

About WATC

WATC is the central financial services provider for the Western Australian public sector, and delivers the following efficient and cost-effective services for all government agencies:

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

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Out From Under the Doona

"We need to reduce unemployment, we need to get businesses open, we need to enable Australians to get back to work (...) We can't keep Australia under the doona. We need to be able to move ahead."

Prime Minister Scott Morrison
30 April 2020

THE GLOBAL ECONOMY

The global economy is experiencing the most severe downturn since World War II, resulting from the COVID-19 pandemic and the measures taken to contain it. The sharp slump in activity is likely to be followed by an initial steep bounce. Going forward, however, the return to pre-crisis activity and full employment is likely to be a slow grind.

Q1 GDP numbers for the advanced economies did not capture the full impact of the crisis on growth. However, the monthly activity indicators and business surveys suggest that the global economy has plunged into a deep pit. The Bank of England anticipates that this could be the deepest UK recession since 1706.

The employment numbers across a range of countries have been distorted by various wage subsidies and other business support programs, masking the rapid increase in unemployment.

In the US, where there were no wage subsidies, non-farm payrolls plunged by 22 million over the course of March and April, wiping out nine years of gains, taking the unemployment rate to 14.7 per cent, which is the highest level since World War II. Additionally, in spite of the US economy unexpectedly adding 2.5 million

jobs in May, the unemployment rate remained elevated at 13.3 per cent. These numbers provide an insight into what the labour force numbers might have looked like elsewhere if it were not for the support programs.

In China, where the pandemic struck first, the economy is already in the early stages of recovery following a 9.8 per cent drop in real GDP in the first quarter. The recovery is led by industrial and construction sectors, which have been boosted by government stimulus programs, while several indicators suggest that consumers remain wary.

That wariness was compounded in the second half of June by a fresh COVID-19 outbreak in Beijing, with some containment measures being re-imposed in the city and a nearby county. The re-emergence of the pandemic in the Chinese capital has heightened anxiety over a possible second wave.

THE AUSTRALIAN ECONOMY

In Australia, real GDP contracted by 0.3 per cent in Q1 2020. Given a certain COVID-19 driven slump in the second quarter, the Australian economy is beyond doubt in the first technical recession since 1991.

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From the CEO's Desk



Dear clients and staff

What a roller coaster of a quarter. We started April with financial markets barely functioning, COVID-19 cases still on the rise, with 303 new cases recorded in Australia on 1 April alone, and the curve still on its upward trajectory. Western Australia was in the peak of the social distancing restrictions, and most of the WATC workforce were working from home.

Fast forward to the end of June 2020, and Western Australia is free of any community transmission of the virus, having events with up to 30,000 people in attendance and we are all back in the office. Most importantly for us, financial markets have returned to a degree of normality, and we have been able to raise debt in the scale and tenor required by our clients.

Notwithstanding this positive development, economic conditions remain challenging, with the most

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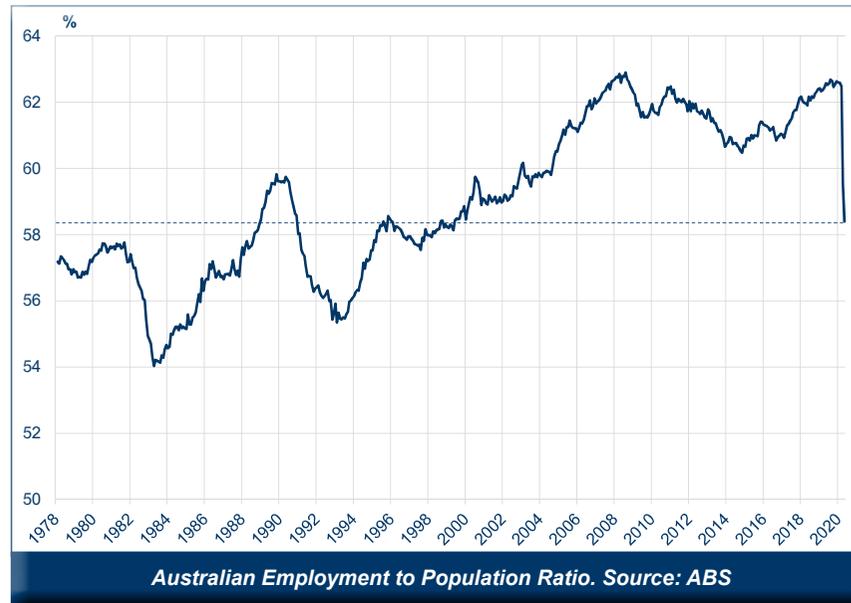
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Several indicators, including record falls in various business indicators and retail sales in April, suggests that the recession has been severe. Thanks to the JobKeeper program, and a drop in the labour force participation, the official unemployment rate has climbed to 'just' 7.1 per cent. However, over the course of April and May, 835k people have lost their jobs. If they had been counted as unemployed, the unemployment rate would have risen to 11.3 per cent. Moreover, 360k people were classified as employed but worked no hours at all during May, taking the shadow unemployment rate to around 14.0 per cent. Another 1.2 million people worked less hours than usual. While the new ABS payrolls and wages report is signalling the labour market is in the early stages of recovery, total wages were still 6.3 per cent lower in the week ending 13 June than on 14 March.

Despite these pretty shocking numbers, the impact of the pandemic on the economy has not been as large as feared, mainly thanks to relatively successful containment of the pandemic in Australia (touch wood). There are some signs of a rebound in economic activity, evident particularly in consumer spending. However, the sustainability of this nascent recovery will depend on how the simultaneous unwinding of the JobKeeper and JobSeeker programs as well as mortgage and rent deferrals are handled later this year. Even if the recovery persists, it is likely to take at least two years for the Australian economic activity to come back to pre-crisis levels.

THE WESTERN AUSTRALIAN ECONOMY

The Western Australian economy was emerging from its long downturn prior to the onset of the pandemic, with real state final demand rising in three of the four quarters leading into the crisis. Ongoing strong demand for Western Australian commodities, the long period of housing market adjustment already undertaken and the relatively quick re-opening of the economy, suggest that WA is best placed of the States for the recovery stage of the crisis.



FINANCIAL MARKETS

Financial markets settled down in Q2 after an extremely volatile Q1, as central banks stepped in to shore up sentiment with huge asset purchases and other market support programs.

The so-called G4 central banks (the US Fed, ECB, Bank of England and Bank of Japan) have pumped almost US\$4 trillion into the global financial system in Q2.

The RBA began its yield curve control policy with a bang late in Q1, signalling its commitment to maintain a 0.25 per cent 3-year Commonwealth government bond yield and the smooth functioning of the bond market with large purchases of Commonwealth and state government bonds. With both those objectives currently being met, the RBA has stayed out of the market after purchasing A\$51.35 billion in Commonwealth and semi-government bonds between 20 March and 6 May (including \$2.3 billion in WATC bonds), but stands ready to restart its purchases should it be necessary.

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severe downturn in the global economy since WWII. Australia has entered its first recession in almost 30 years, and unemployment numbers are only being contained by government wage subsidies. The borrowing task of the Commonwealth and all State Governments is expected to increase, although the full extent will not be known until budgets are released during October 2020.

Intervention by the RBA, through cuts to the cash rate and a large purchasing program of sovereign and semi government bonds, has helped stabilise market conditions. A strong focus by the RBA on yield curve control at the 3 year point appears to have been successful, allowing the Australian central bank to pause in its intervention from early May – a unique position around the world.

A signal of improved market conditions has been the successful issue of a new WATC 2031 benchmark bond – the first syndicated transaction by a semi government borrowing authority since the crisis had commenced. The issue received a positive market response, with strong domestic and off shore interest allowing us to print one of the largest primary issues in our history (\$1.5 billion). Another achievement for the quarter was the issue of an 'ultra long' 2041 bond, with an initial \$300 million issued to offshore investors.

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The RBA's bond purchases and other efforts to support the smooth functioning of the financial system has led to a sharp rise in money market liquidity, which has pushed the effective interbank cash rate and BBSW rates well below the official cash rate target.

The RBA's policy stance and large asset purchase programs from the major central banks has seen a decline in bond market volatility over the past three months following an eventful first quarter of the year. Aussie Commonwealth government bond yields at the front end of the yield curve have been well anchored by the RBA's 0.25 per cent target, while at the longer part of the curve the 10-year yield traded between 0.68 per cent and 1.09 per cent before closing at 0.87 per cent.

A somewhat optimistic outlook for the economy by traders and plenty of fuel from central banks have seen equity markets bounce sharply off their March lows.

Aussie equities have gained 16 per cent over the quarter, with the ASX 200 closing at 5898 from 5077 at the end of Q1. All the major industry sectors gained with information technology seeing the biggest increase of 51 per cent, boosted by work-from-home and remote communication requirements driven by the COVID-19 social restrictions.

On Wall Street, the S&P 500 gained 20 per cent making it its best quarter since 1998 while the 18 per cent increase in the Dow Jones was its biggest quarterly rise since 1987.

There was some weakness early in the quarter in commodity markets, highlighted by extreme dysfunction in the oil market as record production collided with collapsing demand and a lack of storage space. US oil prices slumped into negative territory on 20 April with the spot price for West Texas Intermediate crude closing the day at minus US\$37.63 / barrel, as holders of the May futures contract were desperate enough to avoid taking

delivery that they were willing to pay to have the obligation taken off their hands ahead of the 21 April expiry. Futures contracts for the global benchmark, Brent crude, are cash settled rather than deliverable so with no risk of having to take delivery the spot price remained in positive territory. Nevertheless the closing price of US\$19.33 on 21 April was the lowest since early 2002. Oil prices have since bounced as the OPEC+ group of major oil producers agreed to fresh production cuts and the outlook for demand appears to be not quite as dire as previously expected with Brent crude closing the quarter at US\$41.15 / barrel, although that's still almost 40 per cent lower than at the start of 2020.

A rebound in the demand for iron ore and ongoing supply troubles in Brazil helped drive iron ore prices over US\$100 / tonne for the first time since August last year. The price of the most active Singapore futures contract for 62 per cent Fe iron ore climbed from US\$81.74/tonne, to a high US\$102.47, before falling back to close the quarter at US\$98.42 as Brazilian mines subject to closure due to a COVID-19 outbreak were given the all clear to reopen.

Gold continues to be supported by central bank low interest rate policies and QE programs, closing the month at US\$1,781/oz, its highest level since 2012.

The AUD has recovered almost all of its Q1 losses, with the currency finding support as financial market volatility subsided. The currency opened the quarter at USD0.6131 and hit a close of day high of USD0.7021 on 8 June before easing back to close the quarter at USD0.6903. The Aussie remains extremely vulnerable to a deterioration in sentiment, particularly with the market looking a little too relaxed about what is a very uncertain outlook.

*Craig McGuinness, Chief Economist
Patrycja Beniak, Economist
June 2020*

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A huge achievement during May was the change over to the new Quantum treasury management system – a culmination of over 2 years of work. While we now move into Phase 2 work to maximise the new system's capabilities, the initial Phase has been a great success – on time and on budget being a rare combination for ICT projects!

WATC staff are all back in the office, although we are making the most of having developed on-line capabilities to support structured work from home opportunities for our staff. Our client teams have been busy over the quarter, monitoring agency cash balances and developing new lending products to support the university and local government sectors. The Short Term Lending Facility will be available from 1 July 2020 and provides a low cost option to support liquidity over these challenging times.

We all have our fingers crossed that the positive health and economic trends in Western Australia and Australia continue into the new financial year – and that the roller coaster that has been 2020 has less volatility for the second half of the year!

Kind regards,

Kaylene Gulich

Chief Executive Officer
June 2020

Support for Local Governments and Universities Impacted by COVID-19

Since the outbreak of COVID-19 WATC has been working closely with the Treasurer and Government Ministers, Departments, industry associations, and our local government and university clients, to determine how WATC can best provide support during this time.

On 7 May 2020, the State Government announced a new lending facility through WATC to support WA local governments and universities impacted by reduced revenue due to the COVID-19 pandemic. The full media statement can be accessed [here](#).

WATC's new Short Term Lending Facility (STLF) will enable local governments and universities to access short-term loans to support the liquidity of their operations. Some of the key features of the STLF include:

- Applications opened on 1 June 2020 with funding available from 1 July 2020 through to 30 June 2021, with the facility to be fully repaid and closed by 30 June 2023.
- Low interest rate, calculated on the daily balance and payable monthly, with the option to capitalise interest for the first 12 months.

- No establishment fees or commitment fees.
- The standard 0.70% government guarantee fee payable on loans with WATC has been waived by the Department of Treasury for this facility.
- Simple operational process for deferral of existing loan repayments with WATC.

As part of the STLF application process, WATC has developed a cash flow forecast model to assist local governments determine their cash flow requirements for the 2020/21 financial year.

To outline the operation of the STLF, Kaylene Gulich, CEO, and Stephen Morhall, General Manager Client Services, presented two webinars to local government CEOs and CFOs, which was kindly facilitated by WALGA. A similar video conference was also held with our university clients. Subsequently to the webinars, WATC's client relationship managers have been busy liaising with clients working through each client's specific situation.

If your organisation needs to access the STLF, please contact your client relationship manager to discuss your requirements and to progress an application.

Discontinuation of LIBOR Benchmark and Transition to RFR Benchmarks

London Interbank Offered Rate (LIBOR) is a benchmark interest rate at which major global banks are willing to lend to one another in the international interbank market for short-term loans. LIBOR is the reference interest rate benchmark for more than US\$350 trillion of loans and derivatives exposures across the world.

Due to the significant decline in activity in the unsecured interbank funding market, Global Regulators are concerned that LIBOR is no longer fit-for-purpose. The UK Financial Conduct Authority will no longer require banks to submit quotes for LIBOR beyond 31 December 2021 and reliance upon LIBOR beyond that date cannot be assured.

Whilst the vast majority of exposure to LIBOR in Australia resides with Australian Financial Institutions, Australian Corporates and Government Agencies could potentially have LIBOR exposures in contracts, particularly those that utilise off-shore funding sources, derivatives to hedge off-shore exposures or conduct off-shore activities.

The transition from LIBOR and other IBORs (interbank offered rates) to alternative Risk Free Rates (RFRs) is a challenge for the global financial industry because there are significant structural differences between IBORs and RFRs.

As such, fall-back provisions in contracts referencing IBORs are required to ensure that contracts will continue to function as closely as possible to the original intent of the contract when RFRs take effect.

Cognisant of the discontinuation of LIBOR, Public Sector CFOs should develop a transition strategy that, among other things, seeks to:

- Identify contracts that have an exposure to LIBOR and quantify the exposure
- Engage with your legal team to discuss your agency's transition strategy and with the counterparty to your LIBOR exposed contracts
- Avoid a LIBOR Benchmark exposure in any new contracts and, if not possible, incorporate suitable fall-back provisions
- Consider including improved fall-back provisions for all benchmarks e.g. contracts referencing BBSW.

Should you have any questions please email us on watc@watc.wa.gov.au.

New Appointment...

WATC is pleased to introduce our new staff member to clients.



Phillip Metaxas
Senior Compliance Officer

Phillip Metaxas

Phillip Metaxas commenced as Senior Compliance Officer on 30 April 2020. Phillip joined WATC after over six years with NAB, where he held roles in regulatory affairs, funding & liquidity risk and business lending. In his most recent role at NAB, Phillip managed NAB's relationships with APRA primarily across treasury, market risk and credit risk. Phillip holds a first class honours degree in economics from the University of Western Australia.

Replacement TMS is Live

At the beginning of June, WATC successfully transitioned to the Quantum treasury management system (TMS), replacing our Summit system that had served us well for nearly 20 years.

With a TMS being core to our operations, this was a major undertaking and change. The successful transition of systems was achieved as a direct result of a lot of planning and hard work put in by the dedicated project team and staff across WATC.

Clients will also notice a few minor changes resulting from the changeover of systems, such as the new Quantum deal number and formatting changes to some reports. WATC will continue to notify to clients of any specific changes as a result of the system transition.

Once the Quantum system is fully bedded in it will provide additional functionality and a platform for WATC to achieve greater efficiencies in processes, enabling us to continue to enhance our service delivery and offerings to our clients.

Syndicated Launch of a New 10 Year Benchmark Bond and Non-syndicated 21 Year Bond

On 26 May 2020, WATC issued by syndication a Benchmark Bond with a 22 October 2031 maturity. Prominent performers on WATC's fixed interest panel Bank of America Securities, CBA, NAB and UBS, were appointed as joint lead managers for the syndicated benchmark bond issue.

The new issue found strong investor interest with total bids exceeding \$2.6 billion from 51 bidders, with the final issue volume of \$1.5 billion being allocated to 50 bidders. Domestic investors included asset managers, bank balance sheets and other official institutions. Offshore investors also participated strongly with 25 per cent of the issue being placed with various central banks, fund managers and commercial banks.

On 22 June 2020, WATC issued through a non-syndicated placement, a bond with a 23 July 2041 maturity. The placement was managed solely by Citigroup Global Markets Australia Pty Ltd. The issue volume of \$300 million was placed entirely offshore and is expected to increase over time.

The investor term sheets can be viewed on the WATC [website](#).

Temporary Office Relocation

WATC will be temporarily relocating to 140 William Street, Perth CBD from early August until the end of the year. All other contact details will remain the same during this time.

For information on any products or services, please contact one of the Business Unit Managers listed below:

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For economic commentary or clarification, please contact:

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