



<u>Committee and Date</u>	<u>Item</u>
Cabinet 7 September 2020	
	<u>Public</u>

TREASURY MANAGEMENT UPDATE – QUARTER 1 2020/21

Responsible Officer James Walton

e-mail: james.walton@shropshire.gov.uk

Tel: (01743) 258915

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 first quarter of 2020/21 the internal treasury team achieved a return of 0.83% on the Council's cash balances, outperforming the benchmark by 0.87%. This amounts to additional income of £399,710 during the quarter which is included within the Council's outturn position in the monthly revenue monitor. Following a decision by the Monetary Policy Committee in March 2020 to cut the Bank Rate to 0.1%, this resulted in the 7 Day benchmark rate for quarter 1 20/21 being a negative figure of 0.04%.

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 1 performance is above benchmark and has delivered additional income of £399,710 which is reflected in the Period 3 Revenue Monitor.
- 4.3. As at 30 June 2020 the Council held £164 million in investments as detailed in Appendix A and borrowing of £304 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 April 2020 and 30 June 2020.

7. Economic Background

- 7.1. Economic growth in 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 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%. However, the main fall in growth did not occur until April when it came in at -24.5% 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.

- 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. 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.
- 7.3. 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 MPC decided to add a further £100bn of QE purchases of gilts, but to be implemented over an extended period to the end of the year. The total stock of QE purchases will then amount to £745bn. It is not currently thought likely that the MPC 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 QE before raising interest rates. Some forecasters think this could be as far away as five years.
- 7.4. The Government and the Bank were also very concerned about job losses 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%.
- 7.5. 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.

- 7.6. 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 MPC 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 GDP 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.
- 7.7. US growth in quarter 1 of 2020/21 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 GDP) 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.
- 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. Non-farm payrolls (a measure of employment levels) 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 reimpose localised lockdowns since then.
- 7.10. The Eurozone economy shrank by 3.6% on quarter in the first three months of 2020. So far, the ECB 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 ECB 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 ECB

Governing Council also committed to continue net asset purchases under the PEPP until at least the end of June 2021 and to continue to reinvest maturing principal payments under the PEPP until at least end-2022. It has also made clear that it would not hesitate to top up PEPP as much as needed to contain the risk of a crisis.

- 7.11. Just as important as the size of the PEPP is its flexibility. Whereas previous asset purchase programmes adhered to strict issuer limits, the PEPP was designed to be flexible across “time, asset classes and jurisdictions”. This means that the ECB 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 GDP and the crisis will make that level even worse at the same time as GDP 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?’
- 7.12. What is currently missing is a major 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. The EU’s recently-proposed rescue fund, (officially designated “Next Generation EU”), is a major first step towards financial integration in the EU. 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 GDP (over the seven-year budget period). It will therefore supply relatively little support to the weaker and more vulnerable countries within the EU. This has therefore left individual national governments to implement a patchwork of support measures within each country. This shows up how far away the EU is from being an effective fiscal union.
- 7.13. 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 lockdown of the country and a major contraction of economic activity in February-March 2020. The Chinese economy shrank 6.8% in Q1 2020, following 6% growth in Q4 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.
- 7.14. 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.

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 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 2020/21 was approved by Full Council on 27 February 2020. 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 first quarter of 2020/21 the internal treasury team outperformed its benchmark by 0.87%. The investment return was 0.83% compared to the benchmark of -0.04%. This amounts to additional income of £399,710 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 30 June 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 first quarter of 2020/21. 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 first quarter of 2020/21 was £183 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 first quarter of 2020/21 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 first quarter of 2020/21 was marginally decreased to 2.26%. No new external borrowing has been undertaken to date in 2020/21. 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	1.77%	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%

List of Background Papers (This MUST be completed for all reports, but does not include items containing exempt or confidential information)

Cabinet, 6 July 2020, Treasury Management Update Quarter 4 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 30 June 2020
- B. Prudential Limits
- C. Prudential Borrowing Schedule