

**Committee and Date**

Cabinet
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Item

Public

TREASURY MANAGEMENT UPDATE – QUARTER 4 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 fourth quarter of 2019/20 the internal treasury team achieved a return of 1.03% on the Council's cash balances, outperforming the benchmark by 0.59%. This amounts to additional income of £232,080 during the quarter which is included within the Council's outturn position in the monthly 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 4 performance is above benchmark and has delivered additional income of £232,080 which is reflected in the Period 12 Revenue Monitor.
- 4.3. As at 31 March 2020 the Council held £157 million in investments as detailed in Appendix A and borrowing of £308 million at fixed interest rates.

5. Climate Change Appraisal

- 5.1. The Council's Financial Strategy includes proposals to deliver a reduced carbon footprint for the Council therefore the Treasury Team is working with the Council in order to achieve this. There are no climate change impacts arising from this report.

6. Background

- 6.1. 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 January 2020 and 31 March 2020.

7. Economic Background

- 7.1. Economic growth in quarter 4 2019/20 has been very volatile due to the global pandemic. 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 GDP statistics in January were disappointing, being stuck at zero growth. Since then, the whole world has changed as a result of the coronavirus outbreak. It now looks likely that the closedown of whole sections of the economy will result in a fall in GDP of at least 15% in the second quarter. What is uncertain, however, is the extent of the damage that will be done to businesses by the end of the lock down period, when the end of the lock down will occur, 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.

- 7.2. Although the UK left 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. It is also unclear as to whether the coronavirus outbreak may yet impact on the deadline of agreeing a deal by then.
- 7.3. After the Monetary Policy Committee raised Bank Rate from 0.5% to 0.75% in August 2018, Brexit uncertainty caused the MPC to sit on its hands and do nothing until March 2020; at this point it was abundantly clear that the coronavirus outbreak posed a huge threat to the UK economy. Two emergency cuts in Bank Rate from 0.75% occurred in March, 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. The Government and the Bank were also very concerned to stop people losing their jobs during this lock down period. Accordingly, the Government has introduced various schemes to subsidise both employed and self-employed jobs for three months 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 lock down 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.
- 7.4. This is a rapidly evolving situation so there may be further measures to come from the Bank and the Government. The measures to support jobs and businesses already taken by the Government will result in a huge increase in the annual budget deficit from about 2%, to nearly 11%. The ratio of debt to GDP is also likely to increase from around 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 lock down is ended. Provided the coronavirus outbreak is brought under control relatively swiftly, and the lock down is eased, then it is hoped that there would be a sharp recovery, but one that would take a prolonged time to fully recover previous lost momentum.
- 7.5. Inflation is not going to be an issue for the near future as the world economy will be heading into a recession which is already causing a glut in the supply of oil which has fallen sharply in price. Other prices will also be under downward pressure; wage inflation has also been on a downward path over the last half year and is likely to continue that trend in the current environment. While inflation could even turn negative in the Eurozone, this is currently not likely in the UK.
- 7.6. Employment had been growing healthily through the last year but it will obviously be heading for a big hit in the coming months. The good news over the last year is that wage inflation has been significantly higher than CPI inflation which means that consumer real spending power has been increasing and so will have provided support to GDP growth. However, while people cannot leave their homes to do non-food shopping, retail sales will also take a big hit.
- 7.7. US growth in quarter 4 of 2019/20 fell from 3.1% to 2.1% in the last quarter.

The slowdown in economic growth resulted in the Federal Reserve cutting rates from 2.25-2.50% by 0.25% in each of July, September and October. 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% – 0.25%. Near the end of March, Congress agreed a \$2 trillion stimulus package (worth about 10% of GDP) and new lending facilities announced by the Fed which could channel up to \$6 trillion 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.

- 7.8. The loans for small businesses, which convert into grants if firms use them to maintain their payroll, will cost \$367 billion and 100% of the cost of lost wages for four months will also be covered. In addition, there will be \$500bn of funding from the Treasury's Exchange Stabilization Fund which will provide loans for hard-hit industries, including \$50bn for airlines.
- 7.9. However, all this will not stop the US falling into a sharp recession in second quarter of 2020; some estimates are that growth could fall by as much as 40%. The first two weeks in March of initial jobless claims have already hit a total of 10 million and look headed for a total of 15 million by the end of March.
- 7.10. The annual rate of growth in the Eurozone has been steadily falling. 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%, has prompted the ECB to take new measures to stimulate growth. At its March 2019 meeting it announced a third round of Targeted Longer-Term Refinancing Operations (TLTROs); this provides banks with cheap two year maturity borrowing every three months from September 2019 until March 2021. However, since then, the downturn in EZ and world growth has gathered momentum so at its meeting in September 2019, 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 €20 billion per month, a relatively small amount, plus more TLTRO measures.
- 7.11. Once coronavirus started having a major impact in Europe, the ECB took action in March 2020 to expand its QE operations and other measures to help promote expansion of credit and economic growth. What is currently missing is a coordinated EU 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; action is therefore likely to be patchy.
- 7.12. Chinese 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 lock down of the country and a

major contraction of economic activity in February-March 2020. While it appears that China has put a lid on the virus by the end of March, these are still early days to be confident and it is clear that the economy is going to take some time to recover its previous rate of growth. 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.

- 7.13. 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 2019. In 2020, coronavirus is the big issue which is going to sweep across most countries in the world and have a major impact in causing a world recession in growth in 2020.

8. Economic Forecast

- 8.1. 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 | | | | | | | | |
|--|--------|--------|--------|--------|--------|--------|--------|--------|
| | 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 |

- 8.2. Uncertainty over Brexit caused the MPC 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 MPC 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.

- 8.3. Link's 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 only cover two years, not three as provided in the past.

- 8.4. Long term PWLB rates are expected to rise to 2.4% in March 2021 before increasing to reach 2.5% by December 2021.

9. Treasury Management Strategy

- 9.1. 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.
- 9.2. 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.
- 9.3. In the fourth quarter of 2019/20 the internal treasury team outperformed its benchmark by 0.59%. The investment return was 1.03% compared to the benchmark of 0.44%. This amounts to additional income of £232,080 during the quarter which is included in the Council's outturn position in the monthly revenue monitor.
- 9.4. A full list of investments held as at 31 March 2020, 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 fourth 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.
- 9.5. As illustrated in the economic forecast section above, investment rates available in the market for three months and longer have decreased significantly as a result of the decrease in Bank Rate in March 2020 to 0.1%. The average level of funds available for investment purposes in the fourth quarter of 2019/20 was £159 million.

10. Borrowing

- 10.1. 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 fourth quarter of 2019/20 and have not been previously breached. The schedule at Appendix C details the Prudential Borrowing approved and utilised to date.
- 10.2. Link's target rate for new long term borrowing (50 years) for the fourth quarter of 2019/20 was marginally increased to 2.40%. 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% | 2.45% | 2.76% | 3.25% | 3.05% |
| Date | 21/10/2019 | 19/03/2020 | 19/03/2020 | 19/03/2020 | 31/12/2019 |
| Average | 1.83% | 1.77% | 2.00% | 2.56% | 2.40% |

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
 Cabinet, 12 February 2020, Treasury Management Update Quarter 3 2019/20
 Council, 28 February 2019, Treasury Strategy 2019/20
 Council, 27 February 2020, Treasury Strategy 2020/21.

Cabinet Member:

David Minnery, Portfolio Holder for Finance

Local Member

N/A

Appendices

- A. Investment Report as at 31 March 2020
- B. Prudential Limits
- C. Prudential Borrowing Schedule