ANNEX C

TREASURY MANAGEMENT POSITION 2020/21 – QUARTER 1

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 1 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 2019/20 the Council supported its Capital Expenditure by capital receipts, reserves, revenue contribution, long term borrowing and the use of surplus funds for cash flow purposes. The council continues to have an underlying need to borrow for capital purposes and has long term external borrowing of £27,700,000 at an average interest rate of 2.21%. These loans were all taken from Public Works Loan Board (PWLB) as follows:

Loan Number	Amount (£)	Start Date	Maturity Date	Number of Years	Interest Rate
1	1,200,000	05/09/16	05/09/21	5	1.05
2	9,000,000	07/03/19	07/03/69	50	2.45
3	2,500,000	25/03/19	25/03/64	45	2.24
4	5,000,000	02/09/19	02/09/29	10	1.20
5	5,000,000	05/09/19	05/19/34	15	1.43
6	2,500,000	16/03/20	16/09/67	47.5	2.23
7	2,500,000	16/03/20	16/09/33	13.5	2.19

1.5 The capital financing requirement in 2020/21, which is the amount of borrowing required to support the capital expenditure programme, is set at £86,073,196. The capital expenditure of the Council is supported by grants, contributions, reserves and borrowing. 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 30 June 2020:-

	30 June 20 £000's	Rate %
Capital Financing Requirement	86,073	
Borrowing	27,700	2.21
Investments	16,250	0.30

Table 1: Borrowing and Investment position at 30 June 2020

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 2020/21 – QUARTER 1:

3.1 The Treasury Management Strategy Statement (TMSS) for 2020/21 which includes the Annual Investments Strategy, was approved by the Council on 25 February 2020. It sets out the Council's investment priorities as being:

- Security of capital;
- Liquidity;
- 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 Although the credit rating agencies changed their outlook on many UK banks from stable to negative outlook during this quarter, due to upcoming risks to banks' earnings and asset quality during the economic downturn caused by the pandemic, the majority of ratings were affirmed due to the continuing strong credit profiles of UK banks. Although Credit Default Swap (CDS) prices, (these are market indicators of credit risk), for UK banks spiked upwards at the end of March due to the liquidity crisis throughout financial markets, those Credit Default Swap (CDS) prices have returned to more average levels since then.

3.4 The average level of funds available for investment purposes during Quarter 1 – 30 June 2020 - was £24,381,648. The level of funds available is higher than previous years due to receiving government grants relating to COVID-19, it is also dependant on the timing of precept payments, receipt of other grants and the progress of the Capital Programme. The Council held £16,250,000 cash flow balances at the end of Quarter 1.

3.5 The Council is currently not experiencing any cash flow issues as a result of COVID-19, the amount of borrowing continues to support the level of the capital programme and the level of the shortfall of increased expenditure and income losses from the pandemic. There are currently no changes to the Treasury Management Strategy. Further information relating to Covid-19 regarding income, expenditure and reserves are included in the 2020/21 Quarter 1 Revenue Monitoring report.

3.6

Benchmark	Benchmark Return	Council Performance	Investment Interest Earned
7 day	-0.04%	0.30%	£18,452

Table 2: Investment performance for quarter 1 at 30 June 2020

3.7 The table shows that the Council monitors its cash flow investments against the 7 day rate. The Council outperformed the 7 day benchmark by 0.34%. The current 7 day benchmark return shows a negative amount due to the 7 day benchmark being calculated using the London Inter-Bank Bid (LIBID) rate which is linked to the London Inter-Bank Offer Rate (LIBOR) figure. The Bank of England Base Rate is currently just 0.1%, which means the LIBOR rate will be a similar rate, if not lower given the large amount of liquidity in the very short end of the market. Therefore this effects the LIBID rates as they are always lower than the LIBOR rate so at the very short end of the curve the LIBID 7 day benchmark is a negative figure.

3.8 The Council's budgeted investment return for 2020/21 was approved at £35,000. Following the Bank of England Base Rates cuts in March 2020 to 0.10%, interest rates available on the Council's investments have reduced in the first quarter of 2020/21, these now range from 0% to 0.20%.

3.9 The budget is anticipated to be achieved despite the lower rates due to increased cashflow balances available to invest as a result of Government Grants received for example £30,866,000 for Business Grants, Business Rates Section 31 grants being paid in full at the beginning of the year and other grants relating to COVID-19 support. The amount available to invest is also dependant on the timing of payments relating to the Capital Programme.

4.0 BORROWING 2020/21 – QUARTER 1

4.1 At 30 June 2020 the Council had seven loans borrowed from the Public Works Loan Board (PWLB) to the value of £27,700,000, these can be seen in paragraph 1.4.

4.2 Public Works Loan Board (PWLB) rates have fallen a little between the start and end of the quarter with not a great deal of volatility between those dates. The 50 year Public Works Loan Board rate for new long term borrowing was 2.30% during the quarter.

4.3 The table below shows the Public Works Loans Board interest rates which were available for loans during Quarter 1 of 2020/21. The Public Works Loans Board 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 at the beginning of the financial year and are 0.02% (or 20 basis points) below Public Works Loans Board rates. This was introduced by the Government in October 2012.

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.77%	1.74%	1.96%	2.40%	2.13%
Date	30/06/2020	30/06/2020	22/05/2020	18/06/2020	24/04/2020
High	1.94%	1.99%	2.19%	2.69%	2.45%
Date	08/04/2020	08/04/2020	08/04/2020	07/04/2020	07/04/2020
Average	1.84%	1.85%	2.07%	2.50%	2.26%

Table 3: Public Works Loan Board (PWLB) certainty rates, quarter ended 30 June 2020

4.4 **Treasury Borrowing**: Due to the overall financial position and the underlying need to borrow for a capital purposes, the external borrowing position at 31 March 2020 was £27,700,000, where all loans were taken from the Public Works Loan Board (PWLB).

4.5 No borrowing was undertaken during the quarter ended 30 June 2020. The requirement of additional borrowing will be closely monitored in line with the Council's capital programme throughout 2020/21.

4.6 **Debt Rescheduling**: Debt rescheduling opportunities have been limited in the current economic climate and following the various increases in the margins added to gilt yields which has impacted Public Works Loan Board (PWLB) new borrowing rates since October 2019, no debt rescheduling was undertaken during the quarter ended 30 June 2020 as the Council's borrowing rates remain comparatively low.

4.7 **Repayment of Borrowing**: the Council did not have any borrowing to repay during Quarter 1 of 2020/21.

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 25 February 2020 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 30 June 2020.

ANNEX D

Economic Update

1.1 ECONOMIC BACKGROUND:

United Kingdom

Economic growth 2020 started with optimistic business surveys pointing to an upswing in growth after the ending of political uncertainty as a result of the decisive result of the general election in December settled the Brexit issue. However, the three monthly Gross Domestic Product statistics in January were disappointing, being stuck at 0.0% growth.

Since then, the whole world has changed as a result of the coronavirus outbreak. The overall growth rate in quarter 1 was -2.2%, -1.7% y/y. However, the main fall in growth did not occur until April when it came in at -24.5% y/y after the closedown of whole sections of the economy. What is uncertain, however, is the extent of the damage that will have been done to businesses by the end of the lockdown period, how consumer confidence and behaviour may be impacted afterwards, whether there could be a second wave of the outbreak, how soon a vaccine will be created and then how quickly it can be administered to the population. This leaves huge uncertainties as to how quickly the economy will recover to what was formerly regarded as normality. However, some changes during lockdown are likely to be long lasting e.g. a shift to online purchasing, working from home, etc.

The lockdown has also had a sharp effect in depressing expenditure by consumers which means their level of savings have increased and debt has fallen. This could provide fuel for a potential surge in consumer expenditure once some degree of normality returns.

Although the UK left the European Union 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. At the end of June, the UK government rejected extending the transition period beyond 31 December 2020. This has increased the chances of a no-deal Brexit. However, the most likely outcome is expected to be a slim deal on trade in order to minimise as much disruption as possible. However, uncertainty is likely to prevail until the deadline date which will act as a drag on recovery.

After the Monetary Policy Committee left Bank Rate unchanged at 0.75% in January 2020, the onset of the coronavirus epidemic in March forced it into making two emergency cuts in Bank Rate first to 0.25% and then to 0.10%. These cuts were accompanied by an increase in quantitative easing (QE), essentially the purchases of gilts (mainly) by the Bank of England of £200bn.

In June, the Monetary Policy Committee decided to add a further £100bn of quantitative easing purchases of gilts, but to be implemented over an extended period to the end of the year. The total stock of quantitative easing purchases will then amount to £745bn. It is not currently thought likely that the Monetary Policy Committee would go as far as to cut Bank

Rate into negative territory, although the Governor of the Bank of England has said all policy measures will be considered.

The Governor also recently commented about an eventual tightening in monetary policy – namely that he favours unwinding quantitative easing before raising interest rates. Some forecasters think this could be as far away as five years.

The Government and the Bank were also very concerned to stop people losing their jobs during this lockdown period. Accordingly, the Government introduced various schemes to subsidise both employed and self-employed jobs for three months to the end of June while the country is locked down. It also put in place a raft of other measures to help businesses access loans from their banks, (with the Government providing guarantees to the banks against losses), to tide them over the lockdown period when some firms may have little or no income. However, at the time of writing, this leaves open a question as to whether some firms will be solvent, even if they take out such loans, and some may also choose to close as there is, and will be, insufficient demand for their services. The furlough scheme was subsequently extended for another three months to October, but with employers having to take on graduated increases in paying for employees during that period. The Bank of England expects the unemployment rate to double to 8%.

The Government measures to support jobs and businesses will result in a huge increase in the annual budget deficit for the current year, from about 2% to nearly 17%. The ratio of debt to GDP is also likely to increase from 80% to around 105%. In the Budget in March, the Government also announced a large increase in spending on infrastructure; this will also help the economy to recover once the lockdown is ended. Economic statistics during June were giving a preliminary indication that the economy was recovering faster than previously expected. However, it may be a considerable time before economic activity recovers fully to its previous level.

The annual inflation rate dropped to 0.5% in May from 0.8% in April and could reach zero by the end of the year. Inflation rising over 2% is unlikely to be an issue for the Monetary Policy Committee over the next two years as the world economy will be heading into a recession; this has caused a glut in the supply of oil which initially fell sharply in price, although the price has recovered somewhat more recently.

Other UK domestic prices will also be under downward pressure; wage inflation was already on a downward path over the last half year and is likely to continue that trend in the current environment where unemployment will be rising significantly. In May's Monetary Policy Report, the Bank of England predicted that inflation would hit their 2% target by 2022. This was in the context of its forecast that Gross Domestic Product would rise by 3% in 2022 after a recovery during 2021. While inflation could even turn negative in the Eurozone, this is currently not likely in the UK.

USA.

Growth in Quarter 1 of 2020 fell by an annualised 5.0% and will fall sharply in quarter 2. Once coronavirus started to impact the US in a big way, the Fed took decisive action by cutting rates twice by 0.50%, and then 1.00%, in March, all the way down to 0.00 – 0.25%.

Near the end of March, Congress agreed a $2trn stimulus package (worth about 10% of Gross Domestic Product) and new lending facilities announced by the Fed which could channel up to $6trn in temporary financing to consumers and firms over the coming months. Nearly half of the first figure is made up of permanent fiscal transfers to households and firms, including cash payments of $1,200 to individuals.

The loans for small businesses, which convert into grants if firms use them to maintain their payroll, will cost $367bn and 100% of the cost of lost wages for four months will also be covered. In addition there was $500bn of funding from the Treasury's Exchange Stabilization Fund which will provide loans for hard-hit industries, including $50bn for airlines.

Non-farm payrolls unexpectedly increased by 2.5 million jobs in May, beating market expectations of an 8 million fall, and after declining by a record 20.7 million in April. The figures suggest that the economic recovery in the US may happen much faster than initially expected. Some states started reopening in mid-May after a two-month shutdown but a few have had to re-impose localised lockdowns since then.

EUROZONE.

The Eurozone economy shrank by 3.6% on quarter in the first three months of 2020. So far, the European Central Bank has been by far the most important institution in helping to contain the impact of coronavirus and the crisis on financial markets. Since 12th March, it has implemented a range of new policies including providing additional cheap loans for commercial banks and easing capital requirements for the banking sector. But most importantly, the European Central Bank has stepped up and reformed its asset purchase programmes. So far, it has increased its planned asset purchases for this year by €1,470bn on top of the €20bn per month which it was already committed to. The new purchases consist of an additional €120bn within the existing Public Sector Purchase Programme (PSPP), and €1,350bn in the Pandemic Emergency Purchase Programme (PEPP). At its 4 June monetary policy meeting, the European Central Bank Governing Council also committed to continue net asset purchases under the Pandemic Emergency Purchase Programme until at least the end of June 2021 and to continue to reinvest maturing principal payments under the Pandemic Emergency Purchase Programme until at least end-2022. It has also made clear that it would not hesitate to top up Pandemic Emergency Purchase Programme as much as needed to contain the risk of a crisis.

Just as important as the size of the Pandemic Emergency Purchase Programme is its flexibility. Whereas previous asset purchase programmes adhered to strict issuer limits, the Pandemic Emergency Purchase Programme was designed to be flexible across "time, asset classes and jurisdictions". This means that the European Central Bank can act in the interests of the euro-zone as a whole rather than having to treat each national bond market equally. However, while this overall programme will provide protection over the next year or so, some vulnerable countries, particularly Italy, already started the crisis with a high level of debt to Gross Domestic Product and the crisis will make that level even worse at the same time as Gross Domestic Product growth prospects will have worsened. This leaves a big question over 'what happens after then when financial markets will be concerned that those debt levels are unsustainable?'

What is currently missing is a major coordinated European Union response of fiscal action by all national governments to protect jobs, support businesses directly and promote economic growth by expanding government expenditure on e.g. infrastructure. The European Union's recently-proposed rescue fund, (officially designated "Next Generation European Union"), is a major first step towards financial integration in the European Union. However, it is striking just how small this package is as the proposed €500 billion of grants amount to about 0.6% of average annual euro-zone Gross Domestic Product (over the seven-year budget period). It will therefore supply relatively little support to the weaker and more vulnerable countries within the European Union. This has therefore left individual national governments to implement a patchwork of support measures within each country. This shows up how far away the European Union is from being an effective fiscal union.

CHINA.

Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium-term risks have also been increasing. The major feature of 2019 was the trade war with the US. However, this has been eclipsed by being the first country to be hit by the coronavirus outbreak; this resulted in a lockdown of the country and a major contraction of economic activity in February-March 2020. The Chinese economy shrank 6.8% y/y in Quarter 1 2020, following 6% y/y growth in Quarter 4 of 2019.

Ongoing economic issues remain, in needing to make major progress 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. The post Covid government measures to stimulate more infrastructure investment are likely to result in an increase in inefficient low reward investment.

JAPAN

Japan has been struggling to stimulate consistent significant Gross Domestic Product growth for years 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. Japan appears to have escaped the worst effects of the virus - as yet.

WORLD GROWTH

The trade war between the US and China on tariffs was a major concern to financial markets and was depressing worldwide growth during 2019. This year, coronavirus is the inevitable big issue which is going to sweep around most countries in the world and have a major impact in causing a world recession in growth in 2020.

1.2 INTEREST RATE FORECAST:

The Council's treasury advisor, Link Group, provided the following forecast on 31 March 2020. This forecast is going to be updated in early July to take account of recent downward movements in LIBID rates, (currently they are 3 month 0.01%, 6 month 0.15% and 12 month 0.33%).

Link Asset Services Interest Rate View	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 Month LIBID	0.45	0.40	0.35	0.30	0.30	0.30	0.30	0.30
6 Month LIBID	0.60	0.55	0.50	0.45	0.40	0.40	0.40	0.40
12 Month LIBID	0.75	0.70	0.65	0.60	0.55	0.55	0.55	0.55
5yr PWLB Rate	1.90	1.90	1.90	2.00	2.00	2.00	2.10	2.10
10yr PWLB Rate	2.10	2.10	2.10	2.20	2.20	2.20	2.30	2.30
25yr PWLB Rate	2.50	2.50	2.50	2.60	2.60	2.60	2.70	2.70
50yr PWLB Rate	2.30	2.30	2.30	2.40	2.40	2.40	2.50	2.50

The above table is based on PWLB certainty rates – gilt yields plus 180bps.

Uncertainty over Brexit caused the Monetary Policy Committee to leave Bank Rate unchanged during 2019 and at its January 2020 meeting. However, since then the coronavirus outbreak has transformed the economic landscape: in March, the Monetary Policy Committee took emergency action twice to cut Bank Rate first to 0.25%, and then to 0.10%. It is now unlikely to rise for the next two years pending a protracted recovery of the economy from this huge set back.

Our central assumption is that there will be some form of muddle through agreement on a reasonable form of Brexit trade deal but the coronavirus outbreak could affect the timing of reaching a deal. As there is so much uncertainty around the impact of, and pace of recovery from this outbreak, the above forecasts currently only cover two years, not three as provided in the past.

GILT YIELDS / 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 30 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 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.

Gilt yields had therefore already been on a falling trend during the last year up until the coronavirus crisis hit western economies. Since then, we have seen gilt yields fall sharply to unprecedented lows as investors panicked during March in selling shares in anticipation of impending recessions in western economies and moved cash into safehaven assets i.e. government bonds.

However, major western central banks started massive quantitative easing purchases of government bonds which has acted to maintain downward pressure on government bond yields at a time when there has been a huge and quick expansion of government expenditure financed by issuing government bonds; in normal times this would have caused bond yields to rise sharply. At the close of the day on 30 June, all gilt yields from 1 to 5 years were slightly negative while even 25-year yields were at only 0.71 and 50 year at 0.54%. Equity markets have enjoyed a rebound since the lows of March as confidence has started to return among investors that the worst is over and recovery is now on the way.

However, HM Treasury imposed two changes of margins over gilt yields for PWLB rates in 2019-20 without any prior warning; the first on 9 October 2019, added an additional 1% margin over gilts to all PWLB rates. That increase was then at least partially reversed for some forms of borrowing on 11 March 2020, but not for mainstream General Fund capital schemes, at the same time as the Government announced in the Budget a programme of increased spending on infrastructure expenditure.

It also announced that there would be a consultation with local authorities on possibly further amending these margins; this was to end on 4 June but the date has since been put back to 31 July. It is clear that the Treasury will no longer allow local authorities to borrow money from the PWLB to purchase commercial property if the aim is solely to generate an income stream (assets for yield). There is a further item on the September 2020 cabinet agenda in relation to this matter – The Commercial Investment Strategy Report.

Following the changes on 11 March 2020 in margins over gilt yields, the current situation is as follows: -

- **PWLB Standard Rate** is gilt plus 200 basis points
- **PWLB Certainty Rate** is gilt plus 180 basis points
- **PWLB HRA Standard Rate** is gilt plus 100 basis points
- **PWLB HRA Certainty Rate** is gilt plus 80bps
- **Local Infrastructure Rate** is gilt plus 60bps

As the interest forecast table for PWLB certainty rates (gilts plus 180bps) above shows, there is likely to be little upward movement in PWLB rates over the next two years as it will take economies a prolonged period to recover all the momentum they will lose in the sharp recession that will be caused during the coronavirus shut down period. Inflation is also likely to be very low during this period and could even turn negative in some major western economies during 2020-21.