

DECEMBER 2022

From the CEO's Desk



So this newsletter brings us to the end of another fast-paced, challenging and rewarding year at WATC. 2022 saw Western Australia fully wrestle with COVID, as the border re-opening in March correlated with a rapid, but thankfully mostly mild rise in COVID cases. As part of transitioning to living with this endemic disease, we have all remained flexible in when and where we work, and I am really pleased to write that we have continued to deliver our services in a timely way and to our usual high standard.

2022 has also been a challenging year in the international space, with the Russian invasion of Ukraine shaking the geopolitical axis and tripping a number of economic tsunamis that we are still feeling the effects of now through inflation pressures and shocks to fuel and other commodities.

All of this has played out differently at WATC and in the Western Australian economy. The State's economic and fiscal position continues to strengthen against a global backdrop of rising economic stress and an ever-looming shadow of recession in other developed economies.

The Western Australian Government's 2022-23 Mid-year Review Financial Projection Statement was released on 15 December 2022, reflecting the ongoing strength in our State's economy. The domestic economy, as measured by State Final

Demand (SFD), is expected to grow by 4.5% in 2022-23 (up from the 4.0% estimated in the May Budget) while unemployment is forecast to remain at historically low levels at 3.5% (down from the May Budget estimate of 3.75%). Inflation pressures are being experienced across the public sector, with the Perth Consumer Price Index (CPI) forecast now revised up to 5.25%, before moderating at 3.25% in 2023-24.

Reflecting the strength of the State's domestic economy and a lower AUD to USD exchange rate, the revenue outlook has improved, although fluctuations in the iron ore price continues to challenge forecasting. Upside receipts have been largely matched by increased expenditure in priority areas such as salaries and health, and non-parameter areas such as interest expenses, reflecting the ever-changing interest rate environment. This has resulted in a modest increase in the general government operating surplus for 2022-23 from \$1.6 billion (cited in the May Budget) to \$1.8 billion. The State is expected to remain in operating surplus over all years of the forward estimates, and to fund its \$35 billion Asset Investment Program largely from non-debt sources. As a result the WATC borrowing program has been further reduced, with the Government repaying an additional \$400 million in debt.

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This strong fiscal position saw Moody's Rating Agency upwardly revise the outlook for Western Australia's credit rating to Aa1 "positive" in November 2022.

Against this positive domestic backdrop, the growth of the global economy continues to slow, dragged down by rising interest and fuel costs. This is expected to continue into 2023, placing much-needed downward pressure on inflation, but is likely to tip parts of the world into recession. The quarter saw a slowdown in the pace of tightening by central banks, although many, including the Reserve Bank of Australia, have signalled that the monetary policy tightening will continue into next year. Financial markets have started to mirror the slowing expectation for rate hikes, with bond yields trending down over the quarter.

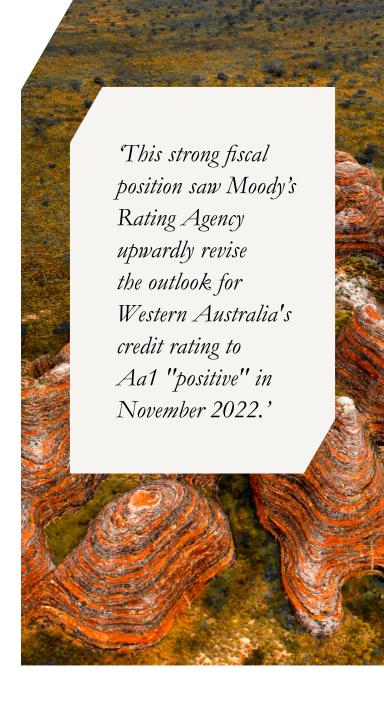
At WATC, work has continued over the quarter on the Sustainable Bond Framework, with our engagement with the State's Portfolio Oversight Group for Climate Action and the Environment (POG) a key input in ensuring whole of government alignment. Additionally our Corporate Treasury Services Team attended the annual Local Government Professionals Australia State Conference and visited regional clients on the ground in Geraldton and Bunbury.

The quarter saw a number of new faces at WATC, as our recruitment effort picked up following some recent retirements. I welcome all of our newcomers and know they look forward to engaging with our stakeholders across their various roles.

On behalf of everyone at WATC I would like to extend our thanks and seasonal best wishes to all of our partners who have worked with us during 2022.

Suh

Kaylene Gulich





Pivot

It makes sense to moderate the pace of our rate increases as we approach the level of restraint that will be sufficient to bring inflation down.'

Fed Chair Jerome Powell, 30 November 2022

The Global Economy

The global economy has lost momentum with growth buffeted by rising interest rates, high inflation and elevated energy costs. The slowdown is expected to continue in 2023, which should help bring inflation down.

US real GDP rose by an annualised 2.9% in Q3, thereby ending the "technical recession" from the first half of the year. The rebound was supported by ongoing solid increases in personal consumption and strong exports, while private

gross fixed capital formation declined amid lower residential investment.

The US labour market remains strong, with non-farm payrolls continuing to post solid increases. Despite a slight increase, the unemployment rate, at just 3.7%, remains close to historical lows.

US inflation is still elevated, though it has come off its 40-year highs. In November, headline CPI inflation dropped to 7.1%, the lowest level since December 2021, while core inflation fell to 6.0% after hitting a 40-year high in September.

European growth has slowed sharply following a solid first half of the year. The euro area narrowly escaped recession in Q3, while UK real GDP fell by 0.2%. The UK is predicted to remain in recession through 2023. Inflation continues to climb in the UK, but there are early signs euro area inflation could be peaking.

The impacts of the zero-COVID policy continue to dent economic growth in China. In Q3, the annual rate of real GDP growth accelerated to 3.9% from just 0.4% in the previous quarter. However, this was followed by a renewed deterioration in activity in October and November, as signalled by activity data and PMIs. Chinese authorities have started to ease some of their COVID measures, however rising infections will likely weigh on output through the winter months.

The Australian Economy

Australian economic conditions remain sound. GDP rose 0.6% in Q3, thanks to resilient household consumption. Business and dwelling investment increased, while public sector investment and net exports made negative contributions.

Retail trade declined slightly in October, but this could have been due to consumers holding back their spending ahead of the Black Friday sales in November.

Following a temporary setback in September, employment saw more strong increases in October and November, driven by full-time jobs. The unemployment rate remained low at 3.4%. The increasing tightness in the labour market has translated into acceleration in the wage price index growth in Q3 to 3.1%, which is the fastest pace since Q1 2013.

The monthly CPI indicator rose by 6.9% over the year to October. This was a deceleration from Q3, when the annual rate of CPI inflation rose to 7.3%, the highest level since Q2 1990. Trimmed mean inflation was at a series record high of 6.1% in Q3.

The ongoing tightening by the RBA has driven a softening in the housing market, with house prices continuing to fall.

The Western Australian Economy

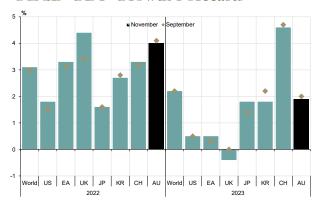
Western Australian gross state product rose by 3.1% in 2021-22, following 3.3% growth in 2020-21. The major contribution to growth came from household consumption, but private investment also saw a solid increase supported by another strong rise in spending on machinery and equipment.

Household consumption was also the major driver of a 0.6% rise in real state final demand in

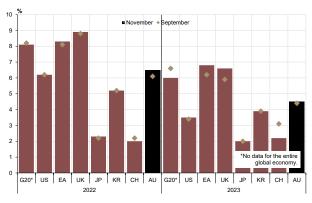
Q3, that took the annual growth rate to 3.3%.

Western Australian labour market conditions remain strong, with an unemployment rate of 3.5%. This was reflected in a 3.8% YoY increase

OECD GDP Growth Forecasts



OECD CPI Inflation Forecasts



Source for all data: OECD

in private sector wages in Q3, which was the strongest annual rise of all states.

The Perth CPI fell by 0.5% in Q3, pushing the annual inflation rate down to 6.0%, the lowest of the eight capital cities. The decline was driven by a 84.5% drop in electricity prices due to the new A\$400 household electricity credit introduced by the Western Australian government.

Financial Markets

Q4 saw some improvement in global market sentiment, as central banks started to signal intentions to, or began to slowdown the pace of their monetary policy tightening.

The US Federal Reserve increased the fed funds rate target range by a further 125bps to 4.25-4.50% in Q4, but slowed the pace of hikes to 50bps in December given the scale of tightening so far and the lags in monetary policy transmission. It also continues to actively shrink its balance sheet.

However, the FOMC revised its fed funds rate projections upwards, with a peak above 5% now expected. Fed Chair Jerome Powell said that interest rate increases will need to continue to bring inflation back to target. However, the markets expect that the fed funds rate target range will peak at 4.75-5.00% in March 2023.

Monetary policy tightening also continues in the

other major advanced economies, with the notable exception of the Bank of Japan. However, interest rate expectations have declined for most central banks, with a slower pace of tightening expected from now on.

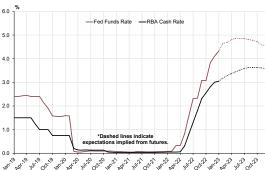
At home, the RBA has increased its cash rate by a cumulative 75bps in Q4, taking the cash rate target to 3.10%, which is the highest level since 2012. RBA Governor Philip Lowe continues to signal further interest rate increases in the months ahead, with the increments being data-dependent. The markets expect the cash rate to peak at 3.75% in Q3 2023, which is markedly lower than the 4.10% expected a couple of months ago.

With expectations for central bank interest rate hikes being downgraded, some tentative signs of easing inflation, and economic growth expected to continue to slow, government bond yields have declined since early November.

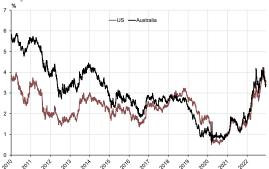
Equity prices have rebounded across most major markets in Q4. However, the trade throughout the quarter was quite choppy, reflecting concerns over mixed signals from the Fed.

Concerns over the growth outlook were reflected in a fall in fossil fuel prices. Brent futures are 5.9% down for the quarter, while coal prices have fallen 6.8%. European gas futures (Dutch TTF) dropped by 20.6% with data showing European storage is over 90% full.

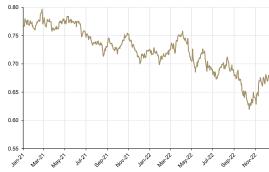
Central Bank Benchmark Rates*



10-year Government Bond Yields



AUD/USD Closing Rates



Source for all data: Refinitiv

Iron ore futures prices are up 13.8% so far in Q4, reflecting optimism about the outlook for the Chinese property sector after the government rolled out a support program for that sector. Since late November, iron ore futures were also supported by hopes of the easing of COVID-19 containment measures in China.

The improved global risk appetite, coupled with a rise in some commodity prices, was supportive of the Australian dollar. The Aussie appreciated against the greenback but depreciated against the euro, Japanese yen and the British pound. The British currency has strengthened markedly against the greenback, as the gilt market turmoil from the turn of Q3 and Q4 eased, following the fiscal austerity measures that were introduced by the new Rishi Sunak government.

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Craig McGuinness CHIEF ECONOMIST



Patrycja Beniak ECONOMIST





WATC's Inaugural Sustainable Finance Issuance Draws Closer

WATC has made significant progress towards launching its first sustainable finance bond issue through the development of a Sustainability Bond Framework (Framework). Establishing a successful sustainable finance program will expand the investor base for Western Australian Government bonds to include those investors seeking exposure to an environmental, social and governance (ESG) labelled issuance.

A sustainable finance program will also support WATC's ongoing debt funding activities by

highlighting to global investors the Western Australian Government's continued efforts towards progressing social and environment objectives that align with the Paris Agreement and UN Sustainable Development Goals.

The foundations for the Framework have been set through the release to global investors of the State's <u>ESG Information Pack</u>, launched by the Premier in November 2021 and the subsequent update following the May 2022 State Budget release.

December Quarter Progress

In mid-November, the draft Framework, which outlines how WATC intends to issue green, social or sustainability (GSS) bonds and their alignment to the environment and social policy objectives of the Western Australian Government, was presented to the State's Portfolio Oversight Group for Climate Action and the Environment (POG). The POG was chosen to provide governance oversight of this initiative with the objectives of:

- ensuring a whole of government 'lens' is applied to the sustainable bond financing program that clearly aligns to government decision making, and
- establishing a conduit for WATC to communicate evolving investor expectations for ESG information to support Western Australian Government financing (i.e. in relation to WATC's entire debt financing program).

The POG provided important feedback on the section of the Framework that outlines the Western Australian Government's overall sustainability strategy – essentially the key deliverables for environmental and social policy that will guide projects to be funded under the Framework.

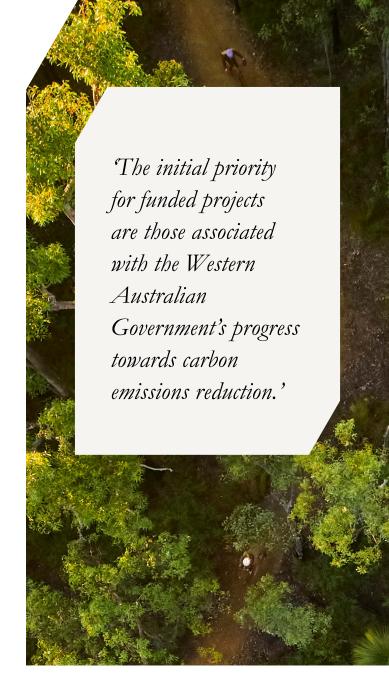
The initial priority for funded projects are those associated with the Western Australian Government's progress towards carbon emissions reduction. This has been significantly enhanced by the Government's recent commitment to phase out State-owned, coal fired electricity generation by 2030 and follows the lead of Metronet, which is targeting emissions reduction in the transport sector.

Importantly, Metronet was a significant first step in delivering <u>Sectoral Emissions Reduction</u> <u>Strategies</u> and demonstrated the Government leadership principle of the Climate Policy. Water assets, including the forthcoming renewable energy powered desalination plant at Alkimos, is likely to also be included, demonstrating an area where the Western Australian Government has been proactive in climate adaptation over a long period of time.

Second Party Opinion

In early November WATC, supported by its joint sustainability finance advisors in ANZ and UBS, appointed Sustainalytics, a global ESG research company, to undertake a Second Party Opinion (SPO) on the Framework.

The SPO independently reviews the alignment of the Framework to the International Capital



Market Association (ICMA) green and social bond principles, to ensure they meet market practice and investor expectations. The SPO will also provide an overview of the Western Australian Government's sustainability strategy, along with a description of how the Framework contributes to its delivery.

The SPO review has been rigorous, covering:

- the proposed Framework governance and bond issuance process
- the ESG credentials of candidate projects compared to ICMA standards, and
- · future intentions for impact reporting.

WATC has been well supported by key State government agencies and its advisors, ANZ and UBS, throughout the SPO review.

The desired outcome at the end of the review is to receive a positive opinion on the Framework's alignment to the ICMA green and social bond principles and confirm that the Framework effectively supports the sustainability objectives of the Western Australian Government. The SPO is heavily relied on by global investors as part of their investment due diligence process, and a positive SPO will enhance the prospect of broad global investor participation in the first sustainable finance issue by WATC.

Next steps

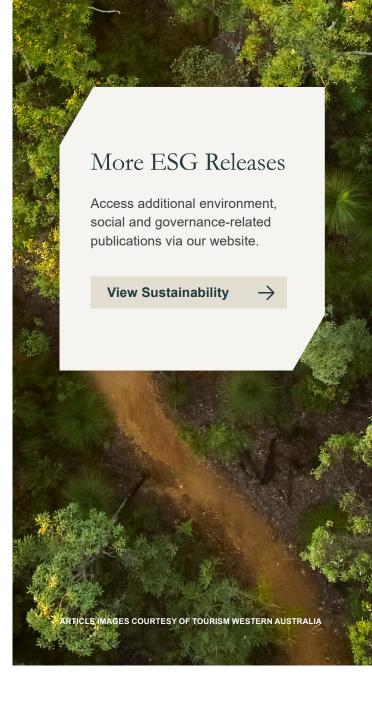
The SPO process should be completed in December. Targeting March 2023, WATC will propose a final project pool to underpin the first bond issuance to the POG and seek final approval from the WATC Board to proceed to issuance. The lead up to the issuance is expected to include a formal release of the Sustainability Bond Framework to the global bond market, and a detailed investor information program. The first issuance under the Framework is expected before the end of the financial year (30 June 2023).

Want to find out more?

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



Richard McKenzie



New Appointments



Chalani De Silva

I work in the Information Technology team and have a degree in Computing from Staffordshire University. I migrated to Australia in 2014 and in 2015 I won an "Expanding Career Options for Women" scholarship from the Department of Training and Workforce Development to pursue a Certificate IV in IT Networking. In 2016 I entered the Cisco NetRiders Asia Pacific and Japan competition and placed Rank 1 (Institutions). I have worked at Department of Fire and Emergency Services, University of Western Australia and the Department of Mines, Industry Regulation and Safety. I am also a mum of two and love spending my time with my family.



John Vojkovich

I am a Chief Advisor (Acting) in the Advisory Services team. I have over 20 years' experience in senior and executive roles across corporate and government sectors, including financial services, manufacturing, agribusiness, health, disability services and the arts. I know many of the WATC team from my previous role as Chief Financial Officer at Keystart Homeloans. I am a Chartered Accountant, Certified Practising Accountant, and Chartered Secretary. I hold a Master of Applied Finance, Graduate Diploma of Applied Corporate Governance and a Bachelor of Commerce. Outside of work I enjoy watching gigs and sport, family time with my two kids, and wondering why DIY projects never run smoothly.

New Appointments



Mark Caldwell

I joined the Finance, Administration and Treasury Operations team in August as the Chief Financial Officer. Most recently I was the Chief Financial Officer at the WA Government Superannuation Fund (GESB). I am a fellow of CPA Australia and the Governance Institute of Australia. I also sit on the Audit and Risk Committees of the Public Sector Commission and Department of Local Government, Sport and Cultural Industries. I have a Masters in Finance and Accounting from the Aberdeen Business School. Outside of work I am a keen golfer (10 handicap) and runner, having completed nearly 50 ultra-marathons to date.



Peter Keung

I am a Corporate Financial Advisor in the Advisory Services team and assist clients with analysis, modelling and the evaluation of capital investment decisions. Prior to joining WATC, I worked in the insurance industry in Hong Kong, with some of the world's leading insurers including Manulife, AIA, Prudential and Chubb. I also have experience in banking operations, including Mortgage Operations with HSBC in Hong Kong and was an early member of UBank, based in Sydney. I hold a Bachelor of Commerce degree, majoring in Actuarial Studies and Finance, from the University of New South Wales (UNSW).



WATC UPDATE

Season's Greetings

On behalf of the team at Western Australian Treasury Corporation, we would like to thank you for your continued support during 2022.

We extend our best wishes to you and your family over the festive season and wish you all the very best for 2023.

Our offices will be closed for the Christmas Day, Boxing Day and New Year's Day public holidays, but will be open as usual on the business days over the Christmas and New Year period.

We look forward to continuing our successful partnership with you next year.

IMAGE COURTESY OF TOURISM WESTERN AUSTRALIA

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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.

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