



<u>Committee and Date</u>	<u>Item</u>
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## TREASURY MANAGEMENT UPDATE – QUARTER 2 2020/21

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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 second quarter of 2020/21 the internal treasury team achieved a return of 0.40% on the Council's cash balances, outperforming the benchmark by 0.46%. This amounts to additional income of £204,090 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 2 20/21 being a negative figure of 0.07%. This negative position continues to be the case since the start of the financial year.

### 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 2 performance is above benchmark and has delivered additional income of £204,090 which is reflected in the Period 6 Revenue Monitor.
- 4.3. As at 30 September 2020 the Council held £162 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 July 2020 and 30 September 2020.

#### **7. Economic Background**

- 7.1. As expected, the Bank of England's Monetary Policy Committee kept Bank Rate unchanged at 0.10% during the quarter. It also kept unchanged the level of quantitative easing at £745bn. Its forecasts were optimistic in terms of three areas:
- The fall in GDP in the first half of 2020 was revised from 28% to 23% (subsequently revised to -21.8%). This is still one of the largest falls in output of any developed nation. However, it is only to be expected as the UK economy is heavily skewed towards consumer-facing services – an area which was particularly vulnerable to being damaged by lockdown
  - The peak in the unemployment rate was revised down from 9% in Q2

to 7.5% by Q4 2020.

- It forecast that there would be excess demand in the economy by Q3 2022 causing CPI inflation to rise above the 2% target in Q3 2022. Nevertheless, even if the Bank were to leave policy unchanged, inflation was still projected to be above 2% in 2023.

7.2. The MPC also decided against any idea of using negative interest rates, at least in the next six months or so. The MPC suggested that while negative rates can work in some circumstances, it would be less effective as a tool to stimulate the economy at this time when banks are worried about future loan losses. It also has other instruments available, including QE and the use of forward guidance.

7.3. The MPC expected the £300bn of quantitative easing purchases announced between its March and June meetings to continue until the turn of the year. This implies that the pace of purchases will slow further to about £4bn a week, down from £14bn a week at the height of the crisis and £7bn more recently.

7.4. In conclusion, this would indicate that the Bank now expected the economy to recover better than expected. However, the MPC acknowledged that the medium-term projections were a less informative guide than usual and the minutes had multiple references to downside risks, which were judged to persist both in the short and medium term. One has only to look at the way in which second waves of the virus are now impacting many countries including the UK, to see the dangers. However, rather than a national lockdown, as in March, any spikes in virus infections are now likely to be dealt with by localised measures and this should limit the amount of economic damage caused.

7.5. In addition, Brexit uncertainties ahead of the year-end deadline are likely to be a drag on recovery. The wind down of the initial generous furlough scheme through to the end of October is another development that could cause the Bank of England (BoE) to review the need for more support for the economy later in the year. Admittedly, the Chancellor announced in late September a second six-month package from 1 November of government support for jobs whereby it will pay up to 22% of the costs of retaining an employee working a minimum of one third of their normal hours. There was further help for the self-employed, freelancers and the hospitality industry. However, this is a much less generous scheme than the furlough package and will inevitably mean there will be further job losses from the 11% of the workforce still on furlough in mid-September. However, the furlough scheme has been revisited and the decision has been made to extend it until the end of March 2021.

7.6. Overall, the pace of recovery is not expected to be in the form of a rapid V shape, but a more elongated and prolonged one after a sharp recovery in June through to August which left the economy 11.7% smaller than in February. The last three months of 2020 are now likely to show no growth as consumers will probably remain cautious in spending and uncertainty over the outcome of the UK/EU trade negotiations concluding at the end of the year will also be a headwind. If the Bank felt it did need to provide further support to recovery, then it is likely that the tool of choice would be more QE.

- 7.7. There will be some painful longer term adjustments as e.g. office space and travel by planes, trains and buses may not recover to their previous level of use for several years, or possibly ever. There is also likely to be a reversal of globalisation as this crisis has shown up how vulnerable long-distance supply chains are. On the other hand, digital services are one area that has already seen huge growth.
- 7.8. One key addition to the BoE forward guidance was a new phrase in the policy statement, namely that it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% target sustainably. That seems designed to say, in effect, that even if inflation rises to 2% in a couple of years' time, do not expect any action from the MPC to raise Bank Rate – until they can clearly see that level of inflation is going to be persistently above target if it takes no action to raise Bank Rate.
- 7.9. In the US, the incoming sets of data during the first week of August were almost universally stronger than expected. With the number of new daily coronavirus infections beginning to abate, recovery from its contraction this year of 10.2% should continue over the coming months and employment growth should also pick up again. However, growth will be dampened by continuing outbreaks of the virus in some states leading to fresh localised restrictions. At its end of August meeting, the Fed tweaked its inflation target from 2% to maintaining an average of 2% over an unspecified time period i.e. following periods when inflation has been running persistently below 2%, appropriate monetary policy will likely aim to achieve inflation moderately above 2% for some time. This change is aimed to provide more stimulus for economic growth and higher levels of employment. It is to be noted that inflation has actually been under-shooting the 2% target significantly for most of the last decade so financial markets took note that higher levels of inflation are likely to be in the pipeline; long-term bond yields duly rose after the meeting.
- 7.10. The Fed also called on Congress to end its political disagreement over providing more support for the unemployed as there is a limit to what monetary policy can do compared to more directed central government fiscal policy. The Federal Open Market Committee's updated economic and rate projections in mid-September showed that officials expect to leave the fed funds rate at near-zero until at least end-2023 and probably for another year or two beyond that. There is now some expectation that where the Fed has led in changing its inflation target, other major central banks will follow. The increase in tension over the last year between the US and China is likely to lead to a lack of momentum in progressing the initial positive moves to agree a phase one trade deal.
- 7.11. The Eurozone economy was recovering well towards the end of Q2 after a sharp drop in GDP, (e.g. France 18.9%, Italy 17.6%). However, the second wave of the virus affecting some countries could cause a significant slowdown in the pace of recovery, especially in countries more dependent on tourism. The fiscal support package, eventually agreed by the EU after prolonged disagreement between various countries, is unlikely to provide significant support and quickly enough to make an appreciable difference in

weaker countries. The ECB has been struggling to get inflation up to its 2% target and it is therefore expected that it will have to provide more monetary policy support through more quantitative easing purchases of bonds in the absence of sufficient fiscal support.

- 7.12. In China, after a concerted effort to get on top of the virus outbreak in Q1, economic recovery was strong in Q2 and has enabled it to recover all of the contraction in Q1. However, this was achieved by major central government funding of yet more infrastructure spending. After years of growth having been focused on this same area, any further spending in this area is likely to lead to increasingly weaker economic returns. This could, therefore, lead to a further misallocation of resources which will weigh on growth in future years.

## 8. Economic Forecast

- 8.1. The Council receives its treasury advice from Link Asset Services. Their latest interest rate forecasts to 31 March 2023 are shown below:



- 8.2. The coronavirus outbreak has done huge economic damage to the UK and to economies around the world. After the Bank of England took emergency action in March to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its last meeting on 6<sup>th</sup> August, although some forecasters had suggested that a cut into negative territory could happen. However, the Governor of the Bank of England has made it clear that he currently thinks that such a move would do more damage than good and that more quantitative easing is the favoured tool if further action becomes necessary. As shown in the forecast table above, no increase in Bank Rate is expected within the forecast horizon ending on 31<sup>st</sup> March 2023 as economic recovery is expected to be only gradual and, therefore, prolonged.

- 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.

- 8.4. Long term PWLB rates are expected to rise to 2.4% in September 2021 before increasing to reach 2.5% by June 2022.

## 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 second quarter of 2020/21 the internal treasury team outperformed its benchmark by 0.46%. The investment return was 0.40% compared to the benchmark of -0.07%. This amounts to additional income of £204,090 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 September 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 second 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 second quarter of 2020/21 was £176 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 second 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 second quarter of 2020/21 was marginally increased to 2.39%. 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	1.70%	1.67%	1.91%	2.45%	2.26%
Date	18/09/2020	30/07/2020	31/07/2020	31/07/2020	08/07/2020
High	1.83%	1.84%	2.19%	2.80%	2.65%
Date	12/08/2020	28/08/2020	28/08/2020	28/08/2020	28/08/2020
Average	1.76%	1.74%	2.02%	2.57%	2.39%

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

Cabinet, 7 September 2020, Treasury Management Update Quarter 1 2020/21  
 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 September 2020
- B. Prudential Limits
- C. Prudential Borrowing Schedule