</th>
</tr>
</thead>
<tbody>
<tr>
<td>225</td>
<td>6.0</td>
</tr>
<tr>
<td>250</td>
<td>3.5</td>
</tr>
<tr>
<td>750</td>
<td>6.5</td>
</tr>
<tr>
<td>150</td>
<td>5.0</td>
</tr>
<tr>
<td>300</td>
<td>10.0</td>
</tr>
<tr>
<td>600</td>
<td>10.0</td>
</tr>
<tr>
<td>360</td>
<td>8.0</td>
</tr>
<tr>
<td>600</td>
<td>10.0</td>
</tr>
<tr>
<td>300</td>
<td>6.1</td>
</tr>
</tbody>
</table>

Source: Bloomberg, Thomson Reuters (October 2020)
Many listed companies posted large profits in the August reporting season as a divergent economy emerged between industries heavily impacted by COVID-19 (i.e. aviation, hospitality) and others that have even benefitted (i.e. online retail, fintech).

Investment grade corporate bond spreads reflected improved confidence in corporate credit risk but an inversion between 7-year and 10-year BBB spreads persisted during the quarter.

Q2 2020 saw the inversion of the 10-year BBB credit margin below the shorter-dated, 7-year BBB corporate bond spread.

There are number of potential influencing factors including investor demand for longer-dated investments in a low-yield environment, high-quality issuers being able to issue more at the 10-year tenor and a relaxation of collateral credit quality requirements for repurchase agreements by the RBA.

The 7-10 inversion has persisted in Q3 2020 but converged to within ~10 bps by the end of the quarter.

MARKET COMMENTARY / OUTLOOK

The continued escalation in the outbreak of COVID-19 around the globe and the onset of further waves of infections presents itself as the primary threat to both global and domestic economic growth.

One of the major ongoing challenges facing governments, capital markets and borrowers is the unknown scale and long term economic impact resulting from COVID-19 and what will be the ‘new normal’.

Despite this uncertainty, debt capital markets remain liquid and functioning. This is underpinned by substantial Government policy stimulus measures, which we expect to continue to play a significant role in the short to medium term until the economic effects from COVID-19 have plateaued.

The Reserve Bank has communicated over recent months that it would not increase the cash rate target until economic conditions improve and inflation is sustainably within the target range of 2% - 3% p.a. Based on its current outlook for the economy and its recent expansionary policy package announcement, this is still some years away. The RBA has noted it does not expect the cash rate to be increased for at least the next 3 years.

We expect financiers to continue to approach lending opportunities with a heightened degree of caution, however, we also expect banks to selectively grow balance sheets to defend and grow market share.

The Australian debt market is now far more diversified given the increased penetration of international banks and the range of non-bank lenders active in the market across the credit spectrum.

This landscape will present some interesting dynamics for borrowers and lenders. We expect non-bank lenders to grow their share of the Australian lending market going forward.

As we wrote last quarter, it is no longer a borrower’s market and ‘liquidity remains king’, despite a continued modest improvement in market conditions during the quarter. However, borrowers that position themselves to have access to a range of funding options, have a well-developed funding plan, and have engaged in robust contingency planning will still achieve good funding outcomes.
Our Global Debt Advisory offices
KPMG’s Global Debt Advisory team of over 120 professionals helps our clients achieve optimal financing outcomes across the entire spectrum of debt products.

Our local team

Scott Mesley
Partner
Head of Debt Advisory, Australia
Melbourne
P: +61 3 9288 6748
E: smesley@kpmg.com.au

Conrad Hall
Partner, Debt Advisory
Brisbane
P: +61 7 3434 9105
E: conradhall@kpmg.com.au

The information contained in this document is of a general nature and is not intended to address the objectives, financial situation or needs of any particular individual or entity. It is provided for information purposes only and does not constitute, nor should it be regarded in any manner whatsoever, as advice and is not intended to influence a person in making a decision, including, if applicable, in relation to any financial product or an interest in a financial product. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

To the extent permissible by law, KPMG and its associated entities shall not be liable for any errors, omissions, defects or misrepresentations in the information or for any loss or damage suffered by persons who use or rely on such information (including for reasons of negligence, negligent misstatement or otherwise).

© 2020 KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved. The KPMG name and logo and are registered trademarks or trademarks of KPMG International. Liability limited by a scheme approved under Professional Standards Legislation.