JUNE QUARTER 2022 Newsletter

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Financial Solutions for the Benefit of All Western Australians

WESTERN AUSTRALIAN

From the Acting CEO's Desk



As with the start of 2022, this quarter has continued to serve up some challenges globally. Commodity prices are still being impacted by the Russian-Ukrainian war and lockdowns across major Chinese cities have put additional pressures on global supply chains. Despite this, there are signs that overall economic growth across the advanced economies remains solid, but management of inflation continues to be the headline topic on the global agenda.

Domestically, during the quarter the RBA increased the cash rate target by 75 basis points to 0.85%, and the interest rate on the Exchange Settlement balances also by 75 basis points to 0.75%, culminating in the largest cash rate hike in 20 years.

Despite these pressures, Western Australia's economy continues to grow strongly, with domestic economic activity estimated to expand at the fastest rate in a decade in 2021-22, as outlined in the <u>Western Australia State Budget 2022-23</u>, released by Hon Mark McGowan, Premier and Treasurer of WA on 12 May 2022.

Additionally, S&P Global Ratings raised Western Australia's credit rating to AAA this week, further highlighting the State's strong budgetary performance. This positive message will be high on the agenda for WATC Chief Executive Officer, Kaylene Gulich, who is currently travelling Europe this month to meet with international investors. The WATC financial markets team have also been busy with a series of domestic investor events this quarter to coincide with the release of the State Budget. With the COVID-19 pandemic putting a dampener on travel in recent times, it's great to see inperson investor meetings back on the WATC agenda.

As our Local Government clients may be aware, at WATC we have been preparing to launch our updated Local Government Lending Framework. Following a comprehensive review, changes are being implemented to ensure responsible and sustainable lending practices continue in this sector well into the future. The updates take effect on 1 July 2022, and to assist our clients, a series of resources have been developed that are now available on our client portal. For more information, refer to the <u>dedicated article</u> in this edition of our newsletter.

In addition, WATC also ran a *Financing Large Scale Investments* program for clients and staff, in collaboration with Macquarie University. This training has proved popular in recent years, with the session held in June marking the third time in as many years that WATC has run this event.

June also brought the 37th Annual W.S. Lonnie Awards, an event that recognises excellence and accountability in public sector annual reporting. WATC's 2021 Annual Report was among a host of publications from government entities around Western Australia that were considered by the judging panel. WATC were winners of the Silver Award for Category 4 - Government Trading Enterprises on the day, a considerable team achievement.

Sadly next quarter we say farewell to Steve Luff, WATC's Chief Financial Officer. With more than three decades of service at WATC, Steve has had a significant impact on our culture and operations and leaves behind a standard of excellence we can all hope to aspire to. The W.S. Lonnie Awards win seems a particularly fitting way for Steve's legacy to be celebrated and a great foundation for new team members at WATC to build on.

Regards,

Steve Morhall Acting CEO

Stagflation?

'Unexpectedly high inflation, wars in key commodity-producing regions, declining real wages, slowing economic growth, fears of tightening monetary policy and turbulence in share markets - we see all of these things in today's world economy'. Martin Wolf, June 2022

The Global Economy

Economic growth remains solid across the advanced economies but the outlook has deteriorated significantly in the past few months and inflation risks rose further.

In the US, headline GDP growth was negative in Q1, yet the details were stronger. The monthly indicators suggest somewhat slower, albeit still solid, growth in manufacturing and services. This comes despite dismal consumer sentiment and ongoing supply disruptions. The unemployment rate has fallen back to pre-COVID levels, although labour force participation remains depressed and US employment is yet to fully recover its pre-COVID peak.

Inflation pressures are elevated across the advanced economies, additionally propped up by elevated prices of oil, gas, coal and cereals due to the war in Ukraine and its spillovers. The lockdowns across the major Chinese cities have put additional pressure on already strained supply chains, translating into higher costs for business. The annual rate of US CPI inflation established a new over 40-year high in May, while PPI inflation also remains elevated. Higher inflation, along with the increase in interest rates, and elevated geopolitical risks, have translated into a deterioration in the global economic outlook and sparked speculation of a return to stagflation similar to that seen in 1970s. All the major international institutions have reduced their 2022 economic growth forecasts, yet global growth is still expected to remain sound at around 3.0%. The risk of stagflation is limited by the fact that unionisation, wage indexation and reliance on fossil fuels are all lower than in the 1970s. The rise in energy and food prices is particularly problematic for developing countries.

China has been adversely affected by the zero-COVID policy, with the economy facing its most challenging period since the Wuhan outbreak in 2020. The economic data improved as restrictions were eased in May. The government maintains its policy of introducing targeted restrictions if needed, but is also rolling out an infrastructure spending program to stimulate the economy and achieve the 2022 growth target of 5.5%.

The Australian Economy

Australian economic conditions remain sound. Q1 GDP growth of 0.8% was slightly stronger than expected, driven mainly by government spending, household consumption and inventory restocking. Early indicators of household spending in Q2, including retail sales, suggest consumer spending remained solid. However, at least part of the increase in spending has likely been the result of higher prices.

CPI inflation rose to 5.1% in Q1, the highest level since the introduction of the goods and services tax and significantly above the 2-3% target band. The RBA's preferred measure of underlying inflation, the trimmed mean, reached 3.7%. The RBA expects inflation to climb to 7.0% this year, before easing in mid-2023 due to base effects.

Employment and hours worked remained strong, while the unemployment rate hit a nearly 50-year low of 3.9%.

High inflation and rising interest rates have driven the consumer confidence index to the lowest level since 2020. Business conditions remain buoyant. However, elevated costs are weighing on business confidence, which has fallen from elevated levels to just above its long-term average.

Aggregate wage growth remains subdued in Australia, with the wage price index picking up by just 2.4% YoY in Q1. However, the RBA's liaison and the business surveys labour cost growth is picking up steam, which will be further strengthened by a 5.2% hike in the minimum wage.

The Western Australian Economy

Western Australian economic conditions remain favourable. Real state final demand rose by 2.2% in Q1, driven by strong investment growth. Real state final demand was 9.3% higher in Q1 than it was in Q4 2019, the last quarter not impacted by the pandemic.

Western Australia continues to lead the other states in terms of labour market performance, with strong employment growth driving the unemployment rate down to 3.1% in May, the lowest of all the states.

Treasury WA are forecasting real GSP growth of 2.0% in 2022-23, driven by strong 4.0% growth in real state final demand. Merchandise export volumes are expected to rise 1.0% from what is already a record level. However, this will be more than offset by rising imports due to the strong domestic economy and reopening of the border.

OECD GDP Growth Forecasts for 2022



Source: OECD

OECD CPI Inflation Forecasts for 2022



Source: OECD



Source: Refinitiv

10-year Government Bond Yields



AUD Closing Rates



Financial Markets

Trade on financial markets has remained volatile in Q2, as the central bank tightening cycle moved into full swing.

The FOMC increased the fed funds rate target range by 125bps to 1.50-1.75% in Q2, including a 75bps hike at its June meeting. This was in line with market expectations as the US central bank moved to rein in inflation, which hit 40-year highs in the quarter.

The median expectation among FOMC participants is for the fed funds rate to rise to 3.4% by the end of this year, in line with market expectations.

The Fed has also begun to gradually reduce the size of its balance sheet in May, initially by US\$47.5b a month.

The Fed is by far the most hawkish major central bank, which is reflected in appreciation of the US dollar to the highest levels in two decades. However, almost all the advanced economy central banks have begun increasing interest rates and even the European Central Bank has said it will start hiking in July. The Bank of Japan remains an outlier and is the only advanced economy central bank left in the dovish camp.

The RBA, which had been in the dovish camp, has quickly shifted to an aggressive tightening cycle after being faced with a large inflation surprise for Q1. The Bank raised interest rates by 25bps in May and 50bps in June, to take the cash rate to 0.85%. RBA Governor Philip Lowe has said that he expects the cash rate to get to 2.50% at some point, but the speed will be determined by events. With the RBA expecting inflation to reach 7.0% in the second half of the year, markets are pricing in the cash rate at slightly above 3.00% by the end of 2022 and 3.75% by the middle of 2023. However, with the highly indebted household sector heavily exposed to rises in interest rates, the RBA faces a delicate balancing act.

The RBA announced that it will not reinvest the proceeds from maturing bonds it purchased under its bond buying programs. The process, and the maturity of term funding facility loans to Aussie banks will see a reduction in surplus exchange settlement balances (currently A\$397b), with particularly sharp reductions in 2023 and 2024.

Central bank tightening and elevated inflation have driven government bond yields to multi-year highs with the 10-year Commonwealth bond yield climbing from 2.84% at the end of Q1 to 4.19% in mid-June, before falling back to 3.66% at the end of the quarter. Tightening and concerns over the impact on the global economy have sparked a selloff in global equities. The ASX 200 fell 12.4% over the quarter, to be 10.2% down for the financial year 2021-22.

The Australian dollar has weakened against the US dollar and in trade weighted terms over the course of Q2, as the positive impact of high commodity prices were offset somewhat by the volatility on financial markets.

Commodity prices were high and, in many cases, rising in Q2. The CRB index picked up by another 1.4% in Q2, which followed a 27% surge in Q1. Brent crude rose by 6.9%, to be hovering near the highest levels in a decade. Prices for gas, coal or wheat have hit fresh record highs. Iron ore prices remained elevated, despite a decline in the quarter amid concerns over the Chinese slowdown.



Craig McGuinness CHIEF ECONOMIST



Patrycja Beniak ECONOMIST



Update to the WA Government ESG Information Pack

On 31 May WATC coordinated the release of an update to the WA Government ESG Information Pack, *Supporting Continuous Improvement in ESG Outcomes for Western Australia*, launched by WA Premier Mark McGowan in November 2021.

The update was simultaneously made available through the <u>Department of Treasury website</u> and the <u>Sustainability Page</u> on the WATC website, and shared with investors via:

- A personal email from WATC CEO Kaylene Gulich to current and former investors in WA Government Debt Securities.
- WATC's 11 panel bank members that act as market intermediaries for the sale of WA Government Debt Securities to distribute to their broad investor networks and through their regular ESG market updates.

All communications emphasised that the inaugural ESG Information Pack remains relevant, with the update developed to inform investors of key ESG initiatives progressed by the WA Government since its release, including through the 2022-23 State Budget.

A number of agencies contributed to the update, although content was kept concise and focused more on climate change related initiatives. A key component was also to update investors on:

• Development of the WA Government's Climate Risk Framework to establish State agencies' capacity to provide disclosures on the implications of climate change on the State's finances – noting that an interim climate risk management guide to build State agencies' capability was delivered in February 2022. Progress on WATC's development of a Sustainability Bond Framework that will provide a vehicle to finance initiatives meeting internationally recognised green and social bond standards to complement the WA Government's concerted efforts towards improving ESG outcomes for the State.

On the latter, WATC is currently establishing the necessary governance protocols, including identifying eligible projects across government that could underpin an initial bond issuance during 2023. This could potentially include projects related to the implementation of the WA Government's Climate Policy, such as:

Clean transportation

- METRONET: \$9 billion investment in electrified rail network.
- Electric Vehicle Strategy: \$80 million for electric vehicle rebates and charging infrastructure.

Clean energy initiatives

- Clean Energy Future Fund: \$19 million to provide grants to industry for innovative projects.
- Renewable Hydrogen Strategy: \$118 million for supporting infrastructure and \$15 million to the Renewable Hydrogen Fund to provide grants to industry.
- Renewables based standalone power stations: \$203 million for 1,000 units by 2025.
- Synergy's 100 megawatt big battery: \$155 million.

Carbon capture

• State's softwood plantation estate: \$350 million to expand the plantation which could facilitate over 50 million trees being planted across at least 33,000 hectares.



Want to find out more?

Please contact Richard McKenzie, Head of Strategy for more information. Call (08) 9235 9127 or email mckenzie@watc.wa.gov.au.



Richard McKenzie HEAD OF STRATEGY

2022 Financing Large Scale Investments with Macquarie University

Following on from the success of WATC's *Financing Large Scale Investments* training programs run in collaboration with Macquarie University in 2020 and 2021, another training session was run in June for WATC staff and clients, to meet strong demand.

The program, adapted from a unit of the Macquarie University's Master of Applied Finance, is based around the Infrastructure Property and Resources subject and provides an overview of financing large-scale investments and how this differs from standard corporate finance. Attendees learn about the process, techniques and principles required to structure, value and finance large scale infrastructure and industrial projects, and the different ways project finance allocates risks and responsibilities in complex projects and renders them financeable.

For the June 2022 program, it was great to have Cosmas Kapsanis, Adjunct Fellow, Macquarie University, in Perth to present the program in person for the first time, as COVID-19 related travel restrictions required the 2020 and 2021 programs to be delivered online.

With 59 WATC staff and clients having now completed the program, WATC, as the State's central financial services provider, is looking for other opportunities to deliver training programs that further develop and enhance the understanding of financial risk management across the WA public sector. The benefits of WATC coordinating specialist financial training include the ability to tailor the training to the WA public sector and to deliver the training here in Perth.

Have any training ideas?

Is there is an area of finance that you are interested in getting specialist training in? Do you think it would benefit others in the WA public sector? Please contact Chris Rinsma, WATC Marketing and Communications Manager with your ideas. Email <u>crinsma@watc.wa.gov.au</u>.

2022-23 Western Australian Budget Presentation

The 2022-23 Western Australian State Budget was handed down by Hon Mark McGowan MLA, Premier and Treasurer, on 12 May 2022.

Following the release, the Western Australian Premier and Treasurer, along with Western Australian Under Treasurer, Michael Barnes and WATC CEO, Kaylene Gulich, attended a State Budget Presentation for domestic investors in Sydney. The luncheon event focused on the newly delivered budget, the State economy and its finances.

Travel restrictions from the COVID-19 pandemic have impacted these kinds of events recently, so it was great for investors to attend this presentation in person for the first time in over two years.



Hon Mark McGowan MLA, Premier and Treasurer of Western Australia.

New Local Government Lending Framework

As the primary provider of term debt funding to local governments across the State, WATC supports the financial sustainability of the local government sector and is committed to continuing to lend to local governments in a responsible and sustainable manner.

In support of this commitment, following a comprehensive review, WATC has updated its local government lending framework with a number of changes that take effect from 1 July 2022.

To help our local government clients transition to the new framework, WATC has developed a series of resources to assist clients navigate the changes and provide support in completing a new loan application. These resources, which can be accessed via the <u>Client Portal</u>, include:

- · An online step-by-step demonstration on completing the new loan application form.
- A set of Frequently Asked Questions (FAQs) with associated answers regarding the changes.

We recommend that local government clients take the time to view each of the resources prior to completing the new loan application form (which is also available to download on the Client Portal) which will be required for all new loan applications from 1 July 2022.

WATC will be holding a number of Q&A webinar sessions in the new financial year, where local government clients can register to attend and ask questions.

Have queries on our new lending framework?

Please send them through to <u>lglending@watc.wa.gov.au</u>.



WATC Annual Report a Lonnie Award Winner

WATC was very pleased to receive an award for its 2021 Annual Report at the 37th Annual W.S. Lonnie Awards, held on Friday 24 June. These awards recognise excellence in annual reporting across the Western Australian Public Sector.

The Lonnie Awards are presented by the Institute of Public Administration Australia WA (IPAA WA) and are designed to higlight the importance of Annual Reports being accountable and transparent. All State agencies across Western Australia are eligible for an award and are automatically considered as part of the judging process.

WATC won a silver award in Category 4 – Government Trading Enterprise. WATC Chief Operating Officer, Ross Moulton, received the award from Mr David Robert Michael MLA, Parliamentary Secretary to the Premier; Treasurer; Minister for Public Sector Management; Federal-State Relations; Parliamentary Secretary of the Cabinet.



Mr David Robert Michael MLA (left) and Mr Ross Moulton (right).

New Staff Roles

Thank you to all WATC team members taking on new challenges in 2022.



Mia Cara-Southey

STAFF SECONDMENT

Mia joins WATC on secondment from a previous role in the Department of Treasury. She is currently working as Executive Assistant to WATC CEO, Kaylene Gulich, for a term of six months.

New Appointments



Connor Donohue

I joined WATC as a Risk Analyst at the end of May and am initially assisting the Risk Team with the rollout of the new Local Government policy.

I completed my study in Accounting and since then, I've worked in many roles, mainly in Retail Banking as a Mortgage Lender with NAB, and later as a Leasing and Mortgage Credit Risk Analyst with Macquarie and CBA, before making the move to the Public Sector.

I like to unwind playing piano and after leaving WAAPA, I like to make sure I don't lose my skills! I take part in charity runs when I can and also spend a lot of time with my little puppy Presley and travelling around WA seeking out new breweries.



Divya Gururajan Sumangala

I joined the WATC Risk Team as a Senior Risk Analyst at the beginning of June and am currently working with the Market Risk team. I have a Bachelors in Geology, an MBA in Finance and a Post Graduate Diploma in Data Analytics.

Previously I've worked in the Superannuation industry as an Investment Analyst, specialising in Foreign Exchange and Risk Management for International Equities. I started my career as an Investment Banker in Mumbai and relocated to Australia 9 years ago.

Outside of work I love reading, especially about alternative investment opportunities and new asset allocation principles, and travelling.



Paul Hollamby

I joined the Program Management Office team as a Business Analyst in March.

At the City of Canning I was most recently a Business Systems Analyst involved in the replacement of the Core Enterprise, and was working with business users and vendors to ensure WA statutory compliance.

I am a volunteer in the State Emergency Service and was recently sent as part of an incident management team to help with the flooding in Lismore.



Sophia Abadi

I joined WATC HR Team as an HR Officer in April.

I graduated from Curtin in 2021 with a Bachelors in Psychology and Human Resources Management. While studying I was awarded a New Colombo Plan grant from the Department of Foreign Affairs and Trade to complete an international internship in the Maldives.

I have a background in recruitment and HR consulting and I'm passionate about employment law, diversity and inclusion, and employee relations.

Outside of work I love being involved in community-led action groups that contribute to neighbourhood improvement. When I have free time I'm usually baking gluten-free goodies.



Shannon Yong

I joined the Finance, Administration and Treasury Operations Team at WATC as a Treasury Operations Officer on 1 June.

I completed a Bachelors Degree in commerce at Curtin in 2015 and have been involved in the banking and finance industry ever since.

Previously I was working with Great Southern Bank as a personal banker for 4 years and was part of the rollout of the digital banking app - iM CUA. Great Southern Bank was the first financial institution that onboarded this banking service within Australia.

Outside of work I enjoy playing golf and soccer and am a Manchester United supporter.

Getting in Touch

If you would like more information about a specific article, product or service at WATC, please contact the relevant team member using the details below.

For information on any products or services, please contact:

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WESTERN AUSTRALIAN TREASURY CORPORATION

Western Australian Treasury Corporation (WATC) is the State's central financial services provider, working with its public sector clients to achieve sound financial outcomes.

WATC's principal activities involve:

- funding and debt management
- asset and investment management
- financial advisory services
- financial risk management
- treasury management services and systems.

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