Shropshire Council	**Committee and Date** Cabinet 12 February 2020	**Item** Public

TREASURY MANAGEMENT UPDATE – QUARTER 3 2019/20

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1. Summary

1.1. The report outlines the treasury management activities of the Council in the last quarter. It highlights the economic environment in which treasury management decisions have been made and the interest rate forecasts of the Council's Treasury Advisor, Link Asset Services. It also updates Members on the internal treasury team's performance.

1.2. During the third quarter of 2019/20 the internal treasury team achieved a return of 0.91% on the Council's cash balances, outperforming the benchmark by 0.34%. This amounts to additional income of £126,340 during the quarter which is included within the Council's outturn position in the revenue monitor.

2. Recommendations

2.1. Members are asked to accept the position as set out in the report.

REPORT

3. Risk Assessment and Opportunities Appraisal

3.1. The recommendations contained in this report are compatible with the provisions of the Human Rights Act 1998.

3.2. There are no direct environmental, equalities or climate change consequences arising from this report.

3.3. Compliance with the CIPFA Code of Practice on Treasury Management, the Council's Treasury Policy Statement and Treasury Management Practices and the Prudential Code for Capital Finance together with the rigorous internal controls will enable the Council to manage the risk associated with Treasury Management activities and the potential for financial loss.

4. Financial Implications

4.1. The Council makes assumptions about the levels of borrowing and investment income over the financial year. Reduced borrowing as a result of capital receipt generation or delays in delivery of the capital programme will both have a positive impact of the council's cash position. Similarly, higher than benchmarked returns on available cash will also help the Council's financial position. For monitoring purposes, assumptions are made early in year about borrowing and returns based on the strategies agreed by Council in the preceding February. Performance outside of these assumptions results in increased or reduced income for the Council.

4.2. The Quarter 3 performance is above benchmark and has delivered additional income of £126,340 which will be reflected in the Period 9 Revenue Monitor.

4.3. As at 31 December 2019 the Council held £133 million in investments as detailed in Appendix A and borrowing of £308 million at fixed interest rates.

5. Background

5.1. The Council defines its treasury management activities as "the management of the authority's borrowing, investments and cash flows, its banking, money market and capital market transactions, the effective control of the risks associated with those activities, and the pursuit of optimum performance consistent with those risks". The report informs Members of the treasury activities of the Council between 1 October 2019 and 31 December 2019.

6. Economic Background

6.1. Economic growth in 2019 has been very volatile with quarter 1 unexpectedly strong at 0.5%, quarter 2 lower 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.

6.2. 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.

6.3. After the Monetary Policy Committee 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 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 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 MPC to act to stimulate growth by either cutting Bank Rate or implementing other monetary policy measures.

6.4. The 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. 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.

6.5. As for 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 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.

6.6. President Trump's easing of fiscal policy in 2018 fuelled a temporary boost in consumption in 2018 which generated an upturn in the strong rate of growth. The annual rate came in at 2.9% for 2018, just below President Trump's 3% growth target. 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.

6.7. The annual rate of growth in the Eurozone has been steadily falling, from 1.8% in 2018 to only 1.1% 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 EZ 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 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.

6.8. Chinese 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 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.

6.9. Japan has been struggling to stimulate consistent significant 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 fundamentally reforming the economy.

6.10 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 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.

7. Economic Forecast

7.1. The Council receives its treasury advice from Link Asset Services. Their latest interest rate forecasts to 31 March 2022 are shown below:

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

7.2. After the August 2018 increase in Bank Rate to 0.75%, the 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 January 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 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 MPC to do an immediate cut of Bank

Rate. All other forecasts for investment and borrowing rates would also have to change.

7.3. The overall balance of risks to economic growth in the UK is probably even, but dependant on a successful outcome of negotiations on a trade deal. The balance of risks to increases in Bank Rate and shorter term PWLB rates are broadly similarly to the downside.

7.4. Long term PWLB rates are expected to rise to 3.3% in September 2020 before steadily increasing over time to reach 4.0% by December 2022.

8. Treasury Management Strategy

8.1. The Treasury Management Strategy (TMS) for 2019/20 was approved by Full Council on 28 February 2019. The Council's Annual Investment Strategy, which is incorporated in the TMS, outlines the Council's investment priorities as the security and liquidity of its capital.

8.2. The Council aims to achieve the optimum return on investments commensurate with the proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term (up to 1 year), and only invest with highly credit rated financial institutions using Link's suggested creditworthiness approach, including sovereign credit rating and Credit Default Swap (CDS) overlay information provided by Link. The Treasury Team continue to take a prudent approach keeping investments short term and with the most highly credit rated organisations.

8.3. In the third quarter of 2019/20 the internal treasury team outperformed its benchmark by 0.34%. The investment return was 0.91% compared to the benchmark of 0.57%. This amounts to additional income of £126,340 during the quarter which is included in the Council's outturn position in the monthly revenue monitor.

8.4. A full list of investments held as at 31 December 2019, compared to Link's counterparty list, and changes to Fitch, Moody's and Standard & Poor's credit ratings are shown in Appendix A. None of the approved limits within the Annual Investment Strategy were breached during the third quarter of 2019/20. Officers continue to monitor the credit ratings of institutions on a daily basis. Delegated authority has been put in place to make any amendments to the approved lending list.

8.5. As illustrated in the economic forecast section above, investment rates available in the market for three months and longer have increased slightly as a result of the increase in Bank Rate in August 2018. The average level of funds available for investment purposes in the third quarter of 2019/20 was £150 million.

9. Borrowing

9.1. 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) are included in the approved Treasury Management Strategy. A list of the approved limits is shown in

Appendix B. The Prudential Indicators were not breached during the third quarter of 2019/20 and have not been previously breached. The schedule at Appendix C details the Prudential Borrowing approved and utilised to date.

9.2. Link's target rate for new long term borrowing (50 years) for the third quarter of 2019/20 was marginally increased to 2.31%. No new external borrowing has been undertaken to date in 2019/20. The low and high points during the quarter can be seen in the table below.

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.17%	1.00%	1.13%	1.73%	1.57%
Date	03/09/2019	08/10/2019	03/09/2019	03/09/2019	03/09/2019
High	2.47%	2.43%	2.67%	3.22%	3.05%
Date	21/10/2019	13/12/2019	31/12/2019	31/12/2019	31/12/2019
Average	1.70%	1.64%	1.88%	2.45%	2.31%

List of Background Papers (This MUST be completed for all reports, but does not include items containing exempt or confidential information)
Cabinet, 04 September 2019, Treasury Management Update Quarter 1 2019/20
Cabinet, 11 December 2019, Treasury Management Update Quarter 2 2019/20
Council, 28 February 2019, Treasury Strategy 2019/20.

Cabinet Member:
David Minnery, Portfolio Holder for Finance

Local Member
N/A

Appendices
A. Investment Report as at 31 December 2019
B. Prudential Limits
C. Prudential Borrowing Schedule