ANNEX C

TREASURY MANAGEMENT POSITION 2019/20 – QUARTER 3

1.0 LEGISLATIVE REQUIREMENT:

1.1 The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management recommends that members be updated on treasury management activities regularly (Treasury Management Strategy Statement, Annual and Mid-year reports, as well as quarterly updates). This report therefore ensures this Council is implementing best practice in accordance with the Code.

1.2 The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This Quarter 3 report therefore updates Members on the current treasury management position and is presented to Cabinet and also Audit, Governance and Standards Committee.

1.3 The Council's treasury management position is based on its requirement to fund the capital programme and it's operational cash flow need. The Council looks to balance the requirement to borrow from external sources with the surplus funds that are available.

1.4 During 2018/19 the Council supported its capital expenditure by capital receipts, reserves, revenue contribution, long term borrowing , as wells as short term borrowing and the use of surplus funds for cash flow purposes. The short term borrowing was taken and repaid in Quarter 1 of 2019/20. The Council continues to have an underlying need to borrow for capital purposes and has five long term external borrowing of £22,700,000. These loans were all taken from Public Works Loan Board (PWLB) as follows;

- £1,200,000 in September 2016 at a rate of 1.05% over 5 years;
- £9,000,000 in March 2019 at a rate of 2.45% over 50 years;
- £2,500,000 in March 2019 at a rate of 2.24% over 45 years;
- £5,000,000 in September 2019 at a rate of 1.20% over 10 years; and
- £5,000,000 in September 2019 at a rate of 1.43% over 15 years.

1.5 The capital financing requirement in 2019/20, which is the amount of borrowing required to support the capital expenditure programme, is set at £56,221,000. The capital expenditure of the Council is also supported by grants, contributions and reserves. The capital financing requirement refers to the amount of borrowing that could be taken to support the capital expenditure programme.

1.6 The following table shows the treasury management position as at 31 December 2019:-

	31 Dec 19 £000's	Rate %
Capital Financing Requirement	56,221	
Borrowing	22,700	2.20
Investments	18,110	0.89

Table 1: Borrowing and Investment position at 31 December 2019

1.7 The table shows that changes in the capital expenditure programme only affects the treasury management position through the surplus funds that are available to the Council to invest, to earn investment income.

2.0 THE ECONOMY, INTEREST RATES AND TREASURY MANAGEMENT STRATEGY:

2.1 The economic background and interest rate forecast, which sets the environment in which the Council's treasury management operates, is attached at Annex D.

3.0 ANNUAL INVESTMENT STRATEGY 2019/20 – QUARTER 3:

3.1 The Treasury Management Strategy Statement (TMSS) for 2019/20 which includes the Annual Investments Strategy, was approved by the Council on 26 February 2019. It sets out the Council's investment priorities as being:

- Security of capital;
- Liquidity; and
- Yield.

3.2 The Council's priority is security of its surplus funds when investing with financial institutions. However the Council will always aim to achieve the optimum return (yield) on investments in line with its risk appetite and which is commensurate with proper levels of liquidity and security. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in periods up to 12 months. Investments are placed with highly credit rated financial institutions, using the Council's treasury Management advisers – Link Asset Services - suggested creditworthiness approach including sovereign credit rating and Credit Default Swap (CDS) overlay information provided by Link Asset Services.

3.3 The average level of funds available for investment purposes during Quarter 3 – 31 December 2019 - was £20,200,000 The level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the Capital Programme.

3.4

Benchmark	Benchmark Return	Council Performance	Investment Interest Earned
7 day	0.57%	0.89%	£44,242

Table 2: Investment performance for Quarter 3 at 31 December 2019

3.5 The table shows that the Council monitors its cash flow investments against the 7 day rate. The Council outperformed the 7 day benchmark by 0.32%.

3.6 The Council's budgeted investment return for 2019/20 was approved at £35,000. In Quarter 3 monitoring it has been reported that the income is estimated to be £100,000, which is an increase of £65,000 due to increased surplus cash invested in short term investments as a result of taking loans from the Public Works Loan Board before capital expenditure has occurred. These have also been invested in a variety of fixed term call accounts that attract higher rates of interest, whilst still remaining accessible. This will be closely monitored throughout the year.

4.0 BORROWING 2019/20 – QUARTER 3

4.1 At 31 December 2019 the Council had five loans to the value of £22,700,000 of long term borrowing with the Public Works Loan Board (PWLB). These can be seen in the paragraph 1.4.

4.2 The table below shows the Public Works Loans Board (PWLB) interest rates which were available for loans during the first nine months of 2019/20. The Public Works Loans Board (PWLB) is the mechanism by which the Government allows local authorities to borrow at slightly lower interest rates than are available to other institutions. Certainty rates, as detailed in the table, are interest rates available to local authorities if they inform the Government of their borrowing requirements and are 0.02% (or 20 basis points) below Public Works Loans Board (PWLB) rates. This was introduced by the Government in October 2012.

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.47%	1.20%	1.39%	1.98%	1.81%
Date	08/10/2019	08/10/2019	08/10/2019	08/10/2019	08/10/2019
High	2.67%	2.63%	2.87%	3.42%	3.25%
Date	05/12/2019	31/12/2019	31/12/2019	31/12/2019	31/12/2019
Average	2.51%	2.38%	2.58%	3.15%	2.99%

Table 3: Public Works Loan Board (PWLB) certainty rates, quarter ended 31 December 2019

4.3 **Treasury Borrowing**: Due to the overall financial position and the underlying need to borrow for capital purposes, external borrowing of £22,700,000 has been taken up to Quarter 3 2019/20 from the Public Works Loans Board (PWLB).

4.4 It is anticipated that further borrowing will be required in 2019/20 to support the overall Capital Programme.

4.5 **Rescheduling of Borrowing**: Debt rescheduling opportunities have been very limited in the current economic climate given the consequent structure of interest rates, and following the increase in the margin added to gilt yields which has impacted Public Works Loan Board (PWLB) new borrowing rates since October 2019. No debt rescheduling has therefore been undertaken to date in the current financial year. The 100bps increase in Public Works Loan Board (PWLB) rates from 9 October 2019 only applied to new borrowing rates, not to premature repayment rates.

4.6 **Repayment of Borrowing**: the Council did not have any borrowing to repay during Quarter 3 of 2019/20.

5.0 COMPLIANCE WITH PRUDENTIAL AND TREASURY INDICATORS:

5.1 It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. The Council’s approved Treasury and Prudential Indicators (affordability limits) were approved in the Treasury Management Strategy Statement by Council on 26 February 2019 and are in compliance with the Council’s Treasury Management Practices.

5.2 During the financial year to date the Council has operated within the Treasury and Prudential Indicators approved which are attached at Annex E.

5.3 Officers can confirm that the approved limits within the Annual Investment Strategy were not breached during the Quarter ended 31 December 2019.

ANNEX D

Economic Update

1.1 ECONOMIC BACKGROUND:

UK. Economic growth in 2019 has been very volatile with quarter 1 unexpectedly strong at 0.5%, quarter 2 dire at -0.2%, quarter 3 back up to +0.4% and quarter 4 expected to come in around zero. Political and Brexit uncertainty have dampened growth in 2019.
Despite political uncertainty ending with a decisive overall majority for the Conservative government in the December general election which clears the way for the UK to leave the EU on 31 January 2020, we still have much uncertainty as to whether there will be a reasonable trade deal achieved by the end of 2020.

After the Monetary Policy Committee (MPC) raised **Bank Rate** from 0.5% to 0.75% in August 2018, it is little surprise that they have abstained from any further increases since then. We are unlikely to see any further action from the Monetary Policy Committee (MPC) until these remaining uncertainties over the likely type of Brexit become clear. If there was a no deal exit, it is likely that Bank Rate would be cut in order to support growth. However, if growth was to flag significantly in any event, the Monetary Policy Committee (MPC) could also cut Bank Rate in 2020. The Government has announced some major spending increases and is expected to make further commitments in the spring budget; these will provide some support to growth and will take some pressure off the Monetary Policy Committee (MPC) to act to stimulate growth by either cutting Bank Rate or implementing other monetary policy measures.

The Monetary Policy Committee (MPC) did have some concerns over the trend in wage inflation, which was on a rising trend, and peaked at a new post financial crisis high of 3.9% in June. Since then, however, it has been falling steadily back to 3.5% in October, (3 month average figure, excluding bonuses). Growth in employment picked up again to 24,000 in the three months to October, after a fall in the previous month's figures. However, this is still well below the 2018 average, although the unemployment rate remained at 3.8 percent, its lowest rate since 1975.

As for **Consumer Price Index (CPI) inflation** itself, this fell to 1.5% in October and November and is likely to remain between 1.5% and 2% over the next two years. If there was a no deal Brexit though, it could rise towards 4%, primarily as a result of imported inflation on the back of a weakening pound.
The strong wage inflation figure and the fall in Consumer Price Index (CPI) inflation is good news for **consumers** as their spending power is improving in this scenario as the difference between the two figures is now around 2.0%, i.e. a real term increase. Given the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months.

USA. President Trump's massive easing of fiscal policy in 2018 fuelled a (temporary) boost in consumption in 2018 which generated an upturn in the rate of growth to 2.9% for 2018, just below his target of 3%. Growth in quarter 1 of 2019 was a strong 3.1% but growth fell

back to 2.0% in quarter 2 and 2.1% in quarter 3. The strong growth in employment numbers during 2018 has subsided into a weaker trend of growth during 2019, indicating that the economy is cooling, while inflationary pressures have also been weakening. After the Fed increased rates by 0.25% in December 2018 to between 2.25% and 2.50%, it has taken decisive action to reverse monetary policy by cutting rates by 0.25% in each of July, September and October in order to counter the downturn in the outlook for US and world growth. The Fed is now likely to pause to see how the economy responds during 2020.

EUROZONE. The annual rate of growth has been steadily falling, from 1.8% in 2018 to only 1.1% y/y in quarter 3 in 2019. The European Central Bank (ECB) ended its programme of quantitative easing purchases of debt in December 2018, which meant that the central banks in the US, UK and EU had all ended the phase of post financial crisis expansion of liquidity supporting world financial markets by purchases of debt. However, the downturn in Eurozone growth, together with inflation falling well under the upper limit of its target range of 0 to 2%, (but it aims to keep it near to 2%), has prompted the European Central Bank (ECB) to take new measures to stimulate growth. At its March meeting it said that it expected to leave interest rates at their present levels "at least through the end of 2019", but that was of little help to boosting growth in the near term. Consequently, it announced a third round of Targeted Longer-term Refinancing Operations (TLTROs); this provides banks with cheap borrowing every three months from September 2019 until March 2021 which means that, although they will have only a two-year maturity, the Bank is making funds available until 2023, two years later than under its previous policy. As with the last round, the new Targeted Longer-term Refinancing Operations (TLTROs) will include an incentive to encourage bank lending, and they will be capped at 30% of a bank's eligible loans. However, since then, the downturn in Eurozone and world growth has gathered momentum so at its meeting on 12 September, it cut its deposit rate further into negative territory, from -0.4% to -0.5% and announced a resumption of quantitative easing purchases of debt to start in November at €20bn per month, a relatively small amount. It also increased the maturity of the third round of Targeted Longer-term Refinancing Operations (TLTROs) from two to three years. However, it is doubtful whether this loosening of monetary policy will have much impact on growth and unsurprisingly, the European Central Bank (ECB) stated that governments will need to help stimulate growth by fiscal policy.

CHINA. Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. The trade war with the US does not currently appear to be having a particularly significant impact on growth. Major progress still needs to be made to eliminate excess industrial capacity and to switch investment from property construction and infrastructure to consumer goods production. It also needs to address the level of non-performing loans in the banking and credit systems.

JAPAN. has been struggling to stimulate consistent significant Gross Domestic Product (GDP) growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

WORLD GROWTH. The trade war between the US and China on tariffs is a major concern to financial markets and is depressing worldwide growth, as any downturn in China will spill over into impacting countries supplying raw materials to China. Concerns are focused on

the synchronised general weakening of growth in the major economies of the world. These concerns resulted in government bond yields in the developed world falling significantly during the first ten months of 2019. If there were a major worldwide downturn in growth, central banks in most of the major economies will have limited ammunition available, in terms of monetary policy measures, when rates are already very low in most countries, (apart from the US), and there are concerns about how much distortion of financial markets has already occurred with the current levels of quantitative easing purchases of debt by central banks. The latest Purchasing Managers' Index (PMI) survey statistics of economic health for the US, UK, EU and China have all been weak which gives a forward indication of a downturn in growth; this confirms investor sentiment that the outlook for growth during 2020 is expected to be weak.

1.2 INTEREST RATE FORECAST:

The Council's treasury advisor, Link Asset Services, has provided the following forecast:

Link Asset Services Interest Rate View													
	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25	1.25	1.25	1.25
3 Month LIBID	0.70	0.70	0.80	0.90	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.30	1.30
6 Month LIBID	0.80	0.80	0.90	1.00	1.10	1.10	1.20	1.30	1.40	1.50	1.50	1.50	1.50
12 Month LIBID	1.00	1.00	1.10	1.20	1.30	1.30	1.40	1.50	1.60	1.70	1.70	1.70	1.70
5yr PWLB Rate	2.40	2.40	2.50	2.50	2.60	2.70	2.80	2.90	2.90	3.00	3.10	3.20	3.20
10yr PWLB Rate	2.70	2.70	2.70	2.80	2.90	3.00	3.10	3.20	3.20	3.30	3.30	3.40	3.50
25yr PWLB Rate	3.30	3.40	3.40	3.50	3.60	3.70	3.70	3.80	3.90	4.00	4.00	4.10	4.10
50yr PWLB Rate	3.20	3.30	3.30	3.40	3.50	3.60	3.60	3.70	3.80	3.90	3.90	4.00	4.00

After the August 2018 increase in Bank Rate to 0.75%, the first above 0.5% since the financial crash, the Monetary Policy Committee (MPC) has put any further action on hold, probably until such time as the fog of Brexit might clear. While the general election in December 2019 has provided political certainty leading to implementation of the UK leaving the EU on 31/01/2020, there is still much uncertainty on what sort of trade deal may be agreed by the end of 2020 and its likely impact on the UK economy. The above forecast, and other comments in this report, are based on a central assumption that there will be some form of muddle through agreement on a reasonable form of Brexit trade deal. Bank Rate forecasts will have to change if this assumption does not materialise e.g. a no deal Brexit could prompt the Monetary Policy Committee (MPC) to do an immediate cut of Bank Rate. All other forecasts for investment and borrowing rates would also have to change.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably even, but dependent on a successful outcome of negotiations on a trade deal.
- The balance of risks to increases in Bank Rate and shorter term Public Works Loan Board (PWLB) rates are broadly similarly to the downside.
- In the event that a Brexit deal is agreed with the EU and approved by Parliament, the balance of risks to economic growth and to increases in Bank Rate is likely to change to the upside.

BOND YIELDS / PUBLIC WORKS LOAN BOARD (PWLB) RATES. There was much speculation during the second half of 2019 that bond markets were in a bubble which was driving bond prices up and yields down to historically very low levels. The context for that was heightened expectations that the US could have been heading for a recession in 2020, and a general background of a downturn in world economic growth, especially due to fears around the impact of the trade war between the US and China, together with inflation generally at low levels in most countries and expected to remain subdued; these conditions were conducive to very low bond yields. While inflation targeting by the major central banks has been successful over the last thirty years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last 30 years. We have therefore seen over the last year, many bond yields up to 10 years in the Eurozone actually turn negative. In addition, there has, at times, been an inversion of bond yields in the US whereby 10 year yields have fallen below shorter term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities. However, stock markets are also currently at record high levels as some investors have focused on chasing returns in the context of dismal ultra-low interest rates on cash deposits.

During the first 10 months of 2019 we therefore saw a sharp fall in longer term Public Works Loan Board (PWLB) rates to completely unprecedented historic low levels - until the Treasury unexpectedly added 1% to all Public Works Loan Board (PWLB) rates from 9th October 2019. Since then, those fears have partially subsided and gilt yields and Public Works Loan Board (PWLB) rates have been rising. The potential danger that may be lurking in investor minds is that Japan has become mired in a 20 year malaise of failing to get economic growth and inflation up off the floor, despite a combination of massive monetary and fiscal stimulus by both the central bank and government. Investors could be fretting that many major western economies could be heading into a similar scenario.

Another danger is that unconventional monetary policy post 2008, (ultra-low interest rates plus quantitative easing), may end up doing more harm than good through prolonged use. Low interest rates have encouraged a debt fuelled boom which now makes it harder for economies to raise interest rates. Negative interest rates could damage the profitability of commercial banks and so impair their ability to lend and / or push them into riskier lending. Banks could also end up holding large amounts of their government’s bonds and so create a potential doom loop, (see appendix 4 Eurozone downside risk). In addition, the financial viability of pension funds could be damaged by low yields on holdings of bonds.